Scottish Law Commission

promoting law reform

(DISCUSSION PAPER No 147)

Review of Contract Law

Discussion Paper on Interpretation of Contract

discussion paper

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February 2011

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The Commission would be grateful if comments on this Discussion Paper were submitted by Friday 20 May 2011.

Please ensure that, prior to submitting your comments, you read notes 1-3 on the facing page. Comments may be made on all or any of the matters raised in the paper. All non-electronic correspondence should be addressed to:

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[1] Amended by the Scotland Act 1998 (Consequential Modifications) (No 2) Order 1999 (SI 1999/1820).

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CFR,
Common Frame of Reference (as discussed in paragraphs 1.2-1.3)

Chartbrook,
Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38; [2009] 1 AC 1101

CISG,
Vienna Convention on the International Sale of Goods, 1980

DCFR,
Draft Common Frame of Reference: Principles, Definitions and Model Rules of European Private Law (Full Edition: Christian von Bar, Eric Clive (eds), 6 vols, 2009; Outline Edition: Christian von Bar, Eric Clive and Hans Schulte-Nölke (eds), 2009)

ICS,
Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 WLR 896 (HL)

McBryde, *Contract*,
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McMeel, *Construction*,
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Multi-Link,
Multi-Link Leisure Developments Ltd v North Lanarkshire Council [2010] UKSC 47 (on appeal from [2009] CSIH 96; 2010 SC 302 (Inner House) and [2009] CSOH 114 (Outer House))

PECL,
Principles of European Contract Law (Parts I and II: Ole Lando & Hugh Beale (eds), 2000; Part III: Ole Lando, Eric Clive, André Prüm and Reinhard Zimmermann (eds), 2003)

PICC,
UNIDROIT Principles of International Commercial Contracts (2nd ed, 2004)

RIPL,
Report on Interpretation in Private Law (Scot Law Com No 160, 1997); references to the "draft Bill" are to the draft Bill annexed to RIPL

Glossary

Contra proferentem:

The rule of construction which says that where a term of a contract has more than one possible meaning, the meaning least favourable to the party which included that term is to be preferred. (See rule (2) in paragraph 2.12.)

Entire agreement clause:

A term in a written agreement stating that the agreement constitutes the whole terms of a contract. Under section 1 of the Contract (Scotland) Act 1997 such a contract term is effective to prevent enquiry beyond the written document for any further contract terms.

Exclusionary rule(s):

The rule or rules of evidence which say that evidence of pre-contractual negotiations or about the conduct of contracting parties subsequent to the conclusion of their contract may not be considered for the purpose of interpreting the contract.

Extrinsic evidence:

Evidence from outside a document about the meaning of that document.

Juridical act:

Any act of will or intention which has, or which is intended by the maker of the act to have, legal effect, but not including any legislative or judicial act.

Parole evidence rule:

The rule, now abolished in Scotland under section 1 of the Contract (Scotland) Act 1997, under which it was normally incompetent to lead evidence of contract terms other than those contained in any writing embodying a contractual agreement. In so far as the rule also disallowed evidence from outside the contractual writing to modify or contradict its terms, it continues to apply. Both parts of the rule continue to apply in English law.

Chapter 1 Introduction

1.1 This Discussion Paper is the first publication in a new project reviewing contract law. The project began early in 2010. The Eighth Programme of Law Reform, published in February that year, announced the Scottish Law Commission's return to a subject with which it has frequently been concerned since its foundation in 1965. The Programme states:

> "We propose to review the law of contract in the light of the publication in 2009 of the Draft Common Frame of Reference: Principles, Definitions and Model Rules of European Private Law (the DCFR). The DCFR provides a contemporary statement of contract law, based on comparative research from across the European Union and written in accessible and non-archaic English. The DCFR has a considerable amount to offer in the law reform process. It may be seen as an instrument to provide an important area of Scots law with a systematic health check, giving a basis for treatment where the law is found to be ailing or otherwise in need of remedial treatment. The DCFR is at least a good working platform for a series of discrete and relatively limited projects on contract law, akin in some ways to our work on trusts and having significance for the wellbeing of the Scottish economy."[1]

The DCFR

1.2 The DCFR is a document prepared by an academic group for the European Commission, which has in mind the creation of a Common Frame of Reference (CFR).[2] The academic group included a number of Scots lawyers, one of whom (former Scottish Law Commissioner Professor Eric Clive) played a leading role in the preparation of the final text of the document.[3] The CFR is intended to be either a legislative "toolbox" for the Commission, that is, an aid to better, more consistent and coherent European Union legislation in the field of contract, or an "optional instrument" for use by parties contracting in the European Union in place of national law. It is possible that there will be both a toolbox and an optional instrument, although the content of the two will not necessarily be the same. The Commission plans the completion of the CFR in 2011. An Expert Group was appointed to review the DCFR for this purpose, and began work in May 2010.[4] An analysis of the DCFR by the Economic Impact Group has already been published.[5] The European Commission itself also published a Green Paper on European Contract Law in July 2010, canvassing various possibilities ranging from a non-binding model law to a full-blown European civil code displacing all domestic laws concerning obligations within the European Union.[6] The Commission's consultation on these issues closed on 31 January 2011, and the

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[1] Scot Law Com No 220, para 2.16.

[2] On the CFR project and its antecedents see the European Commission website on the subject: http://ec.europa.eu/consumers/rights/contract_law_en.htm.

[3] Other Scottish academics involved include Professor John Blackie (Strathclyde) and Professor Hector MacQueen (Edinburgh).

[4] OJ L105, 27.4.2010, 109–111. The progress of the Expert Group can be followed on the European Commission website at http://ec.europa.eu/justice/policies/consumer/policies_consumer_intro_en.htm. Professor Eric Clive is a special adviser to the Group.

[5] Pierre Larouche and Filomena Chirico (eds), *Economic Analysis of the DCFR: The work of the Economic Impact Group within CoPECL* (2010).

[6] Accessible at http://ec.europa.eu/justice/news/consulting_public/0052/consultation_questionaire_en.pdf (Brussels, 1.7.2010, COM(2010)348 final).

UK Ministry of Justice and the Scottish Government's call for evidence with which to respond to that consultation closed on 26 November 2010. Our submissions to the call for evidence and the EC consultation on the Green Paper itself may be consulted on our website.[7]

1.3 The DCFR will, as its title suggests, be the basis of the CFR. It incorporates existing EU contract legislation within an overall system of model rules covering not only general contract law (Books I-III), but also the specific contracts of sale and lease of goods, services, mandate, commercial agency, franchise, distributorship, loan, personal security, and donation (Book IV.A-H). There are also books on "benevolent intervention in another's affairs"[8] (V), delict[9] (VI), unjustified enrichment (VII), acquisition and loss of ownership of goods (VIII), proprietary security in movable assets (IX) and trusts (X). There is also an introductory statement and discussion of the principles underlying the DCFR, namely, freedom, security, justice and efficiency, and an annex of definitions of key words and phrases. The full version includes extensive commentary on each of the model rules as well as comparative notes on the laws of each of the jurisdictions to be found in the EU Member States (including Scotland).

1.4 Why is the DCFR of interest for the Scottish Law Commission, with regard to the law of contract in particular?[10] First, it purports to be a modern or contemporary statement of the best rules of contract law for use in the EU, and is based upon extensive comparative research and intensive collaboration by an international team of contract law experts. Seeing how Scots law measures up against this standard is thus an exercise of some interest. But it has a greater significance than that. As suggested in the Eighth Programme, contract law is clearly a critical element in economic activity of all kinds, whether between businesses, between businesses and consumers, or between parties transacting with each other privately, outside the course of business altogether. It is thus very important that an area of law of such significance for the Scottish economy, including the attraction of foreign business into Scotland, should be of the highest international quality. Scottish Ministers' interest in the contract law review proposed in our Eighth Programme was based primarily upon this consideration.

1.5 A second point is that if the DCFR matures into a CFR used in the EU as a basis of any kind for harmonizing contract law, it will be necessary to ensure that Scots law is at least broadly in line with such emerging European norms. It should be noted that Germany has already reformed its law of obligations in 2002 in line with this imperative,[11] while similar reform projects are under way in France,[12] Spain,[13] and Belgium.[14] Thirdly, the comparative

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[7] See http://www.scotlawcom.gov.uk/law-reform-projects/contract-law/.
[8] What is usually known in Scots law as *negotiorum gestio*.
[9] Entitled in the DCFR: "Non-contractual liability arising out of damage caused to another".
[10] The DCFR is also currently being used in relation to SLC projects including Prescription and Title to Moveable Property (DP No 144), and Moveable Transactions.
[11] For an account of this in English, see Reinhard Zimmermann, *The New German Law of Obligations: Historical and Comparative Perspectives* (2005), pp 30-35. The German reforms were primarily driven by implementation of the Consumer Sales Directive 1999 (99/44/EC), which is itself now incorporated into the DCFR.
[12] See John Cartwright, Stefan Vogenauer and Simon Whittaker (eds), *Reforming the French Law of Obligations* (2009), pp 19-20. We are grateful to Professor Bénédicte Fauvarque-Cosson (University of Paris II, France) and Mme Juliette Gest (French Ministry of Justice) for a copy of the *projet Terré* of December 2008, which remains the latest published document in the reform process. It has since been published by Dalloz: François Terré, *Pour une réforme du droit des contrats* (ISBN: 9782247081790).
[13] See the proposals of the Comisión General de Codificación (Sección de Derecho Civil), accessible at http://www.mjusticia.es/cs/Satellite?c=Documento&cid=1161679730606&pagename=Portal_del_ciudadano%2FDocumento%2FTempDocumento.

information in the DCFR facilitates our statutory task of keeping the law under review and obtaining information about the law of other countries in pursuit of that function.[15]

1.6 Finally, the DCFR is descended from a number of instruments – notably the Vienna Convention on the International Sale of Goods (CISG), the UNIDROIT Principles of International Commercial Contracts (PICC) and the Principles of European Contract Law (PECL) – which were used by this Commission in some of the contract law projects in the 1990s.[16]

1.7 It should be emphasised that the objective of this exercise on interpretation is not simply the adoption, or not, of the DCFR rules as a legislative statement for Scots law. First and foremost this is, as the Eighth Programme says,[17] a health check for the existing Scots law of contract. The results will determine whether legislative intervention is required in pursuit of the general objectives of simplification and modernisation, and to ensure that contract law provides an appropriate framework for economic activity in Scotland, whether that activity is entirely domestic or involves cross-border transactions or, indeed, originates in Scotland at all. The check may also throw up issues that are not directly considered in the DCFR: in this Paper, for example, questions will be asked about the remedy of contract rectification under sections 8 and 9 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985, to which the DCFR has no equivalent. The conclusion of our inquiry may be that the present law is satisfactory; or that it requires some patching; or that a full legislative statement would be useful (whether or not the DCFR is taken as the model for such a statement, and whether or not that statement changes the law as it presently stands).

Previous SLC Reports

1.8 This Commission published a series of Reports on various aspects of contract law in the 1990s. Only one, the Report on Three Bad Rules in Contract Law,[18] has been implemented. The other four remain unimplemented:

- Report on Formation of Contract (Scot Law Com No 144, 1992);
- Report on Interpretation in Private Law (Scot Law Com No 160, 1997) ("RIPL");
- Report on Penalty Clauses (Scot Law Com No 171, 1999);
- Report on Remedies for Breach of Contract (Scot Law Com No 174, 1999).

1.9 The reasons for non-implementation are not easy to discern. There does not seem to have been any opposition to the substance of the Reports at the time. Those published in the later 1990s may have seemed more appropriate for consideration in the Scottish Parliament, where however the immediate priorities in civil law legislation after its

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[14] We understand that an as yet unpublished report on the reform of the law of personal and proprietary security in Belgium, commissioned by the Belgian Ministry of Justice from Professor Eric Dirix, makes extensive use of the DCFR provisions on the subject.
[15] Law Commissions Act 1965, s 3.
[16] See further para 1.9.
[17] See para 1.1.
[18] Scot Law Com No 152 (1996), implemented by the Contract (Scotland) Act 1997. Note also the Requirements of Writing (Scotland) Act 1995, which implemented the Report on Requirements of Writing (Scot Law Com No 112, 1988).

establishment in 1999 were the abolition of feudalism and associated reforms of property law.[19] But with the passage of a decade and more since the contract reports were published, we do not think it right now simply to press as far as we are able for their implementation without further consideration of the issues raised within them. Quite apart from the general evolution of the law and related practice in Scotland over that period, international and in particular European developments in contract law also need to be taken into account. The Reports themselves were prepared under reference to various instruments, notably the Vienna Convention on the International Sale of Goods (CISG), the UNIDROIT Principles of International Commercial Contracts (PICC) and the Principles of European Contract Law (PECL).[20] These instruments have in turn been influential and also developed in substance in the preparation of the DCFR. There is, therefore, a case for reconsidering the topics of the Reports, but this time taking the DCFR into account. Accordingly the first stage of the new review of contract law is a return to our unimplemented Reports on the subject.

1.10 In deciding how to proceed it was thought best to begin with RIPL. It deals with a relatively compact area of law compared to those on Formation and Remedies for Breach.[21] The DCFR develops the PECL and PICC rules to which RIPL refers, while the case law since 1997 has seen some important decisions and differences of view in the courts on the subject.[22] Interpretation is also of crucial importance for legal practitioners, especially in the commercial field, and in addition there has been extensive academic discussion of the subject.

1.11 Finally, conclusions on interpretation may well also help in approaching issues about formation and perhaps also in later stages, if and when the review reaches such matters as implied terms and remoteness in damages for breach of contract.[23] Like our predecessors, we think that while in particular the law on implied terms is closely linked to the rules of interpretation at many points, the issues with the former are also distinct in significant ways, and that the latter subject should be considered first.[24]

Structure of the Discussion Paper

1.12 Chapter 2 summarises the conclusions of RIPL, upon which no legislation followed. In Chapter 3 there is a tabular comparison between the recommendations of RIPL, as expressed in the draft Bill appended to it, and the provisions of the DCFR. The tables also include parallel material from the UNIDROIT Principles of International Commercial Contracts (PICC). Although PICC was also used in the preparation of the DCFR, its rules are not the same as the DCFR and so it provides at least a useful cross-check on the

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[19] This involved the implementation of a number of Reports of this Commission.
[20] Note that PICC was described as "particularly useful" in RIPL, para 1.22; see also its paras 2.16 and 3.7.
[21] We initially agreed that the Report on Penalty Clauses needed no detailed revisit at this stage. The PECL and PICC provisions on the subject used in the Report appear virtually unchanged in the DCFR, and there have been no significant new developments in the case law since 1999. A Scottish Government consultation on the implementation of the Report in the summer of 2010 suggested, however, that further work was required on the subject. (The responses to the consultation, including an analysis of them, can be seen here: http://www.scotland.gov.uk/Topics/Justice/law/damages/contract/pcresponses.) The work which we have done in response to the consultation persuades us that there is still merit in pressing for reform, and we hope to tackle this as part of the review of remedies for breach of contract.
[22] These developments, and other related ones, are discussed at some length in Chs 4 and 5.
[23] The House of Lords and Privy Council have used principles first developed by Lord Hoffmann in the context of interpretation cases to develop the law on both implied terms and remoteness of damages in breach of contract: see *Attorney-General of Belize v Belize Telecom Ltd* [2009] UKPC 10; [2009] 1 WLR 1988 and *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)* [2008] UKHL 48; [2009] 1 AC 61.
[24] RIPL, para 1.6.

international acceptability of the DCFR proposals. The tabular comparison is the subject of a commentary, drawing attention to similarities and differences and relating these to the issues to be raised in the subsequent sections of the Paper. The main conclusion is that there are significant differences between the recommendations of RIPL and the provisions of the DCFR.

1.13 In Chapters 4 and 5 we consider case law developments and resulting debates that have taken place in the United Kingdom since the publication of RIPL in 1997, testing the extent to which the law has moved (or not, as the case may be) in the direction of the lines proposed in either RIPL or the DCFR. We also examine recent developments in parts of the common law world outside the United Kingdom, which show some tendency to move in the direction given by the DCFR. Chapter 5 gives detailed consideration to the position in Scotland, suggesting that while the law has indeed moved some way in line with developments in England and in the direction of RIPL's recommendations, some uncertainty is apparent and the law is not settled in important respects. The questions and proposals to which all this material gives rise are set out, with relevant discussion, in Chapters 6 and 7. Chapter 6 is devoted to a discussion of the commercial background and policy objectives. The objectives are closely based on those which were discussed in RIPL. Chapter 7 sets out our proposals for a new scheme of interpretation. It asks in particular whether the present exclusionary rules of Scots law in relation to the use of extrinsic evidence to aid contract interpretation should be removed to come into line with the more liberal approach of the DCFR. It is suggested that this may be more consistent with two general principles: (1) the aim of the interpretation process is to determine and give effect to the contracting parties' common intention, and (2) courts should have access to all relevant evidence in determining disputed matters. But it is also recognised that there are concerns about certainty and costs, and suggestions are made about how these may be addressed and alleviated. Finally, the questions and proposals are listed in Chapter 8.

1.14 Appendix A contains the comparative tables which are in Chapter 3 but without the intervening commentary. Our motivation in doing this is to facilitate the comparison of the draft Bill which was attached to RIPL with the equivalent provisions of the DCFR and PICC. In Appendix B we list the members of our Advisory Groups and others who have assisted us.

Advisory Groups

1.15 As the matters covered in this Discussion Paper affect a wide range of people and organisations we decided to set up a number of Advisory Groups, each with slightly different areas of expertise. First, we convened a group of practitioners (comprising solicitors and advocates) and academics; we then met a small judicial group; and lastly we gathered together a number of business people from across the country and with a very wide range of contractual experience. The membership of each group is set out in Appendix B, and we are very grateful for all of the comments we received at the various meetings. This Paper has benefited from the stimulating discussions.

Impact assessment

1.16 Assessing the economic impact of the possible law reforms discussed in this Discussion Paper is no easy task, given that so far as we are aware there has been no study

of the economic effects of the law of interpretation as it stands at present.[25] We think, however, that at least some of the current law must present costs for business which might be reduced or avoided by appropriate reform.[26] Interpretation is currently a matter of common law not statute, and the rules must be gleaned from an analysis of court decisions. At present, the Scottish courts are not clearly agreed on the correct basic approach to the interpretation of contracts, and there is uncertainty on such issues as whether ambiguity is required before a court may consider extrinsic evidence from which guidance may be sought as to the meaning of a written contract.[27] The rules on admissibility also involve some fine distinctions between the types of use to which extrinsic evidence may be put: for example, it may be used to assess the parties' shared understanding of the commercial purpose of their contract, but not as a guide to what they meant by expressions used in the contract.[28] Thus in disputes about the interpretation of contracts, advisers must first consider all the potentially relevant evidence in order to determine what to submit to the judge or arbitrator, who then in turn must take time to decide on the admissibility or not of the material put before them.

1.17 The Discussion Paper also shows that there is an awkward overlap and inconsistency between the rules of interpretation and the remedy of rectification.[29] In the latter all evidence relevant to the common intention of contracting parties may be admitted to enable a court to recast a document to reflect that intention accurately. In practice, a claim for rectification is often presented as an alternative to an argument based upon interpretation. As a result evidence excluded for the purposes of the latter may nonetheless be before the court for the purposes of the former. It has been suggested that this may encourage strategic behaviour by parties' advisers.[30] In any event, having to raise a court action under two different headings seems unlikely to be conducive to economic efficiency.

1.18 The reforms which we suggest in this Discussion Paper would remove some of these difficulties and possible sources of cost, in that the approach to the interpretation of a contract would be definitively articulated in statute, and extrinsic evidence would be admissible in relation to a written contract not only in respect of the parties' commercial purpose but also with regard to their common intention on the meaning of the expressions used in the document. It may be asked, however, whether such a liberal approach would lead to greater costs than at present. We have noted with interest the Economic Impact Group's rather negative assessment of the interpretation rules contained in the DCFR (on which many of our suggestions are modelled).[31] It has been suggested to us by some on our Advisory Groups that extra costs will arise inasmuch as advisers in any dispute will have to investigate all the potentially relevant evidential material; but we think, as noted above, that this may already be the case. We also think that the corresponding risk of the courts being deluged with evidential material whenever there is a dispute about a contract's meaning can be minimised by legal rules specifying, not the evidence to be excluded, but rather what evidence is relevant, i.e. that which, objectively assessed from the perspective of a reasonable person, shows the parties' common intention. With clearer, simpler rules there

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[25] There is of course an extensive literature on the economics of contract law in general, although none of it relates specifically to Scots law.
[26] See Chs 4 and 5 for full analysis of the present law..
[27] See paras 7.7-7.8.
[28] See Ch 5.
[29] See paras 4.20-4.25, 5.11-5.12, 5.20 and 5.25-5.26.
[30] See para 4.22.
[31] See paras 3.6 and 3.10.

may anyway be less need for disputes about a contract's meaning to have to go before a court or arbitrator, which would save costs generally. It would also cease to be necessary to use the back door of rectification when one was unable to go through the front door of interpretation as a result of the rules of evidence. In any event, as our Advisory Groups have reminded us, business parties will go to court only as a very last resort. This probably means that any major rule changes will have at worst only a very marginal effect on the use of the courts.

1.19 A further point that has been put to us does not concern the courts directly but arises where, as commonly happens in commerce, rights under written contracts are assigned to third parties. The argument is that an assignee wishing to be sure of exactly what is being acquired will have to investigate all the background material (the investigation being known often as 'the performance of due diligence') before committing to the transaction, and that accordingly the proposed liberalisation of the rules will add significantly to the costs of doing otherwise perfectly ordinary business. This argument may, however, be met in two ways. The first might be to have a rule saying that the meaning of an assigned contractual right is to be ascertained from the document alone, where the assignee has reasonably relied on its apparent meaning. This Discussion Paper accordingly offers an analysis of that possibility and asks whether or not such a rule should be included in any reform.[32] The second possibility is that, given that the law already allows the use of extrinsic evidence to help determine the meaning of a written contract, potential assignees concerned about what they may be acquiring must already be engaged in due diligence, so that little or no extra cost will be imposed as a result of the suggested changes.

1.20 Finally, the Discussion Paper seeks to meet concerns about costs by asking whether it should be possible for parties to 'contract out' of the suggested rules on the admissibility of extrinsic evidence.[33] The model underlying the question is that of the 'entire agreement' clause by means of which, under the Contract (Scotland) Act 1997, a statement by the contracting parties that a document contains all the terms of their contract is given conclusive effect. This overcomes the rule in the 1997 Act that generally enables proof of terms beyond those contained in a contractual document. An extension of this to permit exclusion of the rules on the admissibility of evidence about the meaning of the contract's terms would give the parties a degree of control over any costs that might be incurred should a dispute arise about these matters. We note that the Economic Impact Group on the DCFR appears to be in favour of a degree of party autonomy in relation to the interpretation of contracts,[34] and that there is already some recognition of this possibility in the existing law.[35]

1.21 All these points are discussed in greater depth later. To help us assess the economic impact of any reforms which we may recommend in the Report which will in due course follow on from this Discussion Paper, we would be most grateful for any comments that consultees may have on the matters thus raised for consideration. We would be especially grateful for any evidence with which we can begin to quantify the issues raised, whether that evidence relates to the current situation or is concerned with the possible effects of any reform of the law. In this sense, therefore, the whole Paper is an exercise in impact assessment. To assist us in our task we ask:

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[32] See paras 7.30-7.35.
[33] See paras 7.23-7.29.
[34] See paras 3.6, 3.10 and 3.22.
[35] See para 7.26.

1. Do you have information or comments on any potential impacts either of the current law relating to the interpretation of contract or of reform of the law?

Legislative competence

1.22 The proposals in this Discussion Paper relate to the Scots private law of obligations, which is not reserved in terms of the Scotland Act 1998. We are also of the view that the proposals, if enacted, would not give rise to any breach either of the European Convention on Human Rights or of Community law. Accordingly, the proposals would, if enacted, be within the legislative competence of the Scottish Parliament.

Chapter 2 Summary of Report on Interpretation in Private Law

Background

2.1 The Report on Interpretation in Private Law[1] must be understood first in the context of this Commission's work over the previous twenty years on the rules of Scots law relating to the role and legal significance of writing under the law of contract. The aim of that earlier work was, in general terms, to modernise and, where appropriate, liberalise the law's approach, and most of the Commission's recommendations on the matter had already been enacted by the time RIPL was published in October 1997. Thus the Requirements of Writing (Scotland) Act 1995, implementing a Commission Report of 1988,[2] laid down a modern set of rules about which contracts had to be in writing (reducing the number of such contracts to three),[3] and about the form of such writing – basically, a requirement of a subscription to the document by the party to be bound by it along with the signature of one witness (rather than the previous two) to that subscription. The Contract (Scotland) Act 1997, implementing another Commission Report,[4] *inter alia* abolished the parole evidence rule (under which it was normally incompetent to lead evidence of contract terms other than those contained in any writing embodying a contractual agreement). Instead the Act enabled the proof of terms additional to those contained in a written contract while also allowing parties to a contract to exclude this possibility by way of an "entire agreement" clause (that is, a term stating that the written agreement constituted the whole terms of the contract). In other words, the 1997 Act replaced a rule under which the existence of contractual writing excluded any other evidence as to the content of the contract and replaced it with one which allowed all relevant evidence as to what the contract terms are, subject to parties' freedom to restrict the inquiry to the contents of a written document.

2.2 Reference should also be made to the contract rectification remedy introduced by sections 8 and 9 of the Law Reform (Miscellaneous Provisions) (Scotland) 1985 in implementation of another Commission Report, published in 1983.[5] Under these provisions the court may rectify a contract where the document in which it is embodied fails to express accurately the common intention of the parties to the agreement at the date it was made, whereas under the pre-existing common law, unless the error in expression was "patent" (that is, obvious on the face of the document), correction had to be by way of a reduction of

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[1] Scot Law Com No 160 (1997), henceforth "**RIPL**".
[2] Report on Requirements of Writing (Scot Law Com No 112).
[3] Although under s 1(1) of the 1995 Act the legislation does not affect any other enactment under which writing may be required for the constitution of a contract. Examples include the Policies of Assurance Act 1867, s 5 (as amended by the Finance Act 1956, s 22 and the Income and Incorporation Taxes Act 1970, s 226); the Bills of Exchange Act 1882, ss 3(1), 73 and 83(1); the Merchant Shipping Act 1995, s 25 and Sch 1, para 7; the Marine Insurance Act 1906, s 22; the Finance Act 1989, s 30(6); the Patents Act 1977, s 31(6); the Copyrights, Designs and Patents Act 1988, ss 90 and 92; the Civil Aviation Act 1982, s 86 (as amended by the Merchant Shipping Act 1995, Sch 13, para 64(b)); the Consumer Credit Act 1974, ss 6(1) and 105(1); the Employment Rights Act 1996, ss 1 and 13(1)(b); and the Housing, Grants, Construction and Regeneration Act 1996, s 107.
[4] Report on Three Bad Rules in Contract Law (Scot Law Com No 152, 1996).
[5] Obligations: Report on Rectification of Contractual and Other Documents (Scot Law Com No 79).

the document, followed by a declarator of the terms in which it should have been written.[6] As with the 1997 Act, the legislative intent in 1985 was clearly to reduce the definitive and exclusive nature of a written document in the eyes of the law and to prioritise instead what the parties to the contract could be shown to have intended in the light of all the available evidence about their common intention. This emphasis upon common intention as the basis for rectification is of significance for the law on interpretation of contracts, as will be discussed more fully later in this Discussion Paper.[7] But we note here that nonetheless RIPL made almost no reference to rectification and does not seem to have realised the links between that and its own subject-matter.[8]

Extrinsic evidence

2.3 RIPL focused upon reform of the law on the use of extrinsic evidence (that is, evidence from outside the document itself) in the interpretation of writings. Its scope therefore extended beyond the law of contract to all private law where writing had legal significance including, most significantly, conveyances and wills. The recommended reform was the abolition of the existing rules prohibiting or limiting the use of extrinsic evidence as an aid in interpretation and, within limits, to make such evidence generally admissible.[9] It is important in what follows, however, to distinguish between RIPL's focus on evidence in relation to interpretation, and evidence in relation to matters of, *inter alia*, contract formation and contents. It is clear that when the question is whether or not parties have concluded a contract, all relevant evidence is admissible, including both their oral and written communings as well as their conduct towards each other, while when the question is about what the terms of the agreement are, again all relevant evidence is admissible unless the parties have chosen to restrict that by way of an entire agreement clause in a written contract.[10] But when the question is the meaning of the admitted (or proven) terms of an admitted (or proven) contract, the law either forbids or restricts the leading of evidence from beyond that contract to show what the parties meant by the expressions they have chosen to use.

2.4 In considering the abolition of the extrinsic evidence rule this Commission thought it necessary also to restate and clarify the rules on interpretation of written expressions, "because the rules on the admissibility of extrinsic evidence cannot be reformed in a safe and satisfactory way unless the major substantive rules on interpretation are themselves as clear as possible".[11] Four main policy considerations underpinned the resulting recommendations:

> "1. The same rules of interpretation ought to apply, unless there is good reason to the contrary, whatever the nature of the juridical act and whatever the medium used.
>
> 2. The rules of the substantive law on interpretation ought to be such that it is possible to determine what facts and circumstances the interpreter can properly take into consideration, whether the interpreter is or is not a court.

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[6] The common law survives the innovation of 1985: see *Aberdeen Rubber Ltd v Knowles & Sons (Fruiterers) Ltd* 1995 SC (HL) 8.
[7] See paras 5.25-5.26.
[8] For brief references to rectification in RIPL, see its paras 2.8 and 2.9.
[9] RIPL was not confined to writings and was concerned with expressions in any medium, including oral expressions: see its para 1.9.
[10] For the meaning of "entire agreement" clause see para 2.1. We return to this topic in paras 7.23-7.29.
[11] RIPL, para 1.1.

3. Third parties ought not to be affected by secret meanings attached to expressions in juridical acts.

4. Relevant evidence should be admissible and irrelevant evidence should be inadmissible."[12]

2.5 Because RIPL was dealing with the whole of private law, it used the concept of a "juridical act", defined in its draft Bill as "any act of will or intention which has, or which is intended by the maker of the act to have, legal effect, but does not include any legislative or judicial act".[13] A contract (and offers and acceptances) are examples of juridical acts, as are unilateral promises, conveyances and wills.

General interpretative rule

2.6 Thus, apart from the abolition of the rule against the admissibility of extrinsic evidence (effected in clause 2 of the draft Bill attached to RIPL), a general interpretative rule was proposed for all juridical acts, namely an objective approach of giving expressions the meaning reasonably to be given to them in their contexts, with regard also being possible to the surrounding circumstances and, in so far as they could be objectively ascertained, the nature and purpose of the juridical act. This was a change to the existing law, in allowing reference to the surrounding circumstances even when the wording of the document showed no ambiguity (that is, either an expression capable of two meanings or one that is otherwise unclear or uncertain).[14] The proposed objective rule was also found in CISG and PICC,[15] but its context in those texts was different, namely, as subordinate to a search for the common intention of the parties, and so to be resorted to only if that initial search was unsuccessful.[16]

2.7 RIPL distinguished between the "context" provided by the juridical act itself, viewed as a whole, and the "surrounding circumstances", which are facts external to the juridical act. While both were to be considered in the process of interpretation, RIPL further recommended limits with regard to the admissibility of surrounding circumstances. Not to be included were: (1) parties' individual and direct statements of intention; (2) instructions, communings or negotiations forming part of the process of preparation of the juridical act; and (3) conduct subsequent to the juridical act. Thus the extrinsic evidence which would be needed in relation to these matters continued to be excluded from the courts' purview. In excluding evidence about parties' prior negotiations and subsequent conduct, RIPL was differing from both CISG and PICC.[17] The justification for excluding prior negotiations was that these were part of the history of the formulation rather than the actual preparation of the juridical act, and so were not truly "surrounding circumstances" in relation to the juridical act. With regard to subsequent conduct, while acknowledging that this could cast backward light on what the parties meant by their contract, RIPL argued that exclusion was justified on the basis that the meaning of a juridical act ought to be consistent over time.

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[12] Ibid, para 1.12.
[13] Clause 3.
[14] See also paras 7.7-7.8.
[15] CISG Art 8(2); PICC Art 4.1(2), discussed at paras 3.6-3.7 of RIPL.
[16] CISG Art 8(1); PICC Art 4.1(1). See also PECL Art 5:101.
[17] CISG Art 8(3); PICC Art 4.3. RIPL also differed from the approach subsequently adopted in PECL Art 5:102.

Special rules

2.8 In addition, RIPL proposed separate special rules for both contracts and testamentary writings. For the moment, the proposal on testamentary writings has not been re-considered: it is thought that the implementation of RIPL (or a revised version) could be confined to contract (or voluntary obligations) alone.[18] The proposed special rule for contracts was that any expression forming part of a contract and used by one party in a particular sense (whether or not used in that sense by any other party) should be interpreted in that sense if every other party at the time of contracting knew, or could reasonably have been assumed to know, that it was being used in this sense. RIPL suggested, with reference to *Houldsworth v Gordon Cumming*,[19] that this was probably the existing law in Scotland.[20] It was also the rule unambiguously adopted in CISG and PICC, albeit in a context rather different from that being put forward in RIPL, i.e. one where the general rule was pursuit of the parties' subjective rather than their objective intentions.[21] In *Houldsworth* the issue was the meaning of the phrase "the estate of Dallas" in a contract for the sale of land: was it the whole lands of Dallas as possessed by the seller under his titles, or was it the lesser area delineated in a plan prepared by the seller and, although not referred to in the contract itself, used during the negotiations between the parties to identify the subjects of the sale? The House of Lords, reversing the Second Division and restoring the decision of the Lord Ordinary, held that the evidence of the parties' negotiations could be considered to determine the meaning attributed to the phrase "the estate of Dallas" by the seller and that the buyer knew, and had not objected to, the seller's understanding of the phrase as limited to the area delineated on the plan.

2.9 RIPL decided against putting into legislative form the rules that ordinary words are presumed to bear their ordinary meaning unless the result would be absurd or inconsistent with the remainder of the document, while technical or legal expressions are taken to bear their technical or legal meaning when used in a context where that is appropriate. It was thought that these were probably already covered by the general interpretative rule of giving expressions the meaning reasonably to be given to them in their contexts, and that an express statement would add little value.[22]

2.10 The draft Bill attached to RIPL adopted the technique of putting much of the substance of the reform in a Schedule rather than in the main clauses. Thus, while the abolition of the rule preventing the use of extrinsic evidence was to be found in clause 2, the rules on interpretation were placed in the Schedule. The reasons for using this approach are not discussed in the Report.

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[18] The proposed special rule for testamentary writings, in para 3(2) of the Schedule to the draft Bill, was: "Any expression in a testamentary writing which describes a beneficiary or a bequest in terms which are applicable to two or more persons or, as the case may be, things shall be interpreted as applying to such one of those persons or things as corresponds to the intention of the testator."

[19] 1910 SC (HL) 49.

[20] RIPL, paras 3.3-3.5. RIPL also cited *Macdonald v Newall* (1898) 1 F 68 (where one party made known to the other the meaning attached to "the property known as the Royal Hotel"), *Hunter v Barron's Trs* (1886) 13 R 883 (where "Whitsunday" was used, unusually, to mean 26 May) and the English case *The Karen Oltmann (Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd)* [1976] 2 Lloyds Rep 708 (where an option exercisable "after 12 months' trading" was understood by the parties to mean "on the expiry" of that period rather than "at any time after the expiry" of it).

[21] CISG Art 8(1); PICC Art 4.2.1. See also PECL Art 5:101(2).

[22] See RIPL, Pt 5.

Rules of preference

2.11 Finally, it was also decided not to recommend enactment of a number of "rules of preference" commonly used in interpretation, such as the *contra proferentem* rule.[23] It was thought that these would continue to operate even after the enactment of the general rule and were not inconsistent with it, or either of the special rules for contracts or wills. A statutory statement might increase the risk of litigation on the meaning and effect of the "rules of preference", and also of divergence between these rules and other similar non-statutory rules, e.g. un-enacted rules on interpretation in other countries, or the rules on statutory interpretation. Such statements were, however, included in the text of PICC.[24]

2.12 A more extensive list of ten "rules of preference for cases of doubt in the construction of a juridical act" identified by our predecessors was, however, included as Appendix B of RIPL. The ten rules are:

> (1) A construction of the juridical act which gives effect to all its terms is preferred to one which does not.
>
> (2) Where, in an onerous juridical act, terms supplied by one party are unclear, there is a preference for their interpretation against that party.
>
> (3) Where a list of items, all of which are members of the same class, is followed by a general term, there is a preference for interpreting the general term as applying only to items of the same class as those in the specific list.
>
> (4) A construction which gives effect to precise terms is preferred to one which gives effect to general language.
>
> (5) A construction which gives effect to operative or essential terms is preferred to one which is in accordance with narrative or incidental terms.
>
> (6) A construction which gives effect to separately negotiated terms is preferred to one which gives effect to standard terms not separately negotiated.
>
> (7) There is a preference for a construction which favours a result other than donation and which, in the case of a gratuitous unilateral act, favours the result least burdensome to the granter.
>
> (8) There is a preference for a construction in favour of freedom from burdens or restrictions.
>
> (9) There is a preference for a construction which leads to results which are lawful, fair and reasonable.
>
> (10) Where a juridical act is executed in two or more linguistic versions, and where it does not itself provide a rule for resolving discrepancies between them, there is, in case of discrepancy, a preference for construction according to the version in which the act was originally drawn up.

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[23] Ibid, Pt 6.
[24] PICC Arts 4.4-4.6. See also PECL Arts 5:103-5:107.

Conclusion

2.13 In sum, it will be apparent that, while RIPL drew upon the rules stated in the CISG and the PICC, it clearly did not accept them upon certain fundamental points. In particular, the objective approach was not subordinated to a subjective one; instead, subjective elements were admitted as special exceptions to the general objective rule. Again, while RIPL's support for a wider use of surrounding circumstances in the interpretation of contracts, without reference to a prerequisite of ambiguity, followed CISG and PICC, the exclusion of such specific circumstances as pre-contractual negotiations and parties' subsequent conduct went against the approach of the international instruments. This was also true of the decision not to recommend a legislative statement of the rules of preference.

Chapter 3 Tabular comparison of DCFR, the Report on Interpretation, and PICC (with comments)

3.1 In this Chapter we present the interpretation rules in the DCFR in a form which enables them to be immediately compared with the legislative recommendations of RIPL, and also with the rules in the 2004 version of PICC (which are unchanged from those in the 1994 version referred in RIPL).[1] We have laid out the comparison of the DCFR with RIPL and PICC under thematic headings, in order to assist in identifying the major topics of discussion. Each part has comments on the differences or similarities of approach between those proposals and the DCFR (as well as the 2004 version of PICC, where relevant).[2]

3.2 We deal with the following topics:

(i) general approach (paragraphs 3.3-3.6);

(ii) material which may or may not be considered (3.7-3.10);

(iii) expressions used in a particular sense, which is known to other party (3.11-3.14);

(iv) extrinsic evidence and "entire agreement"/merger clauses (3.15-3.19);

(v) rules of preference (3.20-3.22);

(vi) unilateral juridical acts (3.23).

(i) General approach

DCFR	***RIPL (Schedule to draft Bill)***	***PICC 2004***
II.-8:101 General rules (1) A contract is to be interpreted according to the common intention of the parties even if this differs from the literal meaning of the words. (3) The contract is, however, to be interpreted according to the meaning	**General rule** 1(1) Any expression which forms part of a juridical act shall have the meaning which would reasonably be given to it in its context; and in determining that meaning, regard may be had to - (a) the surrounding	**4.1 Intention of the parties** (1) A contract shall be interpreted according to the common intention of the parties. (2) If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as

[1] It is not necessary, however, to add the relevant PECL rules, since they are entirely reproduced in the DCFR.
[2] The tables are reproduced, without intervening commentary, in Appendix A.

which a reasonable person would give to it: (a) if an intention cannot be established under the preceding paragraphs; … **II.-8:105 Reference to contract as a whole** Terms and expressions are to be interpreted in the light of the whole contract in which they appear.	circumstances; and (b) in so far as they can be objectively ascertained, the nature and purpose of the juridical act. (3) The rule set out in sub-paragraph (1) above is referred to in this Schedule as "the general rule"	the parties would give to it in the circumstances. [*See also CISG art 8(1) and (2)*] **4.4 Reference to contract or statement as a whole** Terms and expressions shall be interpreted in the light of the whole contract or statement in which they appear.

3.3 The "general rule" of interpretation for juridical acts which was recommended in RIPL was in different terms from the rule as expressed in the first edition of PICC (and now in its second edition as well). In 1997 this Commission chose not to formulate its rule in terms of the parties' common intention (the PICC starting point), on the basis that this was too subjective if, as in PICC, it contrasted with an objective approach only to be used when a common intention could not be established. So this Commission's general rule began with an objective approach of finding the meaning which would reasonably be given to the expression given its context (that is, the text of the juridical act viewed as a whole), its surrounding circumstances (facts outside the juridical act), and the nature and purpose of the juridical act "in so far as objectively ascertainable". The approach is thus not one of establishing what the parties intended but instead of finding the meaning reasonably to be attributed to their language, the inquiry not being limited to the words actually used. RIPL did not, however, take into account that the standard of "common intention" had already been used in the context of rectification.

3.4 In contrast to RIPL, the DCFR continues to follow and indeed elaborate the PICC approach. The subjective search for the parties' common intention overcomes even the literal meaning of the words (Article II.-8:101(1)). The DCFR commentary says that the combination of a subjective approach with an objective "fall-back" position "follow[s] the majority of laws of EU Member States".[3] The commentary adds: "This is normal because the contract is primarily the creation of the parties and the interpreter should respect their intentions, expressed or implicit, even if their will was expressed obscurely or ambiguously."[4]

3.5 RIPL did not need to state a separate rule about interpreting a term in the light of the whole contract (as found in the DCFR), since that is covered by the rule about giving expressions the meaning they would reasonably be given in their context (that is, the context provided by the contract as distinct from its external surrounding circumstances).

[3] DCFR, vol 1, 554.
[4] Ibid.

3.6 The Economic Impact Group assessment of the DCFR rule is as follows:[5]

> "We do not believe the subjective approach of Article 8:101(1) should have been chosen as the default. … [F]irms probably typically prefer courts to adhere as closely as is possible to the ordinary meanings of the words the parties used, i.e. in our opinion firms typically prefer the textualist approach. At the same time, the textualist theory will not suit all of the parties all of the time. Therefore, parties should have the possibility to contract around the textualist default. It should be noted, however, that ultimately the preference of firms between the objective and subjective approaches is an empirical question about which we have no real evidence."

(ii) Material which may or may not be considered

DCFR	***RIPL (Schedule to draft Bill)***	***PICC 2004***
II.-8:102 Relevant matters (1) In interpreting the contract, regard may be had, in particular, to: (a) the circumstances in which it was concluded, including the preliminary negotiations; (b) the conduct of the parties, even subsequent to the conclusion of the contract; (c) the interpretation which has already been given by the parties to terms or expressions which are the same as, or similar to, those used in the contract and the practices they have established between themselves; (d) the meaning commonly given to such terms or expressions in the branch of activity concerned and the interpretation such terms or expressions may already have received; (e) the nature and purpose of the contract; (f) usages; and (g) good faith and fair dealing.	**General rule** 1(2) For the purposes of this rule the surrounding circumstances do not include – (a) statements of intention; (b) instructions, communings or negotiations forming part of the process of preparation of the juridical act; (c) conduct subsequent to the juridical act.	**4.3 Relevant circumstances** In applying Articles 4.1 [*above*] and 4.2 [*below*], regard shall be had to all the circumstances, including: (a) preliminary negotiations between the parties; (b) practices which the parties have established between themselves; (c) the conduct of the parties subsequent to the conclusion of the contract; (d) the nature and purpose of the contract; (e) the meaning commonly given to terms and expressions in the trade concerned; (f) usages. [*See also CISG art 8(3)*]

[5] Geerte Hesen and Robert Hardy, "Contract interpretation – interpretive criteria", in Pierre Larouche and Filomena Chirico (eds), *Economic Analysis of the DCFR: The work of the Economic Impact Group within CoPECL* (2010), pp 83-95 at p 93.

3.7 There is a clear difference of position here between the recommendations in RIPL and the DCFR, as there was between those recommendations and the provisions of the first edition of PICC. In particular, the DCFR (like PICC 2004) allows reference to evidence of the parties' pre-contractual negotiations and their conduct subsequent to the conclusion of the contract, in order to help to ascertain their common intention (Articles II.-8:102(1)(a), (b)), whereas such evidence is explicitly excluded in the draft Bill. The DCFR commentary observes that "not all the laws of the Member States allow evidence to be given of pre-contractual negotiations";[6] in fact, it appears from the comparative law notes that this refers to the jurisdictions of the United Kingdom and Ireland alone.[7] The DCFR commentary states: "A better approach is not to exclude the evidence but to allow the court to assess it for what it is worth. Similarly with subsequent conduct."[8]

3.8 RIPL also recommended the explicit exclusion of evidence about statements of one party's intentions in entering the contract; these would also be excluded as such under the DCFR, since standing alone such statements are not evidence of the parties' *common* intention (Article II.-8:101(1)). Since the draft Bill makes no reference at all to the intention of the parties as the object of the exercise of interpretation, it is perhaps helpful to be clear that on its own, the individual intention of a party in entering a contract is irrelevant. If, however, it was clear that the object of the interpretative exercise was to ascertain the common intention of the parties, it would be less necessary – possibly not necessary at all – to mention individual statements of intention in order to exclude them from consideration (except in so far as they might contribute to the determination of the common intention).[9]

3.9 The DCFR allows reference to the nature and purpose of the contract under the heading of "Relevant matters" (Article II.-8:102(e)), while the draft Bill includes this under the general rule.[10] The further matters to which reference may be made under the DCFR (Article II.-8:102 (c), (d), (f), (g)) and the PICC (interpretation already given by the parties to the expressions used; practices established between them; the meaning commonly given to expressions in the area of activity concerned or the interpretation they may already have received; and usages[11]) are not mentioned in the draft Bill. So far as technical expressions or expressions with an established legal meaning are concerned, RIPL takes the view that these are covered by the general rule requiring expressions to be given the meaning which would reasonably be given to them in their context, having regard to the surrounding circumstances and the nature and purpose of the juridical act.[12] Whether the general rule can be similarly read to cover the other elements mentioned in the DCFR/PICC lists is possibly more doubtful. *Prior* interpretations, *established* practices and usages *before* the contract in question was entered might be seen as part of the surrounding circumstances into which it was legitimate to inquire under the draft Bill's scheme, since these form part of neither the pre-contractual negotiations nor the parties' conduct *subsequent* to the conclusion of contract.

3.10 The Economic Impact Group comments on the matters which may be considered as evidence of the parties' intention:

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[6] DCFR, vol 1, 561.
[7] Ibid, 563-564.
[8] Ibid, 561.
[9] See further para 7.10-7.11.
[10] This is also allowed by PICC 2004 under the heading of "Relevant circumstances".
[11] On "usages" see also DCFR II.-1:104.
[12] RIPL, paras 5.4-5.7.

> "We are of the opinion that courts, in principle, should use narrow evidentiary bases when interpreting agreements. … On the other hand, courts should also comply with party requests to broaden the base that is applicable to them."[13]

This remark, like the observations quoted at paragraph 3.6 above, seems to be underpinned by the view that parties should have freedom to determine in advance, through provision in their contract, the evidence to which a court may refer in determining any dispute. In principle, therefore, such freedom could also enable the parties to provide for a narrow approach to evidence where the general law allowed a wide approach. The DCFR in fact explicitly addresses that possibility in Article II.-4:104(3), as discussed below.[14]

(iii) Expressions used in a particular sense, which is known to other party

DCFR	*RIPL (Schedule to draft Bill)*	*PICC 2004*
II.-8:101 General rules (2) If one party intended the contract, or a term or expression used in it, to have a particular meaning, and at the time of the conclusion of the contract the other party was aware, or could reasonably be expected to have been aware, of the first party's intention, the contract is to be interpreted in the way intended by the first party. (3) The contract is, however, to be interpreted according to the meaning which a reasonable person would give to it: (a) if an intention cannot be established under the preceding paragraphs; or (b) if the question arises with a person, not being a party to the contract or a person who by law has no better rights than such a party, who has reasonably and in good faith relied on the contract's apparent meaning. **II.-8:102 Relevant matters** (3) In a question with a person, not being a party to the contract or a person who by law has no better	**Contracts** 2(1) Any expression which forms part of a contract shall be interpreted in accordance with the general rule unless the rule in sub-paragraph (2) below has effect. (2) Subject to sub-paragraph (3) below, any expression forming part of a contract which is used by one party in a particular sense (whether or not it is also used in that sense by any other party) shall be interpreted in that sense if every other party at the time of contracting knew, or could reasonably have been assumed to know, that it was being used in that sense. (3) Sub-paragraph (2) above does not apply – (a) to a contract which is recorded, or intended by the parties to be recorded, in the Register of Sasines or which is presented, or is intended by the parties to be presented, in support of an	**4.2 Interpretation of statements and other conduct** (1) The statements and other conduct of a party shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention. (2) If the preceding paragraph is not applicable, such statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.

[13] Geerte Hesen and Robert Hardy, cited at fn 5, at p 94.
[14] See paras 3.15-3.19.

rights than such a party, who has reasonably and in good faith relied on the contract's apparent meaning, regard may be had to the circumstances mentioned in paragraphs (a) to (c) above [as set out in para 3.3 above] only to the extent that those circumstances were known to, or could reasonably be expected to have been known to, that person.	application for registration in the Land Register; or (b) in any question with a person, not being a party to the contract, who has reasonably relied on the meaning which would be given to the expression by the application of the general rule.	

3.11 The "special rule" for contracts, supplementing the "general rule" for juridical acts, as set out in RIPL,[15] was drawn from PICC and did admit a subjective element into the interpretative process. This is the rule that if a party uses an expression in a particular sense when every other party knew or could be assumed to know that the use had that sense, then the expression is given that sense. The DCFR also contains this rule (Article II.-8:101(2)) but, like PICC, qualifies it by saying that if a party's particular subjective intention cannot be established for this purpose, then an objective construction is to be used (Article II.-8:101(3)(a)). Given that RIPL makes the objective approach the overall starting point, it has no need to qualify the "special rule" for contracts in a similar way.

3.12 The DCFR adds one further qualification: where a third person has reasonably and in good faith relied on the contract's apparent meaning, and the question to be resolved involves that party, an objective approach is required (Article II.-8:101(3)(b)). However, this provision does not apply to an assignee: a person who by law has no better rights than a contracting party cannot claim whatever may be the benefit of an objective interpretation of the contract distinct from the meaning which would have applied as between the original contracting parties. The reasoning behind this exclusion is explained thus in the Comments to Article II.-8:101(3):

> "[P]aragraph 3 preserves the rule that an assignee has no better right against the other party to the original contract than the assignor. An assignee has to take many risks, including the risk that a contract has been modified by agreement between the parties since it was concluded, and has appropriate rights against the assignor who conceals the existence of defences or exceptions available to the other party to the contract. To allow an assignee to take advantage of the apparent meaning of a term, when its real meaning as between the parties was something else, would be to allow one party to a contract to cheat the other party by the simple expedient of an assignment. This would be contrary to the requirements of good faith and fair dealing. Of course, if the other party to the contract participated in a fraud on the assignee there would also be delictual remedies against that party based on the fraud."

3.13 The special rule in RIPL also provides for third parties, which is consistent with one of its stated policy objectives – third parties ought not to be affected by secret meanings attached to expressions in juridical acts. The special rule also says that a party's subjective intention cannot be invoked in relation to contracts recorded or intended to be recorded in

[15] See para 2 of the Schedule to the draft Bill.

the Register of Sasines, or presented or intended to be presented in an application to the Land Register, a clear example where third parties might reasonably rely on the apparent meaning of the contract.[16]

3.14 However, by contrast with the DCFR, there is no express exclusion in RIPL for assignees. But it would seem that assignees were not to have the benefit of an objective approach, being regarded as parties to the contract and so outwith the scope of the exception for those not being party to the contract and reasonably relying on its apparent meaning.[17]

(iv) Extrinsic evidence and "entire agreement"/merger clauses

DCFR	*RIPL (draft Bill)*	*PICC 2004*
II.-4:104 Merger clause (1) If a contract contains an individually negotiated term stating that the document embodies all the terms of the contract (a merger clause), any prior statements, undertakings or agreements which are not embodied in the document do not form part of the contract. (2) If the merger clause is not individually negotiated it establishes only a presumption that the parties intended that their prior statements, undertakings or agreements were not to form part of the contract. This rule may not be excluded or restricted. (3) The parties' prior statements may be used to interpret the contract. This rule may not be excluded or restricted except by an individually negotiated term. (4) A party may by statements or conduct be precluded from asserting a merger clause to the extent that the other party has reasonably relied on such statements or conduct.	**Clause 2** Evidence of any description relevant to the interpretation of a juridical act shall be admissible notwithstanding that it is extrinsic evidence. **Contract (Scotland) Act 1997, section 1 Extrinsic evidence of additional contract term etc** 1(3) … where one of the terms in the document (or in the documents) is to the effect that the document does (or the documents do) comprise all the express terms of the contract or unilateral voluntary obligation, that term shall be conclusive in the matter.	**1.2 No form required** Nothing in these Principles requires a contract, statement or any other act to be made in or evidenced by a particular form. It may be proved by any means, including witnesses. **2.1.17 Merger clauses** A contract in writing which contains a clause indicating that the writing completely embodies the terms on which the parties have agreed cannot be contradicted or supplemented by evidence of prior statements or agreements. However, such statements or agreements may be used to interpret the writing.

[16] The DCFR commentary also mentions negotiable instruments in this context (vol 1, 556). Shipping documents such as bills of lading provide another example, although here the decision of the House of Lords in *The Starsin* (see para 4.5 below) may raise some difficult issues.
[17] RIPL, para 3.17, fn 23.

3.15 It is of course un-necessary for the DCFR or PICC to state a rule on extrinsic evidence, which is clearly generally competent under their respective schemes. But their rules, set out above, on "merger clauses" (more usually known in Scottish practice as "entire agreement clauses") may be relevant. Such clauses are common in commercial contracts, and in general terms provide that the document executed by the parties forms their "entire agreement" or their "entire understanding", and that it "supersedes all prior agreements, negotiations and discussions between the parties relating to it".[18] The intention of such a clause is to ensure that the document containing it is an exhaustive statement of the express terms of a contract. It therefore provides that all terms pertaining to the bargain are included – or "merged" – in one executed document. Thus, such clauses seek to exclude or limit reference to material outside the contract document, typically for the particular purpose of preventing such extraneous material becoming part of the contract. Both the DCFR and PICC give effect to these clauses.

3.16 Scots law also enables such clauses to have their intended effect. As we have already noted,[19] when the rule preventing proof of terms additional to those in an apparently complete written contract was abolished by the Contract (Scotland) Act 1997, it was also provided that parties might agree to exclude the possibility of going beyond their document for the terms of the contract between them. The relevant provision is reproduced above. Where a term in a document states that the document comprises all the express terms of a contract, it is conclusive on the matter.

3.17 Further effects of such clauses are, however, quite limited in Scots law. Since the legislation only disables the addition of *express* terms an entire agreement clause does not prevent the *implication* of terms into the contract.[20] Nor are such clauses usually regarded as preventing use of extrinsic matter in cases where the question is not whether terms exist beyond those in a particular document. So, for example, they have no effect on claims in respect of pre-contractual misrepresentation,[21] or in rectification actions.[22] It is thought that an entire agreement clause could not exclude liability for fraud. But, unlike both the DCFR (Article II.-4:104(3)) and the PICC, which are explicitly clear on the point, the 1997 Act says nothing about whether an entire agreement clause does or can prevent reference to material beyond the document containing it for the purpose of interpreting the rest of that document. Consistently with the DCFR/PICC position, however, it has been held in the Outer House of the Court of Session that an entire agreement clause does not preclude reference to surrounding circumstances in the interpretation of the contract.[23]

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[18] See further Malcolm Combe, "The whole deal" (2010) 55 JLSS 24, accessible at http://www.journalonline.co.uk/Magazine/55-11/1008875.aspx. On such clauses in English and other common law systems see Elizabeth Peden and John Carter, "Entire agreement – and similar – clauses" (2006) 22 Jnl of Contract Law 1; Catherine Mitchell, "Entire agreement clauses: contracting out of contextualism" (2006) 22 Jnl of Contract Law 22; and Catherine Mitchell, *Interpretation of Contracts: Current Controversies in the Law* (2007), pp 129-134.

[19] At para 2.1.

[20] *Macdonald Estates plc v Regenesis (2005) Dunfermline Ltd* [2007] CSOH 123; 2007 SLT 791, para 131 per Lord Reed.

[21] See e.g. *Inntrepreneur Pub Co (GL) v East Crown Ltd* [2000] 2 Lloyds Rep 611; *BSkyB Ltd v HP Enterprise Services UK Ltd* [2010] EWHC 86 (TCC); [2010] BLR 267.

[22] *MacDonald Estates* (cited at fn 20). The English courts have reached the same conclusion: *Surgicraft Ltd v Paradigm Biodevices Inc* [2010] EWHC 1291 (Ch); *JJ Huber (Investments) Ltd v The Private DIY Co Ltd* [1995] NPC 102.

[23] *MacDonald Estates* (cited at fn 20), para 131.

3.18 The DCFR, however, leaves open the possibility that an entire agreement clause could exclude reference to external material for the purposes of interpreting the contract document, but only if the clause is individually negotiated (Article II.-4:104(3)). In a similar vein, in a recent obiter dictum in the Outer House, Lord Hodge remarks: "It is no doubt possible for parties to frame a clause which seeks to exclude consideration of extrinsic evidence when construing the contract and forces the reader to find its meaning exclusively within the four corners of the document. But I would expect clear words to manifest such an intention."[24]

3.19 The DCFR goes further than the PICC in distinguishing between those merger clauses that are individually negotiated and those that are not (Article II.-4:104(1), (2), (3)), probably because the PICC is concerned only with commercial contracts while the DCFR takes account of consumer contracts as well. With clauses that are not individually negotiated, there is only a presumption that the parties intended to exclude material outside the contract document by the clause, and this can be rebutted by evidence (Article II.-4:104(2)). It may be in Scotland that entire agreement clauses in standard form or consumer contracts could be challenged under general unfair contract terms legislation, making it questionable whether there is a need for such a specific protection here.[25] The DCFR also provides for what in Scotland would be known as personal bar against a party turning to a merger clause which previous conduct had suggested was not to be used or enforced. Again, therefore, this scenario would seem to be covered by the existing general law in Scotland.[26]

(v) Rules of preference

DCFR	***RIPL (Appendix B)***	***PICC 2004***
II.-8:103 Interpretation against supplier of term or dominant party (1) Where there is doubt about the meaning of a term not individually negotiated, an interpretation of the term against the party who supplied it is to be preferred. (2) Where there is doubt about the meaning of any other term, and that term has been established under the dominant influence of	**Rules of preference** (2) Where, in an onerous juridical act, terms supplied by one party are unclear, there is a preference for their interpretation against that party.	***4.6 Contra proferentem* rule** If contract terms supplied by one party are unclear, an interpretation against that party is preferred.

[24] *Gillespie Investments Ltd v Gillespie* [2010] CSOH 113, para 59. See also McBryde, *Contract*, para 8.27.
[25] McBryde, *Contract*, para 8.34; Andrew Bowen, "Threshing through the undergrowth: entire agreement clauses and the Unfair Contract Terms Act 1977" 2004 SLT (News) 37. See also the joint Report between the Scottish Law Commission and Law Commission of England and Wales on Unfair Terms in Contracts (Law Com No 292, Scot Law Com No 199; 2005).
[26] See the discussion of implied waiver of obligations in Elspeth Reid and John Blackie, *Personal Bar* (2006), paras 3.18-3.24; also paras 19.43-19.44 on bar of rights to state or insist in a plea, and paras 19.68-19.69 on bar of right to have evidence excluded as inadmissible.

one party, an interpretation of the term against that party is to be preferred.		
II.-8:104 Preference for negotiated terms Terms which have been individually negotiated take preference over those which have not.	(6) A construction which gives effect to separately negotiated terms is preferred to one which gives effect to standard terms not separately negotiated.	
II.-8:106 Preference for interpretation which gives terms effect An interpretation which renders the terms of the contract lawful, or effective, is to be preferred to one which would not.	(1) A construction of the juridical act which gives effect to all its terms is preferred to one which does not. (9) There is a preference for a construction which leads to results which are lawful, fair and reasonable.	**4.5 All terms to be given effect** Contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect.
II.-8:107 Linguistic discrepancies Where a contract document is in two or more language versions none of which is stated to be authoritative, there is, in case of discrepancy between the versions, a preference for the interpretation according to the version in which the contract was originally drawn up.	(10) Where a juridical act is executed in two or more linguistic versions, and where it does not itself provide a rule for resolving discrepancies between them, there is, in case of discrepancy, a preference for construction according to the version in which the act was originally drawn up.	**4.7 Linguistic discrepancies** Where a contract is drawn up in two or more language versions which are equally authoritative, there is, in case of discrepancy between the versions, a preference for the interpretation according to a version in which the contract was originally drawn up.
	(3) Where a list of items, all of which are members of the same class, is followed by a general term, there is a preference for interpreting the general term as applying only to items of the same class as those in the specific list. (4) A construction which gives effect to precise terms is preferred to one which gives effect to general language. (5) A construction which gives effect to operative or essential terms is preferred to one which is in accordance with narrative or incidental terms. (7) There is a preference for a	

	construction which favours a result other than donation and which, in the case of a gratuitous unilateral act, favours the result least burdensome to the granter. (8) There is a preference for a construction in favour of freedom from burdens or restrictions.	

3.20 The DCFR follows the PICC in containing specific rules about interpretation *contra proferentem* and preferences for certain interpretations, broadly ones aimed at giving the contract effect (Articles II.-8:103, 106). The DCFR adds a further rule on the preference to be given to negotiated terms (Article II.-8:104). After consultation, this Commission rejected the inclusion of such rules of preference in the draft Bill annexed to RIPL.

3.21 A rule about "linguistic discrepancies" between different language versions of a contract is found in both the PICC and the DCFR (Article II.-8:107), and is clearly necessary against the background for both instruments of international, cross-border and multi-lingual contracting. It may be for consideration whether the introduction of such a rule would be conducive to encouraging non-Anglophone parties to contract under Scots law. This Commission included the rule in its appendix of rules of preference, drawing it from the first edition of PICC. We consider the question in more depth in Chapter 7.[27]

3.22 The Economic Impact Group states that DCFR Articles 8:104 and 8:107 "contain rules that parties generally prefer. These rules are thus likely to lower transaction costs".[28]

(vi) Unilateral juridical acts

DCFR	***SCOT LAW COM NO 144*[29] *(Schedule to its draft Bill) NB not RIPL – see below***	***PICC 2004***
Article II.-8:201: General rules (1) A unilateral juridical act is to be interpreted in the way in which it could reasonably be expected to be understood by the person to whom it is addressed. (2) If the person making the juridical act intended the act, or a term or expression used in it, to have a particular meaning, and at the time of the act the person to whom it was addressed was aware, or could reasonably be expected to have been aware, of	3(1) … statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was. 3(2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a	**4.2 Interpretation of statements and other conduct** (1) The statements and other conduct of a party shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention. (2) If the preceding

[27] See paras 7.39-7.40.
[28] Geerte Hesen and Robert Hardy, cited at fn 5, at p 94.
[29] Report on Formation of Contract: Scottish Law and the United Nations Convention on Contracts for the International Sale of Goods (Scot Law Com No 144, 1993).

the first person's intention, the act is to be interpreted in the way intended by the first person. (3) The act is, however, to be interpreted according to the meaning which a reasonable person would give to it: (a) if neither paragraph 91) or paragraph (2) applies; or (b) if the question arises with a person, not being the addressee or a person who by law has no better rights than the addressee, who has reasonably and in good faith relied on the contract's apparent meaning. **II.-8:202: Application of other rules by analogy** The provisions of Section 1, apart from its first Article, apply with appropriate adaptations to the interpretation of a juridical act other than a contract.	reasonable person of the same kind as the other party would have had in the same circumstances. 3(3) In determining the intent of a party or the understanding that a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.	paragraph is not applicable, such statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.

3.23 The DCFR has to make special provision for juridical acts other than contracts because the rules discussed hitherto apply expressly to contracts only. The draft Bill, on the other hand, applies to all juridical acts, including such unilateral acts as promises, offers and acceptances. This Commission had also recommended in an earlier Report on Formation of Contract[30] that Article 8 CISG should be adapted for use in the interpretation of statements made in the formation of a contract, and the draft provision to give effect to this is set out in the table above. It seems clear that, if the rules on interpretation of contracts were to be as recommended, the legislation would have to find some way of extending those rules to the interpretation of statements made in concluding the contract (and probably also promises as well). Were the rules on interpretation to provide for the admissibility of evidence about pre-contractual negotiations and conduct subsequent to the conclusion of the contract, there might also have to be provision about the interpretation of statements forming part of those negotiations or conduct, although these are not juridical acts.

Conclusion

3.24 Overall, it is clear that the DCFR scheme of interpretation is quite similar to one considered but rejected by this Commission after consultation in the late 1990s (i.e. the PICC model). However, those specific PICC rules which inspired this Commission's recommendations largely remain in place in the DCFR. The latter therefore continues to provide alternatives for consideration in a number of controversial areas, such as the

[30] Report on Formation of Contract: Scottish Law and the United Nations Convention on Contracts for the International Sale of Goods (Scot Law Com No 144, 1993).

admissibility of pre-contractual negotiations and parties' subsequent conduct, and the provision of statements of rules of preference. Questions also arise on whether the existing Scottish statutory provision on entire agreement clauses, contained in section 1 of the Contract (Scotland) Act 1997, requires elaboration along the lines found in the DCFR and the PICC to make clear the possible effects of such clauses on the admissibility of evidence extrinsic to the written contracts of which they form part. The DCFR's emphasis on determining the actual common intention of the parties as the primary objective of the process of interpretation may also raise questions about the non-appearance of this concept in the approach recommended in RIPL, especially as the realisation of common intention is already recognised as the basis of the Scots law of rectification. We return to these questions in the discussion in Chapter 7.

Chapter 4 Judicial developments since 1997 (1): England and the common law world

Introduction

4.1 Not long after RIPL had been published, Lord Hoffmann set out what was widely seen at the time as a new approach to contract interpretation in the English House of Lords case, *Investors Compensation Scheme Ltd v West Bromwich Building Society*.[1] After some initial controversy, the approach has succeeded in establishing itself as orthodoxy for the English courts and commentators. The approach has also been frequently referred to in the Scottish courts, usually but not invariably with approval, and sometimes with reservations as to its most radical dimension, which appears to give courts the power not merely to interpret the contracting parties' words but to read them in such a way as to give their expressions the meanings they must have intended, in the light of the background. This can appear at first sight to involve rewriting the contract, but Lord Hoffmann has been at pains to show that this is not in fact what is involved, distinguishing between interpretation and the remedy of rectification of a contract.[2]

4.2 In this Chapter we first set out in summary what we call the "Hoffmann approach" to interpretation and its development in England, noting further reactions in other parts of the common law world (principally New Zealand, Canada and Australia), and observing also the existence of a parallel approach in the USA. While there are some similarities to the DCFR approach in these developments, there are also important differences, especially with regard to the use of pre-contractual negotiations and the conduct of parties subsequent to the conclusion of their contract. We then turn in Chapter 5 to analyse the reaction of the Scottish courts, suggesting that the Hoffmann approach has helped the courts move to a position on interpretation quite close to that recommended by this Commission in RIPL as well as to that now established in England. We note, however, that a number of areas of uncertainty exist, and that the present position is not without some inherent difficulties. This provides a platform from which we go on to discuss first, policy objectives in Chapter 6, and then possible reforms in Chapter 7.

Lord Hoffmann's recasting of the approach to interpretation

4.3 Under the law in England before the *ICS* case, where a contract was reduced to writing a court was not supposed to go outside the document for any further terms or material that would contradict what had been written (the parole evidence rule). Reference to external material was allowed only where the document was ambiguous or unclear. But Lord Hoffmann argued that the process of interpretation *must* involve examining the context in which words are used: "the background of facts ... plays an indispensable part in the way

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[1] [1998] 1 WLR 896 (HL) (hereafter "***ICS***"). Lord Hoffmann's analysis was foreshadowed in an article he published shortly before the case: "The intolerable wrestle with words and meanings" (1997) 114 SALJ 656.
[2] See paras 4.20-4.25; also, for Scotland, paras 5.12, 5.20 and 5.25-5.26.

we interpret what anyone is saying".[3] Accordingly, admissible surrounding circumstances should *always* be examined, whether or not at first sight the words appear to be ambiguous. To this point, Lord Hoffmann was probably going no further than Lord Wilberforce's declarations almost twenty years earlier in the cases of *Prenn v Simmonds* and *Reardon Smith Line Ltd v Yngvar Hansen-Tangen*, that "the time has long passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic considerations",[4] and that "what the court must do must be to place itself in thought in the same factual matrix as that in which the parties were".[5] For Lord Wilberforce this meant that the court should know "the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating".[6] But in *ICS* Lord Hoffmann went on to say that the phrase "matrix of facts" was, "if anything, an understated description of what the background may include".[7] The surrounding circumstances "include … absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man".[8] Indeed, "the background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax".[9] Thus, in the *ICS* case itself, words placed in brackets with other words in the text under consideration were re-placed outside the bracketed phrase to make the contract say what the court held it must have been meant to say.

4.4 This then was a genuine shift in approach to contractual interpretation. Ambiguity is not a pre-requisite of an investigation of the factual matrix in which a contract had been concluded. Such an investigation is an indispensable part of the process of understanding what a contract means in all cases. The background enables the reader, above all the judge, to determine the intended meaning of the expressions actually used in the contract. Even more radically, however, the actual words used do not necessarily govern the meaning to be given to the contract; the background can let the judge decide that the parties used the wrong words, or mis-ordered their words, and he or she may read them in such a way as to give the parties' expressions the meanings they must have intended, in the light of the background.

4.5 Perhaps the most far-reaching application of the new approach by the House of Lords is *The Starsin*,[10] where the court was able not only to read words into a shipping contract where it was "clear both that words have been omitted and what those omitted words were",[11] but also to ignore other words actually in the contract on the basis that the commercial persons to whom the document was addressed would not have paid any attention to them either. In the most recent (and last) House of Lords case on the subject, *Chartbrook Ltd v Persimmon Homes Ltd*,[12] Lord Hoffmann (with whom the other Law Lords agreed) rejected the meaning of a contractual clause "in accordance with ordinary rules of

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[3] [1998] 1 WLR 896 (HL) at 912-913.
[4] *Prenn v Simmonds* [1971] 1 WLR 1381 (HL) at 1383-1384.
[5] *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 (HL) at 997.
[6] Ibid at 995-996.
[7] [1998] 1 WLR 896 at 912-913.
[8] Ibid.
[9] Ibid.
[10] [2003] UKHL 12; [2004] 1 AC 715.
[11] Ibid, para 23 per Lord Bingham.
[12] [2009] UKHL 38; [2009] 1 AC 1101 (hereafter "***Chartbrook***").

syntax",[13] on the grounds that it made no commercial sense, and something must have gone wrong with the way in which the contract was expressed. C had granted P a building licence over its land in order to carry out a mixed residential and commercial development. Parties agreed that the consideration would have two main elements: the "Total Land Value", which brought into account the land's residential, commercial and car parking values as calculated at the time of contracting, and an "Additional Residential Payment" (ARP), whose method of calculation formed the focus of the dispute. On C's reading of the relevant clause, the ARP entitled C to 23.4% of the difference between a pre-determined minimum (£53,438) and the actual sale price of flats in the development. (They were actually selling for well over £200,000.) Thus, C argued, the ARP was £4.84 million. The purpose of the clause had been to protect C against any catastrophic fall in the housing market. But the House instead read the clause as being designed to give C a share of any better-than-expected performance in the sale of the flats, rather than a simple general revenue share. This meant that the ARP was calculated as (23.4% of the net price received by P) minus £53,438,[14] whose effect was that a payment was only triggered if a flat sold for over £228,000. This interpretation, it was said, better reflected the obviously contingent character of the payment. P thus had to pay C only £897,051. Lord Hoffmann said:

> "When the language used in an instrument gives rise to difficulties of construction, the process of interpretation does not require one to formulate some alternative form of words which approximates as closely as possible to that of the parties. It is to decide what a reasonable person would have understood the parties to have meant by using the language they did."[15]

4.6 The precise scope of the Hoffmann approach has continued to be controversial in England, although the general approach, sometimes labelled "contextual" (in contrast with "literalist") interpretation,[16] is now widely accepted in the courts[17] and amongst academic lawyers,[18] while it is also the starting point of a standard practitioners' textbook on the subject written by a serving High Court judge.[19] The New Zealand courts have also taken up the contextual approach,[20] as have the Canadian courts[21] and the Irish.[22] The South African courts appear no longer to require ambiguity before evidence of surrounding circumstances may be considered.[23] Lord Hoffmann's message is further supported, not only by the

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[13] Ibid, para 16.
[14] This contrasts with C's reading that the calculation was 23.4% of (the net price received by P minus £53,438).
[15] [2009] UKHL 38; [2009] 1 AC 1101, para 21. See also para 25.
[16] The use of the adjective "contextual" is awkward in relation to RIPL, where "context" refers only to the juridical act itself, and "surrounding circumstances" to the external fact matrix thereof: see para 2.7 above.
[17] See Lord Bingham, "A new thing under the sun? The interpretation of contract and the *ICS* decision" (2008) 12 Edin LR 374.
[18] See e.g. McMeel, *Construction*; Catherine Mitchell, *Interpretation of Contracts: Current Controversies in the Law* (2007); Burrows and Peel, chs 3-5. An influential New Zealand proponent of the Hoffmann approach is Professor David McLauchlan: see e.g. "Contract interpretation: what is it about?" (2009) 31 Sydney LR 5. Other recent articles by Professor McLauchlan are cited later in this Chapter.
[19] Kim Lewison, *The Interpretation of Contracts* (4th ed, 2007). See in particular ch 1. The author is a Justice of the High Court of England and Wales.
[20] See David McLauchlan, "Interpretation and rectification: Lord Hoffmann's last stand" [2009] NZLR 431. The element of prophecy in this article about future developments in New Zealand is borne out in part by the subsequent case of *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, discussed at para 4.16.
[21] *Prenor Trust Co. of Canada v Kerkhoff Properties Inc* (1994) 21 Alta LR (3d) 122 (Alta QB); *Black Swan Gold Mines Ltd v Goldbelt Resources Ltd* [1997] WWR 605 (BBCA).
[22] The Hoffmann approach has been endorsed by the Irish Supreme Court in *Analog Devices v Zurich Insurance Co* [2005] IESC 12; *Emo Oil Ltd v Sun Alliance & London Insurance Co* [2009] IESC 2; *McCabe Builders v Sagamu Developments* [2009] IESC 31. The approach has been applied several times in the Irish High Court. *Chartbrook* was referred to by the High Court in *Moorview Developments v First Active* [2010] IEHC 275.
[23] *Masstores (Pty) Ltd v Murray & Roberts Construction Pty Ltd* 2008 (6) SA 654 (SCA).

insights of the philosophy of language,[24] but also by those of psychology and linguistics.[25] The Australian courts appear to be unconvinced by the breadth of the Hoffmann approach, however, and continue to impose a requirement of ambiguity before there can be consideration of circumstances beyond the parties' written agreement.[26] While as already noted the Canadian courts favour a contextual approach to interpretation, they likewise defer to a requirement of ambiguity before evidence beyond the agreement itself can be considered.[27] The Hoffmann approach has also been the subject of severe and continuing criticism from contract draftsmen, understandably concerned that their carefully crafted documents may not completely tie the creative hands of the judges or be a wholly self-contained statement of the content of the parties' legal relationship.[28]

4.7 The present general position in English law has been systematised as follows by the leading academic commentator on the subject, Professor Gerard McMeel:[29]

> "1. The aim of the exercise of the construction of a contract is to ascertain the meaning it would convey to a reasonable business person.
>
> 2. An objective approach is to be taken, concerned with a person's expressed rather than actual intentions.
>
> 3. The exercise is a holistic one, based on the whole contract, rather than excessive focus on particular words, phrases, sentences or clauses.
>
> 4. The exercise is informed by the surrounding circumstances or external context, with it being permissible to have regard to the legal, regulatory and factual matrix constituting the background to the making of the expression being interpreted.
>
> 5. Within this framework due consideration is given to the commercial purpose of the transaction or provision."

So summarised, the approach is very similar to that proposed in RIPL, save that the latter spoke, not of business persons, but of reasonable persons in general.[30] RIPL's focus was, of course, on all types of contract rather than the commercial contracts with which Professor

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[24] On which Lord Hoffmann himself initially drew: see his article, cited at fn 1 above, at 657, fn 2. See also Sean Smith, "Making sense of contracts" 1999 SLT (News) 307, 312; *Credential Bath Street Ltd v Venture Investment Placement Ltd* [2007] CSOH 208; 2008 GWD 9-168, para 19 per Lord Reed.

[25] See further Adam Kramer, "Common sense principles of contract interpretation (and how we've been using them all along)" (2003) 23 OJLS 173; Kim Lewison, *The Interpretation of Contracts* (4th ed, 2007), pp 6-8; McMeel, *Construction*, ch 2.

[26] See David McLauchlan, "Plain meaning and commercial construction: has Australia adopted the *ICS* principles?" (2009) 25 JCL 7. The leading judicial summary of the principles of interpretation in Australian law, by Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337 at 347-353, differs considerably from the approach subsequently developed by Lord Hoffmann; see likewise the judgment of Brennan J in the same case. The prevailing orthodoxy was recently re-stated in *Franklins Pty Ltd v Metcash Trading Ltd* [2009] NSWCA 407, save that the court rejected any prerequisite of ambiguity.

[27] *Milano's Dining Room & Lounge (1989) Ltd v CTDC No. 1 Alberta Ltd* (1994) 19 Alta LR (3d) 171 (Alt QB); *Canada (Attorney General) v Bitove Corp* (1995) 23 BLR (2d) 112 (Ont Gen Div); and *Kentucky Fried Chicken Canada v Scott's Food Services Inc* (1998) 41 BLR (2d) 42 (Ont CA). For the leading examples of this approach see *Ahluwalia v Richmond Cabs Ltd* [1996] 1 WWR 656 (BCCA) and *Western Drill-Dredging Mfg Ltd v Suncor Inc* (1994) 26 Alta LR (3d) 39 (Alta QB).

[28] See e.g. Alan Berg, "Thrashing through the undergrowth" (2006) 122 LQR 354; Richard Calnan, "Construction of commercial contracts: a practitioner's perspective", in Burrows and Peel, pp 17-24; James J Spigelman, "From text to context: contemporary contractual interpretation" (2007) 81 ALJ 322.

[29] Gerard McMeel, "The principles and policies of contractual construction", in Burrows and Peel, pp 27-51 at pp 50-51. Professor McMeel offers five further propositions, which are versions of the main "rules of preference" (see paras 3.20 and 7.36-7.38). The approach informs the structure of his book on the subject (above, fn 18).

[30] See para 2.6 above.

McMeel's book is principally concerned. Like RIPL, the approach falls some way short of that set out in the DCFR, although it is significantly wider than that which prevailed in England and Wales before the 1970s.

4.8 It should be noted, however, that Lord Hoffmann's seemingly sweeping statements in the *ICS* case were carefully qualified even at the time they were made. For example, to be relevant the background had to be "reasonably available to the parties";[31] the parties' previous negotiations and declarations of subjective intent continued to be excluded from consideration for reasons of practical policy; and "we do not easily accept that people have made linguistic mistakes, particularly in formal documents".[32] These qualifications were reinforced in subsequent cases. So with regard to the background including "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man",[33] Lord Hoffmann later stated that he "meant anything which a reasonable man would have regarded as *relevant*".[34] He also said in the same case that "the primary source for understanding what the parties meant is their language interpreted in accordance with conventional usage".[35] It is, however, striking that these latter two dicta were uttered in a case where Lord Hoffmann was a lone dissentient as the House of Lords held that a release clause in a redundancy agreement, stated to be 'in full and final settlement of all or any claims of whatsoever nature that exist or may exist', did not prevent a subsequent claim against the former employer of a kind approved by an earlier House in a decision handed down after the redundancy agreement was concluded.[36] So Lord Hoffmann's caution in this case was not necessarily shared by all his judicial brethren.

Pre-contractual negotiations as part of the background

4.9 One of the important limitations upon admissible background stated by Lord Hoffmann in the *ICS* case was, however, strongly reaffirmed by the House of Lords in *Chartbrook* in which a unanimous House, including the Scottish Law Lords, Lord Hope of Craighead and Lord Rodger of Earlsferry, and led by Lord Hoffmann himself, upheld the decision in *Prenn v Simmonds*[37] that, despite their potential relevance as background to the parties' agreement, pre-contractual negotiations were excluded from consideration as a matter of law. In *Prenn*, Lord Wilberforce explained the rule thus:

> "The reason for not admitting evidence of these exchanges is not a technical one or even mainly one of convenience, (though the attempt to admit it did greatly prolong the case and add to its expense). It is simply that such evidence is unhelpful. By the nature of things, where negotiations are difficult, the parties' positions, with each passing letter, are changing and until the final agreement, though converging, still divergent. It is only the final document which records a consensus. If the previous documents use different expressions, how does construction of those expressions, itself a doubtful process, help on the construction of the contractual words? If the same expressions are used, nothing is gained by looking back: indeed, something may be lost since the relevant surrounding circumstances may be different. And at this stage there is no consensus of the parties to appeal to. It may be said that previous documents may be looked at to explain the aims of the parties. In a limited

[31] [1998] 1 WLR 896 at 912.
[32] Ibid at 913.
[33] Ibid.
[34] *BCCI SA v Ali* [2002] 1 AC 251 at 269 (with the emphasis in the original).
[35] Ibid.
[36] The earlier case was *Malik v BCCI* [1998] AC 20.
[37] [1971] 1 WLR 1381 (HL).

sense this is true: the commercial, or business object, of the transaction, objectively ascertained, may be a surrounding fact."[38]

4.10 In *Chartbrook* Lord Hoffmann accepted that while "in principle" previous negotiations "may be relevant",[39] and that evidence about them could be used for purposes other than interpretation, such as establishing that a fact relevant to the background was known to the parties,[40] the general exclusionary rule should be maintained "on pragmatic grounds".[41] He spelled out these grounds as follows:

> "[35] The first is that the admission of pre-contractual negotiations would create greater uncertainty of outcome in disputes over interpretation and add to the cost of advice, litigation or arbitration. Everyone engaged in the exercise would have to read the correspondence and statements would have to be taken from those who took part in oral negotiations. Not only would this be time-consuming and expensive but the scope for disagreement over whether the material affected the construction of the agreement … would be considerably increased. …
>
> [38] … [P]re-contractual negotiations seem to me capable of raising practical questions different from those created by other forms of background. Whereas the surrounding circumstances are, by definition, objective facts, which will usually be uncontroversial, statements in the course of pre-contractual negotiations will be drenched in subjectivity and may, if oral, be very much in dispute. It is often not easy to distinguish between those statements which (if they were made at all) merely reflect the aspirations of one or other of the parties and those which embody at least a provisional consensus which may throw light on the meaning of the contract which was eventually concluded. But the imprecision of the line between negotiation and provisional agreement is the very reason why in every case of dispute over interpretation, one or other of the parties is likely to require a court or arbitrator to take the course of negotiations into account."

Thus here for Lord Hoffmann pragmatism clearly wins out over principle in determining the path to be taken by the law. It is striking that his speech[42] highlighted the policy justification for the parole evidence rule in a lengthy quotation from one of the leading nineteenth-century cases on the subject, *Inglis v Buttery & Co Ltd*,[43] to the effect that the purpose of a written contract is to eliminate consideration of anything other than the document itself in determining its meaning. How this is to be reconciled with the general contemporary approach, following on from the *ICS* case, of always considering the language of the contract in the light of the relevant surrounding circumstances, is, however, not explained.

4.11 A further possible justification for the exclusionary rule discussed in *Chartbrook* is the protection of third parties who may become involved in the contract as assignees or holders of a security over the asset that the contract represents and who will not have had knowledge of the negotiations, or the opportunity to acquire such knowledge. Lord Hoffmann did not seem wholly convinced by this reasoning, however:

> "There is clearly strength in this argument, but it is fair to say that the same point can be made […] in respect of the admissibility of any form of background. The law

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[38] Ibid at 1384-5.
[39] [2009] UKHL 38; [2009] 1 AC 1101, para 33.
[40] Ibid, para 42.
[41] Ibid, para 34.
[42] Ibid, para 29. See also the speeches of Lord Hope (paras 3-4) and Lord Rodger (para 69).
[43] (1878) 3 App Cas 552 per Lord Blackburn at 577 (also (1878) 5 R (HL) 87 at 102), himself quoting Lord Gifford (dissenting) in the Court of Session below: (1877) 5 R 58 at 69-70.

> sometimes deals with the problem by restricting the admissible background to that which would be available not merely to the contracting parties but also to others to whom the document is treated as having been addressed. […] Ordinarily, however, a contract is treated as addressed to the parties alone and an assignee must either inquire as to any relevant background or take his chance on how that might affect the meaning a court will give to the document. The law sometimes has to compromise between protecting the interests of the contracting parties and those of third parties. But an extension of the admissible background will, at any rate in theory, increase the risk that a third party will find that the contract does not mean what he thought. How often this is likely to be a practical problem is hard to say."[44]

4.12 Lord Hoffmann also took the opportunity in *Chartbrook* to over-rule a previous decision by Kerr J which some had thought constituted a significant inroad upon the exclusionary rule. In *The Karen Oltmann*[45] a two-year time charter contained a break clause giving the charterers the option of redelivering the vessel "after 12 months' trading". The question was whether this phrase meant that the clause could operate only at the end of year 1, or at any time during year 2. Kerr J held that he could consider telexes exchanged between the parties during their negotiations, from which he held that they had negotiated on the basis that the word "after" meant "on the expiry of" and not "at any time after the expiry of". The possible relevance of the case in *Chartbrook* was that there was correspondence from Persimmon to Chartbrook indicating the former's understanding of the nature of their deal with regard to the ARP and that this was known and not objected to by the latter.[46] But for Lord Hoffmann this approach infringed the rule excluding consideration of the parties' negotiations. Nor could it be justified by what he termed the "private dictionary" principle, under which evidence may be led to show that parties habitually used particular words in an unconventional sense which should therefore be given that sense when used in their contracts, for *The Karen Oltmann* merely involved a choice between two conventional meanings of the word "after". "Taken to its logical conclusion," wrote Lord Hoffmann, "[the decision] would destroy the exclusionary rule and any practical advantages which it may have."[47]

4.13 Finally, *Chartbrook* is also notable for Lord Hoffmann's explicit rejection of the interpretation principles in "Continental systems" and in CISG, PICC and PECL in so far as they allowed account to be taken of pre-contractual negotiations. He said:

> "But these instruments reflect the French philosophy of contractual interpretation, which is altogether different from that of English law. As Professor Catherine Valcke explains in an illuminating article ("On Comparing French and English Contract Law: Insights from Social Contract Theory") (16 January 2009)[48], French law regards the intentions of the parties as a pure question of subjective fact, their volonté psychologique, uninfluenced by any rules of law. It follows that any evidence of what they said or did, whether to each other or to third parties, may be relevant to establishing what their intentions actually were. There is in French law a sharp

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[44] [2009] UKHL 38; [2009] 1 AC 1101, para 40. This dictum may represent a modification of Lord Hoffmann's position over time. In 1997 he wrote extra-judicially, in the article cited at fn 1: "[I]nterpretation of a contract can affect people other than the contracting parties. To take the simplest case, the benefit of the contract may be assigned to a third party, who will know nothing of the negotiations which preceded its conclusion. It could be unfair if they were relied upon to give the contract a meaning different from the impersonal construction." (at 668).

[45] *The Karen Oltmann (Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd)* [1976] 2 Lloyds Rep 708.

[46] See the evidence summarised by Lord Hoffmann in *Chartbrook* at paras 49-55.

[47] [2009] UKHL 38; [2009] 1 AC 1101, para 47.

[48] This article is published at (2009) 4 *Journal of Comparative Law* 69-95. Lord Hoffmann appears to cite it from its SSRN version, accessible at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1328923.

> distinction between the ascertainment of their intentions and the application of legal rules which may, in the interests of fairness to other parties or otherwise, limit the extent to which those intentions are given effect. English law, on the other hand, mixes up the ascertainment of intention with the rules of law by depersonalising the contracting parties and asking, not what their intentions actually were, but what a reasonable outside observer would have taken them to be. One cannot in my opinion simply transpose rules based on one philosophy of contractual interpretation to another, or assume that the practical effect of admitting such evidence under the English system of civil procedure will be the same as that under a Continental system."[49]

4.14 This view contrasts, however, with the earlier concerns of Lord Nicholls, expressed extra-judicially at a time when he was still a Lord of Appeal in Ordinary, and making reference not only to CISG, PICC and PECL, but also to section 214 of the USA's Restatement (Second) Contracts, as follows:

> "Adherence to the exclusionary rule [on pre-contract negotiations] as an absolute rule would risk this country becoming isolated on this point in the field of commercial law, the very area of law where, it is said, relaxation of the present rigidity would be undesirable."[50]

In relevant part, section 214 of the Restatement reads: "Agreements and negotiations prior to or contemporaneous with the adoption of a writing are admissible in evidence to establish … (c) the meaning of the writing …". In New Zealand Professor David McLauchlan has also referred to CISG, PICC and PECL in support of arguments for relaxation of the exclusionary rule about pre-contractual negotiations, concluding:

> "There is much to be said for the view that, unless there are compelling reasons for doing otherwise, domestic contract law should be guided by established international practice in our increasingly global economy."[51]

In Australia Finn J has also said of the decision in *Chartbrook* that "I would note without disrespect that this rule does not as of course commend itself in all parts of the common law world and, in particular, in parts of the United States".[52] He added:

> "I would comment that in a case such as the present where there are both a dispute as to whether the contract is or is not partly oral and claims as well of misleading or deceptive conduct in the negotiations for the contract, the evidence of the parties' negotiations can be admitted on those issues and can result in the court obtaining an informed appreciation not only of the object and intent of the contract itself but also of individual clauses of it. Where it is found that the contract is, in fact, wholly written, to require the parol evidence rule to be applied to the construction of the contract in disregard of that informed appreciation does sit rather oddly with the concept of party autonomy."[53]

4.15 These perceptions from within the common law world that admitting pre-contractual negotiations is not something altogether alien, and may indeed be desirable on policy grounds, can be reinforced with Professor Vogenauer's comparative observations on interpretation in general: first, that "the French approach is … 'subjective' in terms of

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[49] [2009] UKHL 38; [2009] 1 AC 1101, para 39.
[50] Donald Nicholls, "My kingdom for a horse: the meaning of words" (2005) 121 LQR 577 at 586.
[51] David McLauchlan, "Contract interpretation: what is it about?" (2009) 31(5) Sydney LR 5 at 35.
[52] *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* [2009] FCA 1270, para 118.
[53] Ibid, para 121.

ideology and rhetoric, rather than in substance"; while, second, "the subjective approach has its roots in the ideals of liberty and individualism which are not necessarily strangers to classic English contract law".[54] Lord Hoffmann's argument against following CISG, PICC and PECL (and thus, in effect, the DCFR) on this point seems to rest on ground that is at best contestable.[55] Indeed, an earlier comment in his *Chartbrook* speech – "I do however accept that it would not be inconsistent with the English objective theory of contractual interpretation to admit evidence of previous communications between the parties as part of the background which may throw light upon what they meant by the language they used"[56] – is not readily reconciled with the later passages on the alien-ness of the international instruments to English law.

4.16 The Canadian courts have allowed consideration of pre-contractual evidence for nearly a century.[57] However, some degree of ambiguity or confusion is required before reliance can be placed on such material: "the negotiation cannot be received to change the terms of a written contract, but interpreting the contract in light of surrounding circumstances is another matter".[58] Moreover, since *Chartbrook* two of the five judges in a case before the Supreme Court of New Zealand have indicated that in their view relevant evidence from pre-contractual negotiations is admissible to help determine the meaning to be attached to the language of the contract.[59] Tipping J comments that "irrelevance should be the touchstone for the exclusion of evidence" and finds no "sufficiently persuasive pragmatic grounds on which to exclude evidence that is relevant".[60] Wilson J adds:

> "It is difficult to see why pragmatic considerations of difficulty of proof should be seen as a barrier to admitting evidence of negotiations for the purpose of construing the contract but not for the purpose of rectification; whether the test [of interpretation] is objective or subjective, assistance can and should where necessary be derived from evidence of the negotiations. While the degree of assistance to be derived from prior negotiations in ascertaining the presumed intention of the parties will vary greatly from one contract to another, courts should not disqualify themselves from obtaining that assistance when it is available."[61]

Wilson J also robustly rejects any need to protect assignees or lenders:

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[54] Stefan Vogenauer, "Interpretation of contracts: concluding comparative observations", in Burrows and Peel, pp 123-150 at pp 127 and 129. See also Wayne Barnes, "The French subjective theory of contract: separating rhetoric from reality" (2008) 83 Tulane LR 355 at 389-390. It may be noted that in the current French reform proposals (*le projet Terré*: see fn 12 to para 1.5 above) with regard to the interpretation of contract (arts 152-158), "il est proposé de rappeler le principe de l'interprétation subjective (recherche de la commune intention des parties) et à défaut de l'interprétation objective" ("it is proposed to reaffirm the principle of subjective interpretation (the search for the common intention of the parties), which failing, the principle of objective interpretation"). This is said to follow the model of the European rules (i.e. the DCFR).

[55] See also Catherine Mitchell, "Contract interpretation: pragmatism, principle and the prior negotiations rule" (2010) 26 Jnl of Contract Law 134 at 154-5 ("Lord Hoffmann's rejection of the continental approach to interpretation is not wholly convincing").

[56] [2009] UKHL 38; [2009] 1 AC 1101, para 33.

[57] *Chisholm v Chisholm* (1915) 49 NSR 174; *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 3 All ER 570 at 574-575 per Lord Wilberforce. See further *Qualico Devs. Ltd v Calgary (City)* [1987] 5 WWR 361 (Alta QB); *BC Hydro & Power Authority v Cominco Ltd* (1989) 34 BCLR (2d) 60 (BCCA); *Delisle v Bulman Group Ltd* (1991) 54 BCLR (2d) 343 (BCSC); *Paddon-Hughes Dev Co v Chiles Estate* [1992] 3 WWR 519 at 524 (Alta QB); *Glaswegian Enterprises Inc v BC Tel Mobility Inc* (1997) 49 BCLR (3d) 317 (BCCA); *Toronto Dominion Bank v Leigh Instruments Ltd (Trustee of)* (1998) 40 BLR (2d) 1 (Ont Gen Div).

[58] *Chisholm v Chisholm* (1915) 49 NSR 174 at 181-182 (NSCA) per Ritchie J.

[59] *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5 and the judgments of Tipping J (paras 27-31) and Wilson J (para 129).

[60] Ibid, para 29.

[61] Ibid, para 129.

> "The position of those taking an assignment of or lending on a contract is no reason for excluding reference to prior negotiations; in choosing to involve themselves with the contract those parties must accept that, when interpreting the contract, the courts may have regard to prior negotiations or indeed to the other material outside the contract which, on Lord Hoffmann's approach, they are required to consider."[62]

Two of the other New Zealand Supreme Court judges would admit evidence of pre-contractual negotiations only as part of the overall context and commercial purpose of the agreement,[63] while the fifth member of the court thought pre-contractual negotiations should generally be excluded from consideration except where they gave rise to an estoppel by convention or a claim in rectification.[64] The Supreme Court of Appeal in South Africa appears also to have moved recently in favour of a wider approach to admissibility of evidence of prior negotiations for purposes of interpretation, albeit to be "used as conservatively as possible".[65]

Conduct of the parties subsequent to the contract's formation as admissible background

4.17 Although the rule excluding evidence of parties' conduct after contract formation has been the subject of critical discussion in the periodical literature,[66] there has been no high-level judicial discussion or review of the law, comparable with that in *Chartbrook*, in England. Such material continues to be excluded from the interpretative process following decisions of the House of Lords in the 1970s.[67] Lord Hoffmann's statement of the principles of interpretation in the *ICS* case did not specifically mention subsequent conduct, but it can probably be inferred that he accepted its established exclusion from the admissible background in the following passage of his speech:

> "Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background *knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract*."[68]

4.18 In New Zealand, however, the Supreme Court has departed from this exclusionary rule in a pre-*Chartbrook* decision,[69] while the South African courts have admitted subsequent conduct as an evidentiary guide where contracts are found to be ambiguous.[70] Likewise, the Canadian courts have adopted the view that subsequent conduct evidence can assist

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[62] Ibid.
[63] Ibid, per Blanchard J (paras 13-14), with whom Gault J agreed (para 151). Blanchard J thought, however, that "the question of how much further the courts of this country should go towards admitting evidence of negotiations for the light they may shed on the objective intention of the parties can be left for another day" (para 14).
[64] The fifth judge was McGrath J, for whose views see paras 73-78. On rectification and estoppel by convention see paras 4.20-4.25 below.
[65] See *Coopers & Lybrand v Bryant* 1995 (3) SA 761 (A); *KPMG Chartered Accountants (SA) v Securefin Ltd* 2009 (4) SA 399 (SCA), para 39 per Harms DP.
[66] See e.g. Gerard McMeel, "Prior negotiations and subsequent conduct – the next step forward for contractual interpretation?" (2003) 119 LQR 272 at 290-293; Donald Nicholls, article cited at fn 50 above, at 588-589.
[67] *James Miller & Partners Ltd v Whitworth Estates (Manchester) Ltd* [1970] AC 583; *Schuler v Wickman Machine Tool Sales Ltd* [1974] AC 235.
[68] [1998] 1 WLR 896 at 912 (with added emphasis).
[69] *Wholesale Distributors Ltd* v *Gibbons Holdings Ltd* [2008] 1 NZLR 277.
[70] See e.g. *Breed v Van den Berg* 1932 AD 283 and also the cases cited at fn 65 above.

with determinations on the interpretation of written contracts.[71] The USA's Uniform Commercial Code and Restatement (Second) of Contracts provides that:

> "Where [a contract] involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection *shall be relevant to determine the meaning of the agreement*."[72]

4.19 Writing extra-judicially at a time when he was still a Lord of Appeal in Ordinary, Lord Nicholls criticised the justification for the subsequent conduct rule stated by Lord Reid in 1970,[73] that it might lead to contracts meaning one thing one day and another the next:

> "This is puzzling. Evidence of the parties' subsequent conduct is sought to be used as a means of identifying the meaning borne by the language of the contract from its inception. The fact that this evidence only came into being after the contract was made can hardly be a good reason for declining to admit it."[74]

Lord Nicholls' article was influential in the New Zealand decision to make evidence of subsequent conduct admissible for purposes of interpretation.

Safety mechanisms: rectification and estoppel by convention

4.20 There are ways around the limitations of evidence imposed by the exclusionary rules relating to pre-contractual negotiations and subsequent conduct in English law, provided by the long-established equitable remedy of rectification and the equitable doctrine of estoppel by convention, which by contrast began to develop only in the 1980s. *Rectification* applies in cases where a contracting party argues that the document embodying the contract fails to reflect what the parties agreed and asks the court to rewrite it so that it does state what the parties agreed. For this purpose the court may examine evidence of the parties' pre-contractual negotiations.[75] *Estoppel by convention* is defined as follows in the leading case:

> "[W]hen the parties have acted in their transaction upon the agreed assumption that a given state of facts is to be accepted between them as true, then as regards that transaction each will be estopped against the other from questioning the truth of the statement of facts so assumed."[76]

The estoppel may apply in relation to an assumption of fact arising from either the parties' pre-contractual negotiations or their subsequent conduct, and again the court will not be

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[71] See *Manitoba Development Corporation v Columbia Forest Products Ltd* [1974] 2 WWR 237 (Man CA), followed in *Palansky v Palansky* (1993) 89 Man R (2d) 1 (Man QB) and *Montreal Trust Co of Canada v Birmingham Lodge Ltd* (1995) 24 OR (3d) 97 (Ont CA) and, in Alberta, in *Beller Carreau Lucyshyn Ltd v Cenalta Oilwell Servicing Ltd* (1997) 211 AR 1 (Alta QB).

[72] UCC art 2-208(1); Restatement, Section 202(4). In the UCC the words in square brackets are replaced by "a contract of sale", and in the Restatement by "an agreement". The italicised words are found in the UCC but replaced in the Restatement by "is given great weight in the interpretation of the agreement".

[73] *James Miller & Partners Ltd v Whitworth Estates (Manchester) Ltd* [1970] AC 583 at 603: "I must say that I had thought that it is now well settled that it is not legitimate to use as an aid in the construction of the contract anything which the parties said or did after it was made. Otherwise one might have the result that a contract meant one thing the day it was signed, but by reason of subsequent events meant something different a month or a year later."

[74] Donald Nicholls, article cited at fn 50 above, at 589.

[75] On rectification generally see McMeel, *Construction*, ch 17; Chitty, *Contracts* (30th ed, 2008), paras 5-107ff.

[76] *Amalgamated Investment and Property Co Ltd v Texas Commerce International Bank Ltd* [1982] QB 84 at 126 per Eveleigh LJ, quoting Spencer-Bower and Turner*, Estoppel by Representation* (3rd ed, 1977), p 157.

restricted as to the evidence it may consider.[77] The use of estoppel appears to avoid the requirement of consideration which applies to variations and waivers of contractual obligations.[78] Estoppel by convention can clearly be helpful in preventing a party from going back on an apparently shared understanding of the contract's meaning, whether post- or pre-contractual; but it provides only a defence and not a cause of action. So in *Amalgamated Investment & Property Co Ltd v Texas Commerce International Bank Ltd*[79] A negotiated with X Bank for a loan to B (a subsidiary of A), secured *inter alia* by a guarantee to X from A in which A promised to pay all moneys due "to you" (i.e. X) from B, when the loan was actually made to B by Y Bank (a subsidiary of X). Thus on a strict interpretation A's guarantee to X was of no assistance in guaranteeing the loan actually made to B. But it was held that A and X had assumed that the guarantee did cover the loan to B and had continued to behave on that basis in various ways after the guarantee came into operation. Although A had made no representations and the error was X's, it was held that A was estopped from denying that the guarantee covered the loan made by the Y Bank.

4.21 The existence of both rectification and estoppel by convention is used by some to support the existence of a more restrictive approach to evidence in questions of interpretation. Lord Hoffmann, writing extra-judicially, argued that the exclusionary approach in interpretation meant that "ordinarily a court can construe a document simply by reading it" and that both rectification and estoppel were "exceptional" in nature: "they must be specifically pleaded and established unequivocally to a high standard of proof." The remedies were to be seen as "safety mechanisms" to avoid the possible injustice of a relatively strict interpretation rule, although only in the clearest cases.[80] As Lord Hoffmann put it in the *Chartbrook* case: "[R]ectification or estoppel … are not exceptions to the rule. They operate outside it."[81] The nature of the distinction drawn by his Lordship between rectification and "correction of mistakes by construction" perhaps emerges more clearly from his further remarks in *Chartbrook*, that "the process of interpretation does not require one to formulate some alternative form of words which approximates as closely as possible to that of the parties. It is to decide what a reasonable person would have understood the parties to have meant by using the language which they did."[82] In other words, where rectification requires the formulation of replacement language, interpretation involves the identification of what the parties meant by the words they did in fact use.

4.22 Other commentators, including distinguished judges, say, however, that it is simply artificial to deny the courts the use of evidence available in the other contexts provided by rectification and estoppel.[83] Lord Nicholls also notes that the law seems to encourage strategic behaviour by counsel:

> "In my days at the Bar the practice was when the parties' pre-contract negotiations furnished some insight into their actual intentions, one or other of the parties would

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[77] McMeel, *Construction*, ch 18; Treitel, *Contract* (12th ed, 2007), pp 129-135. The assumption may be made by one party and acquiesced in by the other.
[78] Chitty, *Contracts* (30th ed, 2008), para 3-107.
[79] [1982] QB 84. The quotation earlier in this paragraph is taken from this case.
[80] Article cited at fn 1 above, at 667-668.
[81] [2009] UKHL 38; [2009] 1 AC 1101, para 42.
[82] Ibid, para 21. See also para 25 of Lord Hoffmann's speech: "What is clear from these cases is that there is not, so to speak, a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed. All that is required is that it should be clear that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant."
[83] Gerard McMeel, "Prior negotiations and subsequent conduct – the next step forward for contractual interpretation?" (2003) 119 LQR 272 at 290-293; Donald Nicholls, article cited at fn 50 above, at 588-589.

include a rectification claim in the proceedings. By this means, whatever the outcome of the rectification claim, the evidence of the parties' actual intentions would be before the court. The hope was that, either consciously or subconsciously, the judges' thinking on the interpretation issue would be influenced by this evidence."[84]

The *Chartbrook* case itself actually included a claim for rectification alongside the interpretation arguments, and the court was thus able to consider the content of the pre-contractual discussions of the parties while at the same time denying itself their use in the interpretation part of the case. An exchange of letters and other communications showed quite clearly that the ARP was intended by the parties to give Chartbrook a share of any 'uplift' beyond the anticipated price for the flats in the development, rather than an absolute right to a percentage of the net revenue generated by Persimmon's sales activity.[85] Baroness Hale frankly acknowledged, however, that she "would not have found it quite so easy to reach [Lord Hoffmann's] conclusion [on the correct interpretation of the ARP clause] had we not been made aware of the agreement which the parties had reached on this aspect of their bargain during the negotiations which led up to the formal contract".[86]

4.23 In his *Chartbrook* speech Lord Hoffmann again referred to the "two legitimate safety devices"[87] of rectification and estoppel by convention when over-ruling *The Karen Oltmann*. He held that Kerr J was wrong to say that, because "the words used in the contract would *ex hypothesi* reflect the meaning which both parties intended", rectification was not available on the facts of that case. Lord Hoffmann says:

> "I do not understand this, because, on this hypothesis, the telexes would show that the words (as construed by the judge) did *not* reflect the meaning which both parties intended. And it is generally accepted that Brightman J was right in *Re Butlin's Settlement Trusts* [1976] Ch 251 in holding that rectification is available not only when the parties intended to use different words but also when they mistakenly thought their words bore a different meaning."[88]

On estoppel by convention, he adds:

> "If the parties have negotiated an agreement upon some common assumption, which may include an assumption that certain words will bear a certain meaning, they may be estopped from contending that the words should be given a different meaning."[89]

4.24 It may be noted, however, that the USA's Restatement (Second) of Contracts provides a rule similar to that in *The Karen Oltmann*, as follows:

> "Where the parties have attached different meanings to a promise or agreement or a term thereof, it is interpreted in accordance with the meaning attached by one of them if at the time the agreement was made (a) that party did not know of any different meaning attached by the other, and the other knew the meaning attached by the first party; or (b) that party had no reason to know of any different meaning

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[84] Donald Nicholls, article cited at fn 50 above, at 578. *Prenn v Simmonds* [1971] 1 WLR 1381 (HL) provides an example of this practice.
[85] See paras 49-54 of Lord Hoffmann's speech.
[86] [2009] UKHL 38; [2009] 1 AC 1101, para 99.
[87] Ibid, para 47.
[88] Ibid, para 46.
[89] Ibid, para 47.

attached by the other, and the other had reason to know the meaning attached by the first party."[90]

4.25 In sum, it is clear that while the acceptance of the Hoffmann approach to interpretation has not led the English courts to the view that evidence of either the parties' pre-contractual negotiations or their conduct subsequent to the conclusion of their contract should be admitted as part of the background with which the contract may be understood, in other parts of the common law world reference to such material has either long been permissible as part of a generally contextual approach to interpretation (the USA) or is in the process of becoming so (New Zealand, Canada).[91] The remedy of rectification and the doctrine of estoppel by convention are used in England in order to prevent injustices that might otherwise arise from the strict exclusionary rules in the law of interpretation; in particular it appears to be common practice in cases involving a dispute about interpretation to run alongside that a claim for rectification. This can mean that a court has evidence before it for purposes of rectification to which, however, it is forbidden to refer for the purposes of interpretation. There is also some appearance of overlap between rectification and the possibility that the Hoffmann approach to interpretation can allow a court in effect to re-work a contract, explained on the basis that only in rectification is it necessary for the court to spell out the exact words in which the contract should have been framed.

[90] Section 201(2).
[91] Australia is the conspicuous exception but there the Hoffmann approach has yet to gain judicial acceptance at all. However, some blowing of straws in the wind may be detected in recent cases such as *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* [2009] FCA 1270 and *Franklins Pty Ltd v Metcash Trading Ltd* [2009] NSWCA 407.

Chapter 5 Judicial developments since 1997 (2): Scotland

The Scottish response to Lord Hoffmann's approach[1]

5.1 In the *ICS* case the then Scottish Law Lords, Lord Hope of Craighead and Lord Clyde, agreed with Lord Hoffmann's speech, while Lord Hope and Lord Rodger of Earlsferry (the other then Scottish Law Lord) concurred with Lord Hoffmann in the *Chartbrook* case. Lord Hope has also cited the Hoffmann approach, albeit in a qualified way (to be discussed further below),[2] in the recent Supreme Court decision, *Multi-Link Leisure Developments Ltd v North Lanarkshire Council*.[3] This may be seen as a reasonably clear lead that the Hoffmann approach is to be followed by other Scottish courts; and it has indeed been cited with approval several times at Inner House level in the Court of Session.[4] There is even a perception that the Hoffmann approach has fore-runners amongst nineteenth and early twentieth century Scottish judges in so far as, in the words of Gloag on *Contract* published in 1929, "it is always competent to lead evidence of the circumstances surrounding the parties at the time the contract was made".[5] But on the whole the Scottish courts have confined themselves to what is usually called a commercial or purposive approach to interpretation, seeking to give effect to the actual words used in the light of the circumstances surrounding the parties at the time they entered their contract.[6] The approach is in line as much with Lord Wilberforce's earlier speeches as with Lord Hoffmann's, and sometimes tends to downplay any innovation the latter might be thought to involve with regard to re-working the text.[7] The Hoffmann approach has also been strongly criticised in the leading modern text on contract law, especially in so far as it might involve over-riding the express terms of the contract;[8] and an Extra Division has recently expressed its "considerable sympathy" for such criticism.[9] Little reference is now made in the Scottish courts to the parole evidence rule in

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[1] The Hoffman approach is discussed in Ch 4.
[2] See para 5.7.
[3] [2010] UKSC 47, paras 19-23 (hereafter "***Multi-Link***").
[4] *Bank of Scotland v Dunedin Property Investment Co Ltd* 1998 SC 557; *Project Fishing International v CEPO Ltd* 2002 GWD 16-125; *Simmers v Innes* [2007] CSIH 12; 2007 GWD 9-159. This last case went on to the House of Lords ([2008] UKHL 24; 2008 SC (HL) 137), but there was no discussion of the Hoffmann approach in their Lordships' speeches.
[5] See Gloag, *Contract* (2nd ed, 1929), pp 373-375 (quotation in the text at p 373), and the cases there cited; also, e.g., the speeches of Lord Kinnear and Lord Dunedin in *Charrington & Co Ltd v Wooder* [1914] AC 71, cited by Lord Wilberforce in *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 (HL) at 996-997. See also *Aberdeen City Council v Stewart Milne Ltd* [2010] CSIH 81, para 11 per Lord Drummond Young; but note the comment by Lord Hope in *Multi-Link* [2010] UKSC 47, para 2.
[6] Cf para 5.10 for cases involving the replacement of single words in order to give sense to a provision. See further for general discussion Laura Macgregor and Carole Lewis, "Interpretation of contract", in Reinhard Zimmermann, Daniel Visser and Kenneth Reid (eds), *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Comparative Perspective* (2004), pp 66-93; Lord Bingham, "A new thing under the sun? The interpretation of contract and the *ICS* decision" (2008) 12 Edin LR 374 at 385; David Cabrelli, "Interpretation of contracts, objectivity and the elision of consent reached through consent and compromise" 2011 JR (forthcoming).
[7] See e.g. *City Wall Properties (Scotland) Ltd v Pearl Assurance plc* [2003] CSOH 211; 2004 SC 214.
[8] McBryde, *Contract*, paras 8.25-8.27.
[9] *Multi-Link Leisure Developments Ltd v North Lanarkshire Council* [2009] CSIH 96; 2010 SC 302, paras 23-25. The Division's suggestion that Lord Hoffmann's observations were more relevant to commercial contracts than to leases of heritable property (the subject-matter of the case before the court) was implicitly rejected in the

such debates, however, possibly because one of its major elements, the rule prohibiting any search beyond a written contract for additional terms, was abolished by section 1 of the Contract (Scotland) Act 1997. Consideration of the relevant and permissible surrounding circumstances as part of the interpretation process does not in any event offend against the other element of the rule (that preventing contradiction of the written document by extrinsic evidence), since the purpose of the exercise is to understand and explain the language actually used, not to go against it.

Bank of Scotland v Dunedin Property Investment Co Ltd

5.2 The leading modern case on how to interpret contracts in Scotland is usually taken to be *Bank of Scotland v Dunedin Property Investment Co Ltd*,[10] starting with the words used but avoiding interpretations in conflict with business reality or producing an absurd result. In that process the court is entitled to be placed in the same position as the parties were themselves at the time the contract was concluded, "not in order to provide a gloss on the terms of the contract, but rather to establish the parties' knowledge of the circumstances with reference to which they used the words in the contract".[11] The facts of the case were that the Bank (BoS) and Dunedin entered into a loan stock deed, in which a clause provided that Dunedin had a right, on giving six months' notice, to purchase the stock, but "subject to Bank of Scotland being fully reimbursed for all costs, charges and expenses incurred by it in connection with the stock". The loan was for the duration of ten years, at a fixed rate of interest. In order to hedge itself against interest rate fluctuations in the market, BoS entered into a further 'swaps' contract with another bank. Some years into the loan, Dunedin gave BoS notice under the contract that they wished to purchase the debenture stock and so terminate the fixed term loan early. BoS then sought repayment of the breakage charge which it was obliged to pay to the other bank for prematurely terminating the swaps agreement, on the basis that that payment was a cost incurred "in connection with" the stock in terms of the contract. Reversing the Lord Ordinary, the First Division held that the phrase "in connection with" did not limit recoverable costs to such matters as drafting, registration or purely administrative charges, and that BoS could therefore claim the amount of the breakage charge (some £923,253) from Dunedin.

5.3 There were some significant differences in the approaches of the judges of the First Division to the BoS claim. Rather than taking Lord Hoffmann's approach to interpretation, Lord President Rodger found it:

> "helpful to start where Lord Mustill began when interpreting the reinsurance contracts in *Charter Reinsurance Co Ltd v Fagan*[12] at p 384B-C: 'I believe that most expressions do have a natural meaning, in the sense of their primary meaning in ordinary speech. Certainly, there are occasions where direct recourse to such a meaning is inappropriate. Thus, the word may come from a specialist vocabulary and have no significance in ordinary speech. Or it may have one meaning in common speech and another in a specialist vocabulary; and the content may show that the author of the document in which it appears intended it to be understood in the latter sense. Subject to this, however, the inquiry will start, and usually finish, by

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Supreme Court: see [2010] UKSC 47, para 26 per Lord Rodger ("it is appropriate to treat the lease as a commercial agreement which is to be construed accordingly") and para 45 (Lord Clarke). Lord Hope clearly sees the lease concerned as a commercial contract.

[10] 1998 SC 657 (hereafter "***BoS v Dunedin***").

[11] Ibid at 665 per LP Rodger.

[12] [1997] AC 313.

> asking what is the ordinary meaning of the words used.' I begin therefore, not by enquiring into the state of knowledge of the parties to the contract, but by asking myself what is the ordinary meaning of the words 'in connection with' in Condition 3."[13]

Having reached a particular understanding of the words in issue on the basis that in their ordinary meaning the words "in connection with", "while imposing a certain restriction on the costs which fall within the condition, none the less brought in costs over a wide area",[14] the Lord President then confirmed this interpretation by reference to the commercial background to the contract, including the parties' knowledge that BoS would have to engage in a further hedging transaction with a third party to minimise its risk and that charges would be incurred in the event of early termination of the hedging arrangement.[15]

5.4 Lords Kirkwood and Caplan, on the other hand, both indicated that they would have had great difficulty in reaching the Lord President's conclusion on the wording of the contract alone, since the liability which BoS in effect wished to pass on to Dunedin arose under another contract which BoS had not been required to enter under the Dunedin deal, and to which Dunedin was neither party nor aware of its precise content.[16] Each judge referred approvingly to Lord Hoffmann's approach and found it more helpful to bring in the surrounding circumstances from the start of the interpretative exercise.[17] Lord Caplan said:

> "Formal language is less important than an attempt to extract from the language what parties must in all the circumstances have intended. I am certainly not suggesting that plain words should be ignored but equally it is not useful or sensible to struggle with contorted semantic exercises if it is perfectly obvious what reasonable and informed business people must have meant if they were hoping to achieve a workable and intelligent result."[18]

This did not, however, lead to, or indeed require, any re-working or adjustment of the words used in the contract under consideration; the question was interpreting how these words applied to the dispute between the parties.

Re-working the words

5.5 As already noted,[19] there have not in fact been any recent Scottish cases in which re-working of the words used has taken place on the scale seen in the *ICS* case or *The Starsin*. Perhaps the nearest the courts have come to such an approach is *Multi-Link*. In this case North Lanarkshire Council let land to Multi-Link for 50 years for the purpose of developing and using it as a pay and play golf course. Clause 18 of the lease gave Multi-Link an option to buy the land for a sum "equal to the full market value of the subjects .. as at the date of entry for the proposed purchase (as determined by the Landlords) of agricultural land or open space suitable for development as a golf course". Various assumptions about the property being in good order were to be made by the Council in fixing the valuation, which was also to disregard non-obligatory improvements made by Multi-Link and any damage or

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[13] 1998 SC 657 at 661.
[14] Ibid at 663.
[15] For a similar approach in a more recent Inner House case see *Autolink Concessionaires (M6) plc v Amey Construction Ltd* [2009] CSIH 14; 2009 GWD 9-146.
[16] 1998 SC 657 at 670 (per Lord Kirkwood) and 676 (per Lord Caplan).
[17] Ibid at 670 (per Lord Kirkwood) and 676 (per Lord Caplan).
[18] Ibid at 676.
[19] See para 5.1.

destruction of the property. A minimum price of £130,000 was also agreed. When, having established the golf course, Multi-Link sought to exercise the option to buy, a dispute broke out between the parties as to the valuation of the land. Was the "full market value" to be determined, as the Council contended, on the basis of the current potential of the land for housing development, a possibility opened up by changes in the local structural plan seven years after the lease was concluded (in which case the value was £5.3 million); or was it to be settled on the basis of the land's potential for development as a golf course (which according to Multi-Link would be £500,000)?

5.6 In finding for the latter interpretation, the Lord Ordinary (Glennie) made no reference at all to the Hoffmann approach and was provided with no evidence outside the contractual documents, but held in reaching his conclusion that "certain parts of the wording within [clause 18] can safely be disregarded".[20] Without commenting on the legitimacy of this approach (but rejecting the Hoffmann approach in general terms, at least as applicable to leases), an Extra Division reversed the decision of the Lord Ordinary, holding that in a lease due to last for 50 years the words "full market value" should be given a wide meaning unless there were express words to the contrary.[21] The court noted that "the critical sentence of clause 18.2 shows all the signs of having been modified in the course of negotiations without taking full account of the effect on the text read as a whole".[22] However, the court found it clear that the parties' method of valuation involved considering the land at two points in time. The land was to be valued as at the date of the purchaser's entry, but as though it were in the state it was in when the lease began (i.e. agricultural land). The Division observed: "We understood the parties to agree that this is the proper starting pointing for assessment."[23]

5.7 The Supreme Court upheld the decision of the Extra Division but applied different reasoning. Lord Hope (with whom Lord Clarke agreed) criticised the Lord Ordinary for departing from the words used by the parties,[24] and the Extra Division for paying no heed to the words in the clause following the phrase "full market value".[25] He thought that the part of the clause dealing with the "assumptions and disregards" to be carried out by the Council "looks as if it had been borrowed from a different lease without regard to the context",[26] and was "designed to settle the basis for a purchase of subjects in their existing use", whereas the earlier part was "designed to settle the price for the purchase of subjects that will have a value in the open market that takes account of their potential for development".[27] While normally the words used were the starting point, in cases of such poor quality drafting and ambiguity as the present one, it was legitimate to try and give a sensible meaning to the clause as a whole. Account should be taken of the factual background known to both parties at the time of contracting and the aim should be to achieve a result consistent with business commonsense. It was in this context of the pursuit of business commonsense, but almost in passing, that Lord Hope made reference to Lord Hoffmann's speech in the *ICS* case. Approached in this way, the "assumptions and disregards" could not outweigh the words pointing to the commercially sensible meaning contended for by the Council.

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[20] [2009] CSOH 114, para 5.
[21] [2009] CSIH 96; 2010 SC 302.
[22] Ibid, para 26.
[23] Ibid.
[24] [2010] UKSC 47, para 14.
[25] Ibid, para 15.
[26] Ibid, para 17.
[27] Ibid.

5.8 Lord Rodger (with whom Lady Hale and Sir John Dyson SCJ[28] agreed) made no reference to the Hoffmann approach, however, although he recognised that "something has gone wrong with the drafting of the relevant clause".[29] Like Lord Hope, his focus was on the words used in the contract viewed in the light of what would make commercial sense. But his point of departure was different from Lord Hope's. Lord Rodger said that one should "start with the parts whose meaning is clear and then [...] use those parts to unravel the meaning of the parts which are more difficult to understand".[30] The meaning of the "assumptions and disregards" was clear, in his view. The contract required the Council to take account of what Multi-Link had done to develop the golf course, meaning that the course had to be valued as such on the basis it was in good order and repair. Lord Rodger acknowledged that neither party had supported this position in argument (as we have seen,[31] the parties were agreed that the land's value as a golf course was to be completely ignored, and that the land was to be valued on the basis that it was still agricultural land). But, Lord Rodger continued, there was nothing in the contract to require the Council to ignore other factors in value, such as the land's suitability for a possible housing development. To use the words "of agricultural land or open space suitable for development as a golf course" to eliminate that element would lead to "a highly unusual and artificial approach to valuation".[32] An assumption for the purposes of valuation that the land would only be used as a golf course required clearer words than that. Accordingly the Council was entitled to have regard to the housing development value in fixing the sale price of the land.

5.9 It will be apparent from this summary that the approaches of the two Justices are not only different from each other but also, to varying degrees, far from pure applications of the Hoffmann approach as expounded in the *ICS* and, indeed, the *Chartbrook* case. Other than a reference to a prior requirement of ambiguity, Lord Hope's is much the more Hoffmann-esque of the two judgments. Some glancing references to commercial sense possibly apart, Lord Rodger ignores the Hoffmann approach altogether. Even although both Justices recognise that the case is one of bungled drafting, neither feels free to cut away from the words actually used and proceed on the basis of what the parties must be taken to have intended. In part this was probably because they did not have any extrinsic evidence upon which to be reasonably certain of what that intention might have been. While reference is made to business commonsense and the unlikelihood of a commercial agreement taking the form contended for by Multi-Link, some unease must have been caused by Lady Hale's observation that the Council, not being a commercial organisation but one set up to serve the local population rather than make money, might have had only the objective of providing recreational facilities for that population at the time the lease was entered upon, and that it was now the one seeking the benefit of a windfall brought about by subsequent changes to the local structural plan.[33] It is, finally, hard to avoid the impression that actually both Justices are engaging in a degree of re-working what was said in the contract to get it to make some sort of sense: Lord Hope by setting aside express words (despite his criticisms of the courts below for doing exactly the same thing), Lord Rodger first by refusing to accept the common position of the parties that the value of the golf course was not to be brought

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[28] Now Lord Dyson, Supreme Court Justices appointed since the Court's establishment in October 2009 having been given the courtesy title of "Lord" or "Lady" (as required) from 13 December 2010: see the Court's press release of that date, available at http://www.supremecourt.gov.uk/docs/pr_1013.pdf.
[29] [2010] UKSC 47, para 27.
[30] Ibid, para 28.
[31] At para 5.6.
[32] [2010] UKSC 47, para 36.
[33] Ibid, para 41.

into account, and then stressing the significance of the absence of certain words from the document. In his construction of clause 18.2, Lord Rodger also appears to take as a relevant circumstance the fact that five years had passed and the course had been completed. But this was only one of the possible scenarios for which the parties provided when the lease was entered in 2000. The price could also have been required to be fixed at a point between the first and fifth anniversaries of the date of entry when, consistently with their obligations, the tenants still might not have developed a course. Whether it was right in any way to set aside the parties' common position on not taking account of the golf course value is therefore doubtful.

5.10 Where adjustments have been explicitly made to a written text by a Scottish court in the process of interpretation, they have been of a modest nature. Indeed arguably they could have been made under the long-established but much more limited rule allowing correction of "patent errors" in a document as a matter of its construction.[34] In *Hardie Polymers Ltd v Polymerland Ltd*[35] consideration of the surrounding circumstances relating to a commercial agency contract led Lord Macfadyen to conclude that the parties had used the word "compensation" when what they meant to say was "indemnity", and he read the contract accordingly. In *Macdonald Estates plc v Regenesis (2005) Dunfermline Ltd*[36] Lord Reed concluded of a particular contractual provision:

> "The words 'it' and 'its' must be a mistake: the defenders could not sensibly be undertaking to relieve the pursuers of outlays which the defenders had themselves made. Those words must be understood as meaning 'you' and 'your'. So understood, clause 4.5 entitles the pursuers to be relieved of the outlays reasonably required to be made by them as an incident of the performance of their obligations under the contract."[37]

5.11 Lord Reed also discussed the approach to correction of contracts by way of interpretation in *Credential Bath Street Ltd v Venture Investment Placement Ltd*.[38] Although the court would not readily construe a document as having been mistakenly expressed, especially one that had been formally drawn up, it would do so to ascribe to the document the meaning it would convey to a reasonable person aware of the context. The right word might be supplied for a wrong one, or inapt ones disregarded, or missing words inserted. It was not necessary, however, to know more than the substance of what was to be supplied; exactitude was the province of rectification rather than interpretation. This process of correction was, critically, not confined to mistakes apparent from the document itself, but included those which were apparent in the light of the surrounding circumstances: "the classification of mistakes as 'patent' or 'latent' is no longer determinative of the court's power to cure mistakes by construction."[39] But in the actual decision of the case Lord Reed found that the commercial background did "not lead me away from the starting point: that one would ordinarily expect the parties to a formal document to have chosen their words with

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[34] Gloag, *Contract* (2nd ed, 1929), p 435; McBryde, *Contract*, para 8.99. Such errors are evident on the face of the document and do not need reference to the background to become apparent. Nonetheless the doctrine is one which might have been developed in the direction of the Hoffmann approach. See e.g., the addition of "to" to the lease in *Multi-Link* "to make good an obvious omission": [2010] UKSC 47, para 12 per Lord Hope.
[35] 2002 SCLR 64.
[36] [2007] CSOH 123; 2007 SLT 791.
[37] Ibid, para 114
[38] [2007] CSOH 208; 2008 GWD 9-168, paras 18-24.
[39] Ibid, para 22.

care, and to have intended to convey the meaning which the words they chose would convey to a reasonable person".[40]

5.12 This discussion of the court's power to correct mistakes by interpretation brings us to an initial consideration of the relationship between this branch of the law and the remedy of rectification of a contract document under sections 8 and 9 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985. In the *Credential Bath Street* case Lord Reed says that altering, adding to or subtracting from the words of a written instrument is a matter for rectification rather than interpretation, and, as already noted,[41] states that with interpretation only the substance of the correction, rather than exact wording, is needed. Although the basis of the distinction between interpretation and rectification is not further elaborated, it may be that in interpretation words are supplied (or perhaps corrected or omitted) to "complete the sense" of a document, whereas in rectification the document is recast to reflect accurately the common intention of the parties to it. Putting it in another way, the interpreter with the document and evidence of admissible surrounding circumstances can determine what must have been meant, whereas in rectification such is the mis-writing of the document that even with the aid of admissible surrounding circumstances the court will be unable to find the parties' common intention correctly. This seems broadly to anticipate and be in line with Lord Hoffmann's discussion of the same subject in English law in the *Chartbrook* case.[42]

Principles of interpretation?

5.13 Several judges (mostly in the Outer House) have attempted to formulate lists of the principles to be applied to the interpretation of contracts. While no one of these lists was intended to be comprehensive or definite, and they therefore sometimes differ in content and emphasis, a compilation on which there would probably be fairly general agreement can be put together as follows:

1. The words used by the parties must generally be given their ordinary meaning.[43]

2. A contractual provision must be construed in the context of the contractual document or documents as a whole.[44]

3. In construing a contract drafted by lawyers, the words may be expected to have been chosen with care and to be intended to convey the meaning which the words chosen would convey to a reasonable person.[45]

4. The process of construction is objective, according to the standards of a reasonable third party aware of the commercial context.[46]

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[40] Ibid, para 37.
[41] See para 5.11.
[42] See para 4.23.
[43] *City Wall Properties (Scotland) Ltd v Pearl Assurance plc* [2003] CSOH 211; 2004 SC 214; *Middlebank Ltd v University of Dundee* [2006] CSOH 202; *Macdonald Estates plc v Regenesis (2005) Dunfermline Ltd* [2007] CSOH 123; 2007 SLT 791; *Autolink Concessionaires (M6) plc v Amey Construction Ltd* [2009] CSIH 14; 2009 GWD 9-146.
[44] *MRS Distribution Ltd v DS Smith (UK) Ltd* 2004 SLT 631; *Emcor Drake & Scull Ltd* [2005] CSOH 139; 2005 SLT 1233; *Forbo-Nairn Ltd v Murrayfield Properties Ltd* [2009] CSIH 94; 2009 GWD 16-251.
[45] *City Wall Properties* (fn 43); *Credential Bath Street Ltd v Venture Investment Placement Ltd* [2007] CSOH 208; 2008 GWD 9-168; *Forbo-Nairn* (fn 44).

5. Regard is to be had to the circumstances in which the contract came to be concluded to discover the facts to which the contract refers and its commercial purposes objectively considered, although this is limited to matters known or reasonably to be known by both parties.[47]

6. Where more than one construction is possible, the commercially sensible construction is taken to be what the parties intended.[48]

7. The court must not substitute a different bargain from that made by the parties.[49]

5.14 A few comments may be offered on these propositions. The first of them is perhaps the least often specifically mentioned in lists of principles, but where it is, it is often denominated as "the starting point" in the interpretative process – and sometimes as the end point too.[50] (There is a link here also with proposition 3 on professionally drafted documents.) Such an approach appears to gain the imprimatur of the Supreme Court in *Multi-Link*.[51] Some judges who take this approach, like Lord President Rodger in the *BoS v Dunedin* case,[52] do however go on to test conclusions reached under the first proposition against those reached under the fourth, or bring other propositions into play only when, like Lord Hope in the *Multi-Link* case,[53] they find ambiguity under the first. Ambiguity also plays a role in proposition 5, with its idea that the commercially sensible construction is to be preferred to other possible constructions.

5.15 But it has also been accepted by a number of judges in the Court of Session, such as Lord Caplan in the *BoS v Dunedin* case,[54] that words cannot be given meaning without context, and that context cannot be limited to the four corners of the document to be interpreted.[55] Thus in effect propositions 1-5 together form their starting point, rather than proposition 1 by itself. This approach, it may be suggested, is more consistent with the core message of Lord Hoffmann and, before him, Lord Wilberforce. In this approach ambiguity is not a precondition for considering permissible surrounding circumstances, which are rather a crucial part of the means by which understanding of what is intended is achieved.[56] This seemed to be authoritatively recognised in the First Division's recent, categorical statement that "it is not part of our law of contract that the court can have regard to relevant

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[46] *Emcor Drake & Scull Ltd* (fn 44); *Middlebank Ltd* (fn 43); *Forbo-Nairn* (fn 44).
[47] *MRS Distribution Ltd* (fn 44); *Emcor Drake & Scull Ltd* (fn 44); *Middlebank Ltd* (fn 43); *Autolink Concessionaires* (fn 43); *Forbo-Nairn* (fn 44).
[48] *MRS Distribution Ltd* (fn 44); *Emcor Drake & Scull Ltd* (fn 44); *Autolink Concessionaires* (fn 43); *Forbo-Nairn* (fn 44); *Forbo-Nairn* (fn 44).
[49] *City Wall Properties* (fn 43); *Emcor Drake & Scull Ltd* (fn 44); *Middlebank Ltd* (fn 43); *Macdonald Estates* (fn 43); *Credential Bath Street* (fn 45); *Forbo-Nairn* (fn 44).
[50] E.g. *City Wall Properties (Scotland) Ltd v Pearl Assurance plc* [2003] CSOH 211, 2004 SC 214; *Multi-Link Leisure Developments Ltd v North Lanarkshire Council* [2009] CSIH 96; 2010 SC 302, paras 23-25.
[51] [2010] UKSC 47, para 11 (Lord Hope) and para 28 (Lord Rodger).
[52] See para 5.3.
[53] [2010] UKSC 47, para 11.
[54] See para 5.4.
[55] *Luminar Lava Ignite Ltd v Mama Group plc and Mean Fiddler Holdings Ltd* [2010] CSIH 01; 2010 SLT 147, para 44 per Lord Hodge; *Credential Bath Street Ltd v Venture Investment Placement Ltd* [2007] CSOH 208; 2008 GWD 9-168, para 22 per Lord Reed.
[56] Note, however, that while McBryde, *Contract* does not specifically state a requirement of ambiguity before surrounding circumstances may be referred to, this analysis is not sustained in his text: cf paras 8.10 ("Wide and unambiguous words should be given their plain meaning"), 8.12 ("in the absence of ambiguity or absurdity effect will be given to plain words whatever the commercial consequences") and 8.22 ("Also, surrounding circumstances may clear up ambiguities").

background circumstances only if there is ambiguity in the words of an agreement".[57] The further acceptance in the same case that it is "a matter of choice whether a judge in his reasoning first analyses the background facts before considering the relevant contractual provision or looks first at the provision before testing his view of it against those facts",[58] should be understood as simply recognition of the practical reality that the judge must start somewhere and cannot expect to become instantly familiar with all the relevant material all at once, rather than as an endorsement of the approach of checking the meaning obtained from analysis of the words alone against what might be suggested by consideration of the background. Whatever the starting point in gathering information, the words need to be taken together with the surrounding background circumstances in a unitary intellectual process, before reaching a final conclusion on their meaning.[59]

5.16 Finally, proposition 7, about not substituting a new bargain for the one agreed by the parties, forms an important limit on how far the interpretative process can be taken, even for those judges most open to a contextual approach. This is most fully discussed by Lord Reed in *Credential Bath Street Ltd v Venture Investment Placement Ltd*, where he argues that while contextual interpretation can correct words and supply omissions in a contractual document, "the court will not, of course, interpolate words or substitute one word for another merely because the result might appear to be fairer or more commercially sensible".[60] There is a need to be alive to the position of both parties, and aware that the provision may be a compromise, or that a party may have made a bad bargain; the judge should guard "against excessive confidence that [his] view as to what might be commercially sensible necessarily coincides with the views of those actually involved in commercial contracts".[61] This comment has implications for the quite widespread use of Lord Diplock's famous statement that "if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense".[62] It also raises the question of the basis upon which the judge determines business commonsense, and of the evidence that might be used to show that the parties had compromised, or that one of them had made a bad bargain.[63] Our discussion above of the *Multi-Link* case (where, it will be recalled, the judges had no extrinsic evidence with which to work beyond the parties' agreed self-descriptions of themselves and their project) may illustrate the point.[64] Which of the parties there was to be the lucky beneficiary of the change in the local structure plan? Or was the case simply one of failure on both sides to

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[57] *Luminar Lava Ignite Ltd v Mama Group plc and Mean Fiddler Holdings Ltd* [2010] CSIH 01; 2010 SLT 147, para 38 per Lord Hodge. The effect upon this pronouncement of Lord Hope's statement of a requirement of ambiguity in *Multi-Link* [2010] UKSC 47, para 11 is unclear, given that the other Justices make no similar remark.

[58] Ibid.

[59] David McLauchlan, "Contract interpretation: what is it about?" (2009) 31(5) Sydney LR 5 at 7. See also *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, para 24 per Tipping J ("In some recent cases it has been suggested that contractual context should be referred to as a 'cross-check'. In practical terms this is likely to be what happens in most cases. Anyone reading a contractual document will naturally form at least a provisional view of what its words mean, simply by reading them. That view is, in a sense, then checked against the contractual context. This description of the process is valid, provided the initial view is provisional only and the reader is prepared to accept that the provisional meaning may be altered once context has been brought into account. The concept of cross-check is helpful in affirming the point made earlier that a meaning which appears plain and unambiguous on its face is always susceptible of being altered by context, albeit that outcome will usually be difficult of achievement.")

[60] [2007] CSOH 208; 2008 GWD 9-168, para 24.

[61] Ibid.

[62] *The Antaios Compania Naviera SA v Salen Rederierna AB* [1985] AC 191 at 201.

[63] A good example of a judicial analysis sensitive to the issues raised here is *City of Westminster v Urban Wimax Ltd* [2010] EWHC 1166 (Ch) (Roth J). See also *G4S Cash Centres (UK) Ltd v Clydesdale Bank plc* [2010] CSOH 133, para 28 per Lord Menzies.

[64] See paras 5.5-5.9.

anticipate that over the potentially 50-year period of the contract there might be such changes? Or would the matter have been of any concern at all at the time of contracting, given that one of the parties was a local government authority not necessarily having commercial considerations at the forefront of its thinking? On the basis of the contract alone it was extremely difficult to say what the answers to any of these questions might be. Only with the benefit of relevant extrinsic evidence could they have been properly tackled.

The exclusionary rule on pre-contractual negotiations

5.17 Several Scottish decisions since RIPL was published have upheld the rule that evidence about negotiations towards the contract is generally not permitted or helpful in the interpretative process.[65] In *BoS v Dunedin*, for example, the First Division declined to refer to pre-contractual negotiations as an aid to interpretation. (It is cited for this latter point in the *Chartbrook* case.) The court did, however, make extensive reference to the records of pre-contractual meetings between the contracting parties to help it identify relevant surrounding circumstances, from which it was possible to see that BoS had made clear to Dunedin that it would be entering a hedging arrangement in respect of the proposed loan facility, and that early termination of the facility would entail also terminating the hedging arrangement at some indeterminate cost to the bank. Although the precise nature of the hedging arrangement that BoS would make was not made clear to Dunedin, the discussions showed that the cost of terminating it was envisaged as within the scope of the clause allowing BoS to recover costs incurred "in connection with the stock" when the loan facility was ended early. Although Lord Kirkwood had doubts as to whether some of this evidence had been properly admissible as merely going to the surrounding circumstances rather than the parties' intentions,[66] the Lord President indicated that it could be taken into account in establishing the relevant circumstances.[67] Lord Caplan suggested, however, that the exclusionary rule was really about evidence of "parties' aspirations and intentions" at the time the statements in questions were made, thus hinting that in his view its scope was limited to individual declarations of intention made during negotiations.[68] At all events, the documents in this case were not caught by the exclusionary rule. All the judges made use of the evidence in reaching their unanimous decision on the meaning of the contract.

5.18 The most recent case in which it has been held that pre-contractual negotiations may not be referred to as an aid to the interpretation of a contract is *Luminar Lava Ignite Ltd v Mama Group plc and Mean Fiddler Holdings Ltd*,[69] a decision of the First Division in which the *Chartbrook* decision was referred to approvingly. Lord Hodge, giving the main opinion, explained:

> "That rule is justified on two grounds. First, the consideration and interpretation of previous formulations of what one or other party was seeking in the negotiations may be irrelevant to the construction of the words which they eventually adopt to

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[65] *MRS Distribution Ltd v DS Smith (UK) Ltd* 2004 SLT 631; *City Wall Properties (Scotland) Ltd v Pearl Assurance plc (No 2)* [2005] CSOH 137; *Emcor Drake & Scull Ltd* [2005] CSOH 139; 2005 SLT 1233; *Middlebank Ltd v University of Dundee* [2006] CSOH 202; *Wincanton Group Ltd v Reid Furniture plc* [2008] CSOH 109; 2008 GWD 29-446; *Luminar Lava Ignite Ltd v Mama Group plc and Mean Fiddler Holdings Ltd* [2010] CSIH 01; 2010 SLT 147. Note also an extra-judicial declaration of support for the exclusionary rule by Lord Hope of Craighead in a lecture delivered at a conference in Jersey on 15 October 2010, entitled "The role of the judge in developing contract law", available at http://www.supremecourt.gov.uk/docs/speech_101015.pdf.

[66] 1998 SC 657 at 671.

[67] Ibid at 665.

[68] Ibid at 679.

[69] [2010] CSIH 01; 2010 SLT 147.

> express their consensus. Secondly, even if the words which parties used in the negotiations are not irrelevant, they are excluded on pragmatic grounds … The pragmatism, which underlies the exclusionary rule, is concerned with predictability and economy. There is considerable scope for dispute about the meaning of the statements, whether oral or in writing, which parties make in their negotiations. This may distract attention from the construction of the words which parties eventually used to express their consensus and cause greater uncertainty of outcome in contractual disputes. Admission of evidence of the negotiations will in any event, as Lord Hoffmann observed in *Chartbrook Ltd v Persimmon Homes Ltd* (at para 35) 'add to the cost of advice, litigation or arbitration.'"[70]

5.19 Lord Hodge went on to say that evidence about pre-contractual negotiations can be led to show what the relevant background of the contract was.[71] There is indeed examination of pre-contractual communications in that case for that purpose (although it was eventually held that the materials in question were simply statements of subjective intention and so inadmissible as evidence on that ground). It is not explained, however, how the dividing line between permissible and impermissible use of the pre-contractual material is to be identified, or why the judge's eyes must remain closed to some but not all of it.[72] *BoS v Dunedin* may to some other eyes at least be an illustration of how difficult drawing a dividing line of this kind can be.

5.20 There are also Scottish examples of the combination of a claim based on interpretation with an alternate in rectification should the first claim fail.[73] Not all of these were necessarily attempts under the latter head to use evidence of pre-contractual negotiations to help the court indirectly in its interpretative task, but it seems clear that, as in England, rectification can provide both a safety mechanism against injustice resulting from the application of the exclusionary rule on pre-contractual negotiations and an opportunity for strategic behaviour by counsel arguing a point of interpretation. Rectification, it should be noted, has retrospective effect so that a successful action has the effect that the contract is treated as though it had always been expressed in its now rectified terms. The rectification case law, however, shows judicial doubts as to whether the remedy can be used "to shore up or rewrite so as to eliminate the alleged inadequacies or ambiguities of the parties' contract".[74] In *George Thompson Services Ltd v Moore*[75] the parties were in dispute as to whether a purchase of land known as "Dippin Estate" included "Dippin Kennels", which had been included in the sales particulars; but the missives were concluded by reference to descriptions in certain title deeds not including the kennels. The kennels were similarly omitted in the succeeding disposition. A petition to rectify the disposition to include the kennels failed on the ground that the disposition could only be rectified to reflect the preceding agreement in the missives, not any agreement that preceded the missives.

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[70] Ibid, para 40.
[71] Cf Lord Hoffmann in *Chartbrook*, para 42.
[72] Professor McLauchlan suggests that this means the court "merely paid lip service" to the exclusionary rule: "evidence of the negotiations played a decisive role in determining the outcome of the case" ("*Chartbrook Ltd v Persimmon Homes Ltd*: commonsense principles of interpretation and rectification?" (2010) 126 LQR 8, at 10). See also *Wincanton Group Ltd v Reid Furniture plc* [2008] CSOH 109; 2008 GWD 29-446.
[73] *Angus v Bryden* 1992 SLT 884; *Huewind Ltd v Clydesdale Bank plc* 1995 SLT 392; *Macdonald Estates plc v Regenesis (2005) Dunfermline Ltd* [2007] CSOH 123; 2007 SLT 791; *City Wall Properties (Scotland) Ltd v Pearl Assurance plc (No 2)* [2007] CSIH 79; 2008 GWD 5-93; *Caledonian Environmental Services plc v Degrémont SA and AMEC Capital Projects Ltd* [2010] CSOH 73; 2010 GWD 27-528. See also *George Wimpey (West Scotland) Ltd v Henderson*, Edinburgh Sh Ct, 1 March and 10 October 2010.
[74] Donald Reid, "Rectification of deeds: Part 1" (2009) 103 *Property Law* 1 at 4 (citing *Huewind Ltd v Clydesdale Bank plc* 1995 SLT 392 and *Bank of Scotland v Graham's Tr* 1992 SC 79).
[75] 1993 SLT 634, commented upon in Reid, "Rectification of deeds: Part 1" (see previous note) at 4.

Similarly in *Baird v Drumpellier & Mount Vernon Estates Ltd*[76] missives which purported to agree to the transfer of land wrongly believed by both parties to belong in its entirety to the seller were not rectified to give effect to an alleged pre-missives agreement that the buyer would take the title as it stood. It is not suggested that these cases would have been decided differently had the courts simply been able to interpret the parties' contracts in accordance with the rule recommended in RIPL; but they do show that in Scots law rectification is not necessarily a "safety device" against inadequacies of contractual expression.

The exclusionary rule on evidence of subsequent conduct

5.21 There have also been a number of cases since the publication of RIPL in 1997 in which examination of the parties' subsequent conduct as an aid to the interpretation of their contract was refused.[77] RIPL itself stated that "the existing Scottish law on this point is not clear", citing numerous cases in which reference to subsequent conduct to establish the common intention of the parties at the time of the contract was allowed, but observing that these had now to be read in the light of observations in more recent English House of Lords decisions going the other way.[78] But the position recommended in RIPL, on the grounds that admitting evidence of subsequent conduct might mean that the meaning of a juridical act could vary over time, now seems firmly crystallised in the courts. The decisions have, however, been criticised by commentators, the exclusionary rule being regarded as "unfortunate" by Professor McBryde.[79] In *Wincanton Group Ltd v Reid Furniture plc*[80] Lord Glennie suggested that, as with pre-contractual negotiations, evidence about parties' subsequent conduct might be relevant in establishing surrounding circumstances and the parties' knowledge before and at the time of the contract. But this raises again the reality of a distinction between the different uses to which particular kinds of evidence may be put.[81]

5.22 There does not appear to be any equivalent to estoppel by convention in the Scots law of personal bar (perhaps because in practice until quite recently evidence of subsequent conduct was not clearly prohibited in the interpretation of contracts, or because possible cases have instead been argued on the basis of waiver or variation of contract, where in Scots law consideration is not required).[82] The concept of estoppel by convention may be difficult to fit into existing principles of personal bar. In their recent book on the subject Elspeth Reid and John Blackie, who see waiver as part of the law of personal bar,[83] state the elements of bar in general as being inconsistent behaviour by a rightholder and

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[76] 2000 SC 103.

[77] *Bank of Scotland v Junor* 1999 SCLR 284 (really a prior dealings case?); *Cameron (Scotland) Ltd v Melville Dundas* 2001 SCLR 691 (note, however, the critical commentary by William W McBryde); *Ballast plc v Laurieston Properties Ltd* [2005] CSOH 16 at paras 155-160; *Wincanton Group Ltd v Reid Furniture plc* [2008] CSOH 109; 2008 GWD 29-446.

[78] RIPL, para 2.27 and its fn 55. The HL cases are *Whitworth Street Estates (Manchester) Ltd v James Miller & Partners Ltd* [1970] AC 583 (in which the Scottish judges Lords Reid and Guest took part) and *Wickman Tools Ltd v Schuler* [1974] AC 235 (in which again both the Scottish judges (Lords Reid and Kilbrandon) took part). Gloag, *Contract*, written in 1929, says: "Evidence of the actings of parties under the contract during the period when it has been in operation is, as a rule, not admissible. It cannot be regarded as evidence of the circumstances surrounding the parties at the time when the contract was entered into." (p 375).

[79] McBryde, *Contract* at para 8.30, fn 139.

[80] [2008] CSOH 109; 2008 GWD 29-446, para 16.

[81] David McLauchlan, "Contract interpretation: what is it about?" (2009) 31 Sydney LR 5, 43-44.

[82] In *Wincanton Group Ltd v Reid Furniture plc* [2008] CSOH 109; 2008 GWD 29-446, a case about the use of parties' subsequent conduct in interpretation, Lord Glennie makes passing reference to "acquiescence, waiver, personal bar and the like" (at para 16).

[83] Elspeth Reid and John Blackie, *Personal Bar* (2006), para 3.16.

unfairness to another party (the obligant) affected by exercise of that right. Inconsistency arises when:

1. A person claims to have a right, the exercise of which the obligant alleges is barred.

2. To the obligant's knowledge, the rightholder behaved in a way which is inconsistent with the exercise of the right (the behaviour may be words, actions or inactions).

3. At the time of so behaving the rightholder knew about the right.

4. Nonetheless the rightholder now seeks to exercise the right.

If the exercise of the right in such circumstances is unfair, because the rightholder's conduct is blameworthy, the obligant reasonably believed the right would not be exercised and so acted or omitted to act in a proportionate way, and would suffer prejudice as a result of the inconsistency, the rightholder will be barred from its exercise.[84] Item 3 in the elements of inconsistency poses the most immediate difficulties for any idea of an equivalent to estoppel by convention in Scots law, since in the typical case where parties behave as though a contract meant one thing while it reads in another way, it might well be that the parties acted in the way they did because they did not know or realise or consider what the interpretation of their written obligation might be.[85]

Exception to the exclusionary rule on pre-contractual negotiations?

5.23 RIPL suggested that existing Scottish authority allowed the court to give a word the particular meaning it had for one of the parties if every other party at the time of contracting knew, or could reasonably have been assumed to know, that it was being used in this sense. In particular, it cited the House of Lords decision in *Houldsworth v Gordon Cumming*.[86] A question arises, however, as to the impact of the *Chartbrook* judgment on the authority of *Houldsworth*. *Chartbrook*, it will be recalled, over-ruled *The Karen Oltmann*,[87] a case very similar to *Houldsworth* and also referred to in RIPL on the present point,[88] because in allowing the judge to consider the meaning attached to a word by parties during their negotiations to determine the meaning of the word in their eventual contract, it was thought to have the effect of destroying the exclusionary rule on pre-contractual negotiations. *Houldsworth* was, however, not cited in *Chartbrook*. The House of Lords' unanimous judgement in 1910 does not seem to have involved any specifically Scottish considerations, and the two English judges involved, the Lord Chancellor (Loreburn) and the Earl of Halsbury, had no doubt, in the words of the former, that "these negotiations are crucial, and all that passed, either orally or in writing, is admissible in evidence to prove what was in fact

[84] Ibid, ch 2.
[85] We have been told by members of our Lawyers Advisory Group that it is not uncommon for business parties to proceed with their transactions without full regard to the contractual documentation prepared by their legal advisers, with the result being inconsistency between what the former do and what their contract says they will do. See, however, Catherine Mitchell, "Contracts and contract law: challenging the distinction between the 'real' and 'paper' deal" (2009) 29 OJLS 675 and para 6.3 below.
[86] 1910 SC (HL) 49. See para 2.8 for a summary of this case.
[87] See para 4.12.
[88] RIPL, para 3.5.

the subject of sale; not to alter the contract, but to identify its subject".[89] *Chartbrook* is notable for cautionary remarks from Lords Hoffmann and Rodger on when to use the 1966 Practice Statement to over-rule previous decisions of the House.[90] In any event, as a matter of the formal doctrine of precedent, the four-judge House of 1910 in a Scottish appeal cannot be over-ruled by even a five-judge one of 2009 in an English appeal, however persuasive the latter might seem to a subsequent Scottish court. Indeed, it might be questioned whether, perhaps, the later English decision loses something of its own authority by virtue of having been determined without a full view of all the relevant precedents.

5.24 A further discussion point may be whether *BoS v Dunedin* is in fact another illustration of this exception to the exclusionary rule about pre-contractual negotiations. It will be recalled from our previous discussion of this case that the court considered evidence of the parties' negotiations.[91] From this evidence it was apparent that the scope of the disputed clause had been discussed, and BoS had made clear its view that it extended to the costs that would be incurred in relation to the hedging transaction. This view had not been challenged at the time by Dunedin, while BoS had given assurances that it would use its best endeavours to minimise any cost incurred. Thus it seems clear that this was a case where one party to the other party's knowledge attached a particular meaning to a phrase in the contract ("in connection with"), and this understanding was not opposed by the other party at the time it was made manifest. While therefore *BoS v Dunedin* is indeed authority for an exclusionary rule in Scots law in relation to the admissibility of pre-contractual negotiations, that authority is limited, not only by the extent to which pre-contractual negotiations were admitted as evidence of surrounding circumstances, but also as an implicit reaffirmation of the exception to the rule in *Houldsworth v Gordon Cumming*.

5.25 In *Chartbrook* it was said that the safety mechanisms of rectification and estoppel by convention could cover cases like *The Karen Oltmann*.[92] The prior consensus of parties required for rectification does not have to be contained in documents and may be the subject of oral evidence, including that of subsequent conduct. It is only necessary to demonstrate that, objectively, there was a prior consensus which the subsequent formal document failed to capture.[93] The Scottish rectification decisions already discussed above[94] also suggest, however, that in Scots law the remedy is not necessarily a "safety device" that can be brought into play in cases like *Houldsworth v Gordon Cumming*, where the question was clearly about the meaning of a particular expression ("the estate of Dallas"), not about whether that was the correct expression.[95] The same would hold true of *BoS v Dunedin* and the phrase "in connection with".[96] In some respects, therefore, rectification may be narrower than the *Houldsworth* rule, which is essentially concerned with one party's actual meaning of a word, if the other party knew, or could reasonably be assumed to have known, of that

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[89] 1910 SC (HL) 49 at 51. The parties were agreed that there was a valid contract between them (as indeed there was from an objective point of view), so the court could not consider whether a lack of actual consensus meant there never had been a contract. The case is distinguishable in this way from *Mathieson Gee (Ayrshire) Ltd v Quigley* 1952 SC (HL) 38, where objectively there was no contract (although there may have been a subjective consensus).

[90] [2009] UKHL 38; [2009] 1 AC 1101, paras 41 and 70. It is unclear to what extent the Supreme Court can over-rule HL decisions, or indeed its own decisions, as the 1966 Practice Statement has not been carried over into the new dispensation.

[91] See paras 5.2-5.4.

[92] See para 4.23 for a fuller discussion.

[93] See *Chartbrook* [2009] UKHL 38, paras 64-65 (Lord Hoffmann).

[94] At para 5.20.

[95] See para 2.8.

[96] See para 5.2.

particular meaning. Rectification on the other hand is concerned with a "common intention", which may be a rather more demanding requirement, and is in any event to be determined by way of the same objective process as is used in the interpretation of contracts.[97] The whole discussion confirms, however, the extent to which the borderline between interpretation and rectification is indeed somewhat less than distinct and clear.

5.26 One further interpretation/rectification scenario may be drawn from the facts of *Angus v Bryden*,[98] in which one party thought that words in a contract had a particular meaning, to the other's knowledge, but that other party believed they had another meaning, yet did not disclose that different understanding. If in this situation the parties fall into dispute, and the court upholds the second party's interpretation as the meaning of the contract, the first party can, according to the judge in *Angus v Bryden*, reduce the contract if its error about the meaning of the contract was in the essentials, for example, about the subject-matter of the contract. The actual decision, however, was that the first party's understanding of the contract was held to be its objective meaning, and the contract was enforced accordingly. The second party could not reduce the contract for its error, since the first party had neither made any misrepresentation nor had any knowledge of how the second party had interpreted the contract. The second party was bound, in other words, by the meaning which he knew the first party attached to the disputed expression. Nor was rectification allowed in this case because the parties did not have a prior common intention to which their document failed to give effect. The question of whether there can be rectification for unilateral mistakes like those in *Angus v Bryden*, as opposed to reduction with its concomitant that the contract ceases to have any legal effect, lies beyond the scope of the present exercise; but such a mechanism might be necessary if the rule in *Houldsworth v Gordon Cumming* is no longer good law following the *Chartbrook* case. That, however, seems at best to be a cumbersome solution to the problem. It should be noted, though, that the conclusion against any possibility of rectification in *Angus v Bryden* has been critically discussed by Lord Reed in *Macdonald Estates plc v Regenesis (2005) Dunfermline Ltd*.[99] The law may therefore not be settled definitively, although in our view the decision on this point in *Angus v Bryden* is to be preferred at least as a reading of the legislative provisions on rectification, while Lord Reed's concerns may be met by application of the *Houldsworth* case.

5.27 Again, in Scotland there is, as we have seen,[100] no equivalent to the doctrine of estoppel by convention at present, and it is not easy to see how the law of personal bar might be developed to cover it. Would there have been an estoppel by convention in *Houldsworth* because the seller showed the prospective buyer the plan of the estate of Dallas and the buyer inspected the ground using the plan before entering the contract? It is difficult to see this as barring the buyer on the grounds that he had thereby made a representation to the seller that this was all he wished to buy.

Conclusion

5.28 While there are some areas of uncertainty, it can probably be said that the Scottish courts have now developed the law on the interpretation of contracts to a position of

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[97] See Donald Reid, "Rectification of deeds: Part 1", (2009) 103 *Property Law* 1, at 3-4; see also Peter Webster, "Rectification" 2011 JR (forthcoming).
[98] 1992 SLT 884.
[99] [2007] CSOH 123; 2007 SLT 791, paras 168-176.
[100] See para 5.22.

reasonable clarity on a number of points. Judges are clear that an objective approach is to be taken to the interpretative task in which, however, the parties' words and expressions can be considered in the context of the document in which they appear and in the light of the admissible and relevant surrounding circumstances. Pre-contractual negotiations and parties' conduct subsequent to the formation of their contract cannot be used as direct evidence of their intention, although they may be referred to for evidence of the surrounding circumstances known to both parties at the time of contracting. The restriction on use of pre-contractual negotiations is based on pragmatic rather than principled grounds, since the evidence is excluded even if it is relevant. The basis for excluding evidence of subsequent conduct appears to be based on the idea that admitting it would lead to the meaning of the contract varying over time.

5.29 The areas of uncertainty are, however, quite numerous and of practical significance. First, does the courts' willingness to take account of context and surrounding circumstances stretch as far as Lord Hoffmann's approach would seem to require (that is, to all cases where the interpretation of contractual expressions is in issue)? There appear to be differences of view on this between judges at all levels of the system which have not been resolved in the two cases on the matter to reach the final court of appeal,[101] including the question of whether ambiguity is a pre-requisite of such investigations. Second, where is the line to be drawn in the examination of evidence about pre-contractual negotiations and subsequent conduct, between the permissible search for admissible surrounding circumstances and the impermissible search for the parties' understandings of their expressions? Third, does Scots law recognise, or continue to recognise despite *Chartbrook*, a rule to the effect that a court may give a word a particular meaning it had for one of the parties if every other party at the time of contracting knew, or could reasonably have been assumed to know, that it was being used in this sense? Fourth, to what extent does the present Scots law on rectification of documents constitute a safety mechanism against injustice where the exclusionary rules of interpretation prevent the use of pre-contractual negotiations as evidence about the meaning of contractual expressions? Fifth, can the law of personal bar be developed to provide a further safety mechanism equivalent to the English estoppel by convention in cases where injustice may result from the exclusion of evidence about either pre-contractual negotiations or parties' conduct after the formation of their contract? Or would it be simpler, and more consistent with the principles of both interpretation and personal bar, for the law to take a wider approach to the extent to which extrinsic evidence may be admitted for the purpose of interpreting a contract, thus also avoiding (for the moment) any need to review the law of rectification?

[101] In addition to *Multi-Link Leisure Ltd v North Lanarkshire Council* [2010] UKSC 47, see *Simmers v Innes* [2008] UKHL 24, 2008 SC (HL) 137, cited at para 5.1, fn 4.

Chapter 6 Policy objectives

6.1 RIPL identified four policy objectives to underpin its recommendations for law reform in this area. Before moving to our own suggestions for possible reform, it is important to test how far these policy objectives still hold good, or whether adjustment (by either addition or subtraction) is required. It may be helpful at this point to remind readers what the four stated policy objectives were:

> 1. The same rules of interpretation ought to apply, unless there is good reason to the contrary, whatever the nature of the juridical act and whatever the medium used.
>
> 2. The rules of the substantive law on interpretation ought to be such that it is possible to determine what facts and circumstances the interpreter can properly take into consideration, whether the interpreter is or is not a court.
>
> 3. Third parties ought not to be affected by secret meanings attached to expressions in juridical acts.
>
> 4. Relevant evidence should be admissible and irrelevant evidence should be inadmissible.

We think that it is necessary to consider first the commercial background to the problems which we are addressing in this Discussion Paper, following which a number of points may be made about these policy objectives.

Commercial background

6.2 In thinking about policies in this area, we have been greatly assisted by the evidence provided by our Advisory Groups.[1] In particular, the evidence given by members of our Business Advisory Group proved helpful in illustrating the current problems faced by contracting parties, and how the needs of contracting parties might be addressed through any reformed system of interpretation. The Group is made up of business people from a wide variety of sectors, from both small-medium scale enterprises, and larger incorporations. In combination the members have many decades of experience of contracting in their industries, and remain active in their sectors; they were accordingly able to comment on changes and trends over time. While we acknowledge that the evidence gathered from this Group is not systematic in nature, and by no means empirically comprehensive, we have nonetheless found the basically consistent views expressed to be helpful in presenting an up to date picture of the problems facing those involved in contracting.

6.3 The evidence from the Business Advisory Group suggests that businesses generally place great emphasis and care on the detail of their contracts, and view the content of contractual provisions as an important element in any smooth running commercial

[1] See para 1.15 and Appendix B.

enterprise.[2] Entire agreement clauses are favoured as a means of ensuring that the contractual documentation is readily identifiable and can be distinguished from the discarded preceding material. Businesses generally expect contractual provisions to be clear and well articulated but, crucially, recognise in certain circumstances that a flexible approach to interpretation of such provisions will be required. In those circumstances, some businesses in Scotland would be in favour of a contextual approach to interpretation which considered the intentions of the parties as derived from all the relevant material, including but not limited to the final formal document embodying the contract.

6.4 Businesses usually agree upon the scope of any deal or transaction relatively quickly, and in very general terms, often expressed in documents entitled "Heads of Agreement" or something similar. Thereafter, if the contract is to be embodied in a formal document, a much more intricate and elaborate process of drafting the written terms of the contract takes place, negotiated largely by parties' respective legal advisers. We have learned much about this stage from our Lawyers Advisory Group. The documentation resulting from the process may be very substantial, running to many hundreds of pages and clauses. The drafting process can often take considerable periods of time, and many revisions will be exchanged (often by way of email attachment) as the documents develop. Drafts will commonly be a mixture of clauses with different origins: some drawn up specifically for the particular contract, others incorporating text drafted originally for other contracts (including standard forms in use in the relevant business sector), and some so-called "boilerplate" clauses generally included in commercial contracts (such as entire agreement clauses). The conflicting interests of the parties alongside commercial and other time deadlines, plus concomitant hours and days of continuous negotiation for their advisers, can create significant pressure for drafters seeking to produce a coherent overall document, since there is little opportunity for a considered view of the whole. There may also be verbal "fudging" over possibilities deemed not very likely to arise on which precise agreement proves too difficult to achieve.

6.5 All these factors help to produce the problems of internal inconsistency and lack of clarity with which the courts have regularly to deal, alongside the perfectly human inability to foresee all the circumstances in which, as it turns out, the document eventually has to be applied. (The facts in *Multi-Link* are a pertinent example of this.[3]) Advance recognition of this last element often underpins seemingly vague and open-ended clauses, perhaps especially where new and developing technologies are the subject of the contract in question (e.g. in the renewables sector). In cases of this kind, technology can evolve at such a rate during the lifetime of the contract as to render an inflexible approach to interpretation problematic. The very purpose of the contract may be the development of such technology and the exact content or scope of any deal thus impossible to define precisely in advance.

6.6 In order to help us find out whether the evidence we have received from our (necessarily selective) Advisory Groups is fully representative, we would welcome further views and information from consultees, to test whether our understandings outlined above

[2] This evidence is consistent with the recent argument of Catherine Mitchell that a distinction between the 'paper deal' and the 'real deal' in thinking about how to approach contracts from a legal interpretative standpoint may not be the most realistic starting point for analysis: see her "Contracts and contract law: challenging the distinction between the 'real' and 'paper' deal" (2009) 29 OJLS 675.
[3] The case is discussed at paras 5.5-5.9.

are accurate or not, and have appropriately informed the policy objectives developed below in the light of current commercial practice.[4]

Policy objectives

6.7 In the light of the foregoing paragraphs and our comparative research on the current state of the law of interpretation in Scotland we have reconsidered the four policy objectives set out in RIPL. While generally endorsing their tenor, we have a number of observations to make on how they should inform our reform suggestions. We also propose some modifications and additions to the policy objectives that should underlie these suggestions.

(1) A single set of rules on interpretation for all contracts?

6.8 First, the rules of interpretation should *prima facie* be the same whether one is dealing with an entirely oral informal contract or a written commercial one of high financial value drafted by lawyers acting for the parties. Judicial and academic discussion of the subject has, however, tended to focus on the latter because these are the kind of contracts which come most often before the courts and raise issues about the approach to be taken. There may be a genuine question whether an approach built up from thinking about the problems of a particular kind of contract is necessarily the one that should also be taken in interpreting other kinds of contract; thus, for example, in the recent case of *Multi-Link* the Extra Division doubted whether Lord Hoffmann's approach to interpretation could be applied to leases of heritable property as distinct from the commercial contracts under consideration in most of the House of Lords cases on the subject.[5] There may too be questions about the interpretation of non-contractual statements which may or may not constitute juridical acts, such as offers, promises or representations. The issue may be put more broadly still: are there good reasons for distinguishing between the interpretation of formal written statements and other kinds of statements? It might be thought, for example, that the language used in documents drawn up by lawyers should in general be taken to mean what it would ordinarily mean to the reasonable person, whereas informal oral statements should always be considered in the widest possible relevant circumstances. The courts have frequently referred to something akin to a presumption that professionally drafted documents should generally be taken to mean what they say. On the other hand, the frequency of litigation centering on the meaning of formally drafted written commercial contracts suggests that a distinction between the formal and the informal is unlikely to be helpful either to courts or professional advisers if it means confining the inquiry to the document alone, and that the reasonable person will often need to go beyond the document in the search for its intended meaning.

6.9 We are inclined to think that the first policy objective remains sound. It underlies the position under the DCFR, and is also the basis of the Hoffmann approach. We note that this policy may, however, be departed from where there is "good reason" to do so in a particular case. We do not think that the differences between different types of contract, such as those between a lease and a general commercial contract, provide such a "good reason", and observe that this was clearly the view of the Supreme Court in *Multi-Link*.[6] Commercial leases are usually an element of an ongoing commercial relationship and commonly include

[4] See the remainder of this Chapter.
[5] 2010 SC 302, paras 23-25.
[6] [2010] UKSC 47, para 26 (Lord Rodger) and para 45 (Lord Clarke).

further commercial possibilities for the parties, such as the option to buy in the *Multi-Link* case. Nor is there any relevant difference between a formal written document and other forms of contractual statement so far as the process of determining their meaning is concerned. The only qualification we would now make to this policy objective as stated in RIPL is that, since the scope of the present Discussion Paper is less extensive, we state it only in relation to contracts, promises and statements made in connection with the formation of contracts. It will be for discussion elsewhere whether the policy embraces other kinds of juridical acts.

(2) Clarity on the facts and circumstances to be taken into account

6.10 The second policy objective is that the rules of the substantive law on interpretation ought to be such that it is possible to determine what facts and circumstances the interpreter can properly take into consideration, whether the interpreter is or is not a court. The last part of this is clearly especially important. Contracts, and in particular commercial contracts, have to be advised upon after they have been drawn up, sometimes in contentious situations and sometimes not. Even in the contentious cases only a very small minority will end up before a judge; most will be settled, while others will come before arbitrators, adjudicators and mediators. It is plainly extremely important, therefore, that professional advisers and others who become involved with contracts outside court should be able to say with some clarity and certainty what a contract means in any of the situations where their advice or assistance is sought. The policy does not necessarily entail that the facts and circumstances to be considered should be few or limited in number; but obviously the wider the range of material to be considered, the more difficult, resource-consuming and (probably) slow the process of giving that advice or assistance is likely to become.

6.11 There is a link between this second policy objective and the fourth, which states that relevant evidence should be admissible and irrelevant evidence not.[7] The second policy objective raises some questions, however, about the framing of the rules about what is admissible as evidence in court. The present law may lie open to the criticism of uncertainty in, for example, allowing consideration of evidence about pre-contractual negotiations or parties' conduct subsequent to the contract's formation to establish relevant surrounding circumstances but not directly to establish what the parties meant by the expressions used, even if the material provides relevant evidence on the matter. To this extent, the present law may fall short of this policy objective.

(3) Third parties and secret meanings

6.12 The second policy objective also links significantly to the third, which states that third parties should be protected from secret meanings attached to contracts by the original contracting parties. Such third parties might include, for example, assignees (whether outright transferees or holders of security rights over the rights under the contract), or other successors to the original contracting parties. Assignations may relate to a particular contract, or to a set of contracts (as perhaps in intra-group transactions between companies), or to bulk transfers (as in the case of debt factors). The knowledge which the original parties and the drafters of the contract inevitably had about its background, purpose and negotiation as well, perhaps, about how it was performed after conclusion will not

[7] See paras 6.19-6.23.

necessarily – indeed, quite probably not in most cases – be transmitted to such third parties or their advisers. This point was much stressed by our Advisory Groups, who considered that effectively to impose the cost of investigating extensive background material as part of "due diligence" processes in order to be sure what a contract meant would be too great a burden in normal commercial activity involving the assignation of contracts. The point can be taken care of, however, if, as in RIPL's draft Bill, there are rules in place for the protection of third party interests.

6.13 The question of who exactly should be regarded as a third party for these purposes is, however, controversial, as preceding discussions of the topic in this Discussion Paper have shown.[8] In particular, in 1997 our predecessors thought that assignees should not count as third parties, and this is also clearly the position under the DCFR. We discuss this matter further in Chapter 7.

6.14 RIPL's only specific provision applying this policy objective was for contracts recorded or intended to be recorded in the Register of Sasines, or presented or intended to be presented in an application to the Land Register.[9] The DCFR gives expression to the policy in a more general way, by providing that where a third party has reasonably and in good faith relied on the contract's apparent meaning, and the question to be resolved involves that party, a narrower, more objective approach to interpretation should be used. It gives negotiable instruments as an example where this rule is applied.[10] RIPL also provided for a similar general rule protecting third party reliance, but without giving any specific examples of when the rule might arise.

6.15 We have had some difficulty in understanding the meaning of the RIPL recommendation about contracts recorded or to be recorded in the Land Register.[11] Contracts as such are not registered in the Land Register, which is about real rather than personal rights.[12] While we think it clear that parties in general should be able to place reliance on the apparent meaning of a registered title, it seems to us that this has no implications for the law of contract as such. At least two stages follow after the conclusion of a contract under which a title to land is to be transferred: first, the deed or disposition, and then the latter's registration, as the case may be. If the deed does not reflect the preceding contract, it falls to be rectified under the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985; if the registered title is inaccurate because it does not reflect the disposition, it falls to be rectified under the Land Registration (Scotland) Act 1979.[13] Nothing in this compels interpretation of the initial contract so as to reflect the registered title.

6.16 Long leases may provide an example of undoubted contracts that are registered to give them real effects; but registration is not compulsory and it is therefore not clear why the

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[8] See paras 3.12-3.14 and 4.11.

[9] RIPL, paras 3.15 and 3.21. We note here our agreement with our predecessors that registration of a contract in the Books of Council and Session for purposes of execution should not make any difference to its interpretation (RIPL, para 3.16).

[10] We have also mentioned shipping documents such as bills of lading in our earlier discussion of the DCFR on this point (at para 3.13, fn 16).

[11] We refer only to the Land Register although RIPL also discussed the Register of Sasines, since the latter is now in effect a "dying" register.

[12] Long leases provide an exception, which we discuss at para 6.16.

[13] See the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985, s 8; the Land Registration (Scotland) Act 1979, s 9; and, for a full account and analysis, our Report on Land Registration (Scot Law Com No 222, 2010), Pts 17, 18 and 29.

approach to interpretation should vary according to whether or not a lease is registered.[14] Issues between those who are successors to the original contracting parties might be better dealt with under the more general rule on third party reliance.

6.17 The only other case of third party interests in contracts which we can figure apart from assignation and negotiable instruments is where a contract appears on its face to provide an enforceable right or benefit for a third party so that the doctrine of *ius quaesitum tertio* applies.[15] The third party beneficiary is not usually treated as a party to the contract, and if this is correct, then a term apparently in favour of such a person who had relied thereupon might, under the general rule recommended in RIPL and embodied in the DCFR, be enforced in accordance with its apparent meaning rather than that which the contracting parties could otherwise show had been intended. We are not aware of any reported case on *ius quaesitum tertio* in which such issues have arisen, perhaps because in most cases the courts have held that some further step such as intimation or delivery of the contract to the third party, or its registration in court books, is necessary for the third party's right to be constituted at all. As a result, although it remains possible for the third party's reliance to be an element in the creation of such a right,[16] there is a dearth of directly relevant authority on the matter.

6.18 In sum, we do not think that this policy objective entails any special rules relating to contracts which are registered or which preface transactions that must be registered to have real effects, and accordingly we will not be following our predecessors' recommendations in RIPL in this regard. We accept, however, that there may be cases involving third parties where the third party's reliance on the apparent meaning of a written contract is deserving of protection, in particular negotiable instruments and (perhaps) *ius quaesitum tertio*. We think it better to express the policy objective in such terms rather than as a protection against secret meanings, and we do not think that the policy has a wide scope. The really important practical issue is whether assignees fall within the scope of this policy objective, and we discuss this in detail in Chapter 7.[17]

(4) The admissibility and relevancy of evidence

6.19 The fourth policy objective is that relevant evidence should be admissible and irrelevant evidence should be inadmissible. The link between this and the second policy objective has already been noted.[18] While at first sight this fourth objective seems self-evidently right, its framing in RIPL is not free from difficulty. As is pointed out in *Walkers on Evidence*, evidence to be admissible must both be relevant, in the sense that it is logically connected to the matter in dispute between the parties, and must conform to the peremptory rules of evidence.[19] While irrelevant evidence is never admissible, even relevant evidence may be made inadmissible by a peremptory rule imposed for reasons of policy, "excluding certain kinds of evidence as being insufficiently reliable, or too remote, or as creating the possibility of unfairness or confusion".[20] But, as the text goes on to note, evidence will often

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[14] A lease for up to 20 years cannot be registered. A lease for over 20 years can be registered but its validity does not depend on registration. Non-registration simply means that the lease does not have real effects.
[15] This would cover the case of bills of lading, although see also the Carriage of Goods by Sea Act 1992.
[16] See *Carmichael v Carmichael's Exx* 1920 SC (HL) 195.
[17] See paras 7.30-7.35.
[18] At para 6.11.
[19] Margaret Ross and James Chalmers, *Walker and Walker The Law of Evidence in Scotland* (3rd ed, 2009), para 1.1.1 (and see also para 1.3.1).
[20] *Walkers on Evidence*, para 1.1.1.

have to be examined in a court before its admissibility or relevance can be finally determined.[21] In this sense anything purporting to be evidence is therefore in some sense "admissible". The point being put forward in RIPL is really that the court should consider *all* relevant evidence in reaching its final decisions on disputed points of interpretation while discarding the irrelevant. The present law is not wholly consistent with the policy objective so understood, in that even relevant evidence about the parties' intentions to be found in their pre-contractual negotiations is excluded from consideration under the rule reaffirmed in *Chartbrook* and *Luminar Lava Ignite Ltd v Mama Group plc and Mean Fiddler Holdings Ltd*.[22] But that position might be justified on the approach stated above in *Walkers on Evidence*, that certain policy grounds can be a basis for excluding even relevant evidence.

6.20 The courts' adherence to the exclusionary rule on pre-contractual negotiations does indeed appear to be based principally on policy grounds countering the generality of the fourth objective, namely the need to promote certainty, avoid possible confusion and contain costs (this last being, however, an addition to the considerations mentioned in *Walkers on Evidence*). In contrast, RIPL justified its recommendation for the continuation of the exclusionary rule on the basis that pre-contractual negotiations were part of a process of the history of preparing a juridical act (the contract) and were accordingly always irrelevant.[23] But RIPL made an exception to allow use of evidence from negotiations to show that one party gave a particular meaning to an expression and that the other party at the time of contracting knew, or could reasonably have been assumed to know, that it was being used in this sense, which would then be applied in the interpretation of the contract. This, it can be argued, is already the position in Scots law, although that may have been put in some doubt by the *Chartbrook* decision.[24]

6.21 The exception is a substantial one, as we have tried to show in our earlier discussion of it,[25] and may indeed be the typical case in which a court would find itself investigating the pre-contractual negotiations in search of material relevant to the meaning of a contract. If there is unequivocal evidence showing that during negotiations the parties explicitly agreed the meaning of a term or an expression in the contract, it is also more than likely that that agreement will have found its way into the eventual document, or at least not be a matter of dispute. More likely to be of the level of difficulty that needs the judgement of a court is the case where a party makes clear its subjective understanding of an expression's meaning and the question is whether or not it may be reasonably inferred in the circumstances that the other party knew of this meaning and did not query it.

6.22 The primary basis for supporting the exclusion of evidence of parties' subsequent conduct for both the courts and RIPL, however, is that otherwise a juridical act's meaning might change over time. It is irrelevant to what the parties thought at the time of contracting. If however, as Lord Nicholls has argued,[26] such evidence can be used to determine the meaning the juridical act has always had, using the parties' conduct to show the meaning which they appeared to give the expression in question from the outset, then its exclusion

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[21] Ibid, para 1.1.2.
[22] [2010] CSIH 01; 2010 SLT 147.
[23] There is also a view in the courts that in general evidence of pre-contractual negotiations will tend to show only the subjective positions of each of the parties, evolving over time to the final result, and therefore be anyway irrelevant.
[24] See the discussion in para 5.23.
[25] At paras 5.23-5.27.
[26] See para 4.19.

does clearly run counter to the fourth policy objective and there is no convincing countervailing policy consideration.

6.23 Our provisional view is that the fourth policy objective as formulated in RIPL should be qualified slightly in the light of the observations in *Walkers on Evidence*. This might be done in a manner similar to that found in the first policy objective by saying that all relevant evidence should indeed be admissible except where there are good policy reasons to the contrary. Such policy reasons might include the matters mentioned in *Walkers on Evidence* – the evidence's insufficient reliability or too great remoteness from the matter in issue, the possibilities of unfairness and confusion – but might also extend to questions about containing costs, whether in the giving of professional advice or the conduct of litigation. This has clearly been an important consideration for the courts in the development of the law to its current state, in particular in qualifying the extent to which even relevant evidence may be admitted. We certainly agree that any law reform in this area should not add un-necessarily to the costs of doing business or going to law, and that certainty and the avoidance of confusion are important general objectives for the legal system. But we would add the comment that exclusionary rules can have the effect of precluding a court's determining the *weight* to be attached to particular items of evidence, a judicial power which may often give full effect at least to doubts about their reliability and remoteness from the matter in issue.

(5) Ascertaining common intention

6.24 Discussions with our Advisory Groups suggest that perhaps one further policy objective might be added to the list formulated in RIPL. The question is posed by consideration of the difference between the DCFR and both current law and RIPL on the matter. The DCFR starts with a search for the common intention of the parties, which is explicitly to prevail even over anything written in their contract: the contract is the parties', not the interpreters'. Scots law and RIPL, on the other hand, are fundamentally committed to an objective approach, most famously epitomised by Lord Dunedin ("Commercial contracts cannot be arranged by what people think in their inmost minds. Commercial contracts are made according to what people say"[27]) and by Gloag ("The judicial task is not to discover the actual intentions of each of the parties; it is to decide what each was reasonably entitled to conclude from the attitude of the other"[28]). On this approach, the meaning of a contract is ultimately for the court to determine. It is a matter of law, not fact, and it is noteworthy that the intention of the parties is not mentioned by Lord Hoffmann in his statement of principle in the *ICS* case. Long before, Lord Wilberforce in his speech in *Prenn v Simmonds* had cast doubt on the criterion of "common intention":

> "[I]t may be a matter of degree, or of judgment, how far one interpretation, or another, gives effect to a common intention: the parties, indeed, may be pursuing that intention with differing emphasis, and hoping to achieve it to an extent which may differ, and in different ways. The words used may, and often do, represent a formula which means different things to each side, yet may be accepted because

[27] *Muirhead & Turnbull v Dickson* (1905) 7 F 686 at 694.
[28] Gloag, *Contract* (2nd ed, 1929), p 7, approved by Lord Reid in *McCutcheon v MacBrayne* 1964 SC (HL) 28 at 35.

> that is the only way to get "agreement" and in the hope that disputes will not arise. The only course then can be to try to ascertain the "natural" meaning."[29]

Such an approach may be reinforced, at least in the case of contracts drawn up by the parties' professional advisers, by the fact that much of what is contained in a contract may be put there by those advisers rather than by the parties themselves. To talk of the parties' intentions in this context may be no more than an artificial construct to which the courts pay only lip-service.

6.25 But on the other hand the judges do resist the idea that they should use their powers to make contracts more fair or reasonable. As Lord Guthrie observed in a well-known dictum: "The object of our law of contract is to facilitate the transactions of commercial men."[30] The judges further recognise that parties may simply have made bad bargains to which they must be held.[31] In other words, courts defer ultimately to the autonomy of the contracting parties. While they also feel free to prefer results that seem to make commercial sense or are at least not absurd, this is probably justified by the assumption that this is what the parties would want as presumptively rational beings. What the Scottish (and English) courts have already done in widening beyond the four corners of the contractual document the scope of the material to be considered in ascertaining the document's meaning has been in pursuit of what the contract is meant to mean. Finally, we should note that giving effect to the common intention of the parties is the explicit objective of the law of rectification which, as we have seen, has a close connection to the law on interpretation.[32] It would be a strange inconsistency if these two branches of the law were not to point in the same general direction. We also understand from our Business Advisory Group that business people place a high value on the formal contract giving effect to the agreements and bargains that they have struck. The idea that the contract is the parties' seems to us to lie at the very heart of contract law.[33]

6.26 This is, however, not necessarily inconsistent with the general objective approach already outlined. In particular, the meaning of material additional to the contract document must also be determined objectively, at least in the sense that the court will understand it as a reasonable outsider would and in the end cannot be certain that that will match what the producer of the material actually meant. It also follows that the individual party's declaration of an intention during negotiations can only be relevant if it can be seen objectively to have had an impact upon the other party and the contract, while a party's ex post facto evidence as to its pre-contractual intentions can only very rarely, if ever, be relevant. The parties' "common intention" is not the sum of their individual intentions but a construct to be determined on an assessment of the evidence before the court. Widening the field of inquiry, in other words, is not to lapse into subjectivity and a search for the "true" or "real" intention of the parties.[34]

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[29] *Prenn v Simmonds* [1971] 1 WLR 1381 (HL) at 1385.
[30] *R & J Dempster Ltd* v *Motherwell Bridge and Engineering Co Ltd* 1964 SC 308 at 332. For a recent example of this approach see *R & D Construction Group Ltd v Hallam Land Management Ltd* [2010] CSIH 96.
[31] See para 5.16.
[32] See paras 5.12, 5.20 and 5.25-5.26.
[33] We have been much helped in our thinking here by Catherine Mitchell's article, "Contracts and contract law: challenging the distinction between the 'real' and 'paper' deal" (2009) 29 OJLS 675.
[34] See Lord Hoffmann, "Intolerable wrestle with words and meanings" (1997) 114 SALJ 656 at 660-61; and note also his emphasis on the objective approach to be taken to determining the parties' prior consensus in rectification cases in *Chartbrook* at paras 60-66. For the objective approach in rectification in Scots law, see

6.27 There is a link between this objective approach and the policy interest in certainty and the containment of cost which is well captured by the South African writers, Lubbe and Murray:

> "From such a perspective [considerations of legal policy], the traditional view of the parole evidence rule in the present context becomes intelligible. It seeks to protect judges against intractable disputes of fact regarding subjective states of mind and the concomitant risks of fraud and perjury that will undoubtedly arise should parties be entitled to resort freely to extrinsic evidence during the process of interpretation. The consideration that fraud is to be discouraged and that the duration and costs of litigation should be restricted as far as possible, is a normative one that militates against an approach that seeks the true intention of the parties at any price."[35]

It is not necessary, however, to return to the former parole evidence rule to give effect to such considerations. An analysis of the parties' common intention based upon what a reasonable person would have judged that intention to be from their relevant words and actions can be sufficiently stringent.

6.28 Our provisional view is that the fundamental aim of contract law in general, and of the law of interpretation in particular, is to give effect to the common intention of the parties, as suggested in the DCFR, but that the basically objective approach of current Scots law and RIPL in determining that common intention is to be preferred to any more subjective one, and should be the basis for any reform proposals.

Summary

6.29 In conclusion, we think that the policy objectives in this area can be expressed thus:

- The same rules of interpretation ought to apply, unless there is good reason to the contrary, whatever the nature of the contract, promise or other pre-contractual statement to be interpreted and whatever the medium used to make it.

- The rules of the substantive law on interpretation ought to be such that it is possible to determine what facts and circumstances the interpreter can properly take into consideration, whether the interpreter is or is not a court.

- Reasonable third party reliance on the apparent meaning of written contracts should be protected in questions with such third parties.

- All relevant evidence should be admissible except where there are good policy reasons to the contrary, including the provision of certainty, the avoidance of confusion, and the containment of costs.

- The objective of interpreting a contract should be to ascertain the common intention of the parties as far as possible. This should continue to be conducted on an objective basis i.e. the meaning the parties' expressions and the other

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Donald Reid, "Rectification of deeds: Part 1" (2009) 103 *Property Law* 1, at 3-4; also Peter Webster, "Rectification" 2011 JR (forthcoming).

[35] Gerrit F Lubbe and Christine M Murray, *Farlam and Hathaway Contract: Cases, Materials and Commentary* (3rd ed, 1988), p 463.

admissible and relevant evidence about their intentions would convey to a reasonable person.

6.30 We also wish to gather further views on whether the evidence from our Advisory Groups above at para 6.3-6.5 reflects current commercial practice. If you have any empirical or other evidence to support your comments we would be grateful to receive it, together with an outline of the business environment from which the evidence is drawn. We therefore ask:

2. Do you (i) agree with, (ii) disagree with, or (iii) have anything to add to the views expressed in paragraphs 6.3 to 6.5?

Furthermore, we seek the views of consultees on the policy objectives formulated above. We therefore ask:

3. Do you (i) agree with, (ii) disagree with, or (iii) have anything to add to the policy objectives expressed in paragraphs 6.8 to 6.29?

Chapter 7 Proposals for reform

Options for reform

7.1 It seems to us that the discussion so far leads to a number of possible options for reform. The first is to propose a new set of recommendations for legislation, on the basis that the difficulties identified in the present law by this Discussion Paper, particularly in the light of the DCFR and developments in other jurisdictions, are such as to require further reform going beyond that proposed in RIPL. For reasons we discuss in the paragraphs below, we consider that this is the only viable option at present.

7.2 A second option is the consolidation of the judicial development of the law since 1997 by a legislative enactment of RIPL's recommendations. As described above,[1] it is clear that judicial developments since 1997 have brought Scots law broadly in line with those recommendations. Consolidation of these developments in statutory form would be designed to remove remaining uncertainties and put the law overall on a clear statutory footing. However, our own view is that implementation of RIPL at this time would not be appropriate. Our work on the present Discussion Paper suggests to us that RIPL's recommendations were directed towards improving the state of Scots law as it stood in the mid-1990s and that the law has actually moved on significantly since that time, at least partly thanks to RIPL itself. As a result, different considerations now apply. We further think that RIPL did not take full account of the relationship between the law of interpretation and the remedy of rectification, in particular the implications of the latter's focus on the common intention of the parties. The comparative background has also moved on, not only with regard to the DCFR but also in particular in the common law world, where indeed it is perceptibly still in motion. We are impressed by the argument that enactment of RIPL's recommendations could have the effect of freezing Scots law in a position which would leave it out of step with most other major jurisdictions, in particular (but not only) those of our European Union partners. Opportunities for legislative intervention in this area of law are likely to be rare, and in all the circumstances we do not believe that, for all its many merits, RIPL now provides a sound basis for that intervention. We therefore have chosen not to present this option as a possible reform in this Discussion Paper.

7.3 A third option presents itself. It is essentially to do nothing, precisely because the development of the law by the courts since 1997 makes legislative intervention un-necessary, with the likelihood being that any uncertainties will be satisfactorily addressed by the courts when the opportunity arises to do so. Although it appears that the present law is not wholly consistent with the general policy objectives noted above, nor with the provisions of the DCFR, nor with developments in other relevant legal systems, the courts would nonetheless be free to develop the law in ways they deem appropriate in future. A perceived flexibility in the current system would thus be retained. Notwithstanding this, we are not persuaded by this third option. Having regard to the difficulties and uncertainties which remain or have emerged in the present law as so far developed by the courts, and in light of the DCFR and developments in other jurisdictions, we believe that a new set of

[1] See Ch 5 in particular.

recommendations for legislation representing a new statutory scheme of interpretation is the best way of maximising both certainty and fairness. We now turn to that scheme.

A new scheme

7.4 Although this option is perhaps the most radical of those discussed in the preceding paragraphs, it should be stressed at once that the scheme put forward here is not so much a departure from as a development of the approach contained in RIPL. It builds on RIPL's policy objectives and recommendations, and departs from the latter only where that appears more consistent with the former. It is driven by the view, provisionally stated above,[2] that the aim of the interpretation process is to establish objectively the common intention of the parties to the contract, taking account of the admissible surrounding circumstances. The focus in what follows is therefore on RIPL's recommendations restricting what could be considered as admissible extrinsic evidence about the meaning of a contract, i.e. parties' individual declarations of intent, pre-contractual negotiations and parties' conduct subsequent to the conclusion of a contract. We suggest that, the exclusion of declarations of individual intention apart, these restrictions should be removed, on the basis that the admissibility of such material can enable the courts to identify the parties' common intentions, and that the countervailing considerations of policy do not outweigh the general policy in favour of the admission of relevant evidence in court. We recognise, however, that the concerns on these matters are not necessarily limited to what happens in litigation but extend into commercial and chamber legal practice in various ways. We therefore suggest for consideration an extension of the law's recognition of entire agreement clauses, at present limited to the identification of a contract's express terms, to allow parties to exclude consideration of extrinsic evidence in the interpretation of their contract by way of an appropriately drafted contract term. This raises a number of difficult issues on which we would be especially glad of the views of consultees. There is also some brief comment on the possible enactment of the "rules of preference"; we follow RIPL in recommending that, with one possible exception,[3] no attempt be made to embody these in legislation.

General rule

7.5 RIPL recommended that a "general rule of interpretation" be set out in statute.[4] The proposed rule anticipated the general thrust of the Hoffmann approach. As formulated in RIPL, it stated that the meaning of an expression was to be "the meaning which would reasonably be given to it in its context". Account might be taken of the surrounding circumstances and, so far as they could be objectively ascertained, of the nature and purpose of the document in which the expression is contained.[5] However, there was no need for a court to consider surrounding circumstances if parties did not invite it to do so (possibly a qualification of the Hoffmann approach, but one justified on the grounds that otherwise the law "would run the risk of introducing a requirement of evidence in a great many cases where it would serve no useful purpose"[6]). As will be clear from what has gone before, our view is that this approach is sound, though we consider that a reference to the search for parties' common intention should also be incorporated. Like our predecessors in

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[2] See para 6.28.
[3] A rule of preference for when there are different language versions of a contract: see para 7.39-7.40.
[4] See the table above para 3.3 above.
[5] RIPL's focus was wider than just contracts, and so the rule is framed in terms of "juridical acts".
[6] RIPL, para 2.14.

RIPL, we are also of the view that the general rule would capture the need to give technical or legal expressions their technical or legal meaning.[7]

7.6 Since this general rule is arguably an accurate statement of what the law currently is, there is a question of whether there is any need to enact it. Our provisional view in relation to the general rule is that there remains merit in it being included in any legislation on interpretation. We would favour a formulation along the broad lines of paragraph 1(1) of the Schedule to the draft Bill annexed to RIPL,[8] but including a reference to the common intention of the parties, objectively ascertained.

7.7 As a separate but closely related matter, RIPL was clear that there was to be no requirement for ambiguity before surrounding circumstances could be considered.[9] In effect, this is very much in line with the DCFR and the Hoffmann approach.[10] We think that there is considerable force in the view expressed in RIPL that a requirement of ambiguity is illogical and un-necessary:

> "A requirement of ambiguity is illogical. Meaning sometimes depends on the surrounding circumstances and it is therefore unprincipled to refuse to look at the surrounding circumstances because the apparent meaning is clear. It may only become obvious that there is an ambiguity after the admissible surrounding circumstances have been considered: there may be a latent ambiguity. A requirement of ambiguity is unnecessary. If there is any properly arguable dispute about the meaning of an expression it is likely that there will be an ambiguity. If there is no properly arguable dispute the interpreter will have little difficulty in coming to a conclusion in any event. Against the requirement of ambiguity it may also be said that it complicates the process of interpretation by requiring the interpreter to go through a rather artificial extra stage."[11]

7.8 We adhere to this view, and also consider that the statement in RIPL that the "word 'ambiguity' in this context is used in a wide sense, to cover not only the case where it is immediately obvious that an expression is capable of two meanings but also cases where the expression is unclear or uncertain"[12] still holds true. For instance, when Lord Hope of Craighead says in *Multi-Link* that "this [ie re-working the contractual wording] should not be done until it has become clear that the language the parties actually used creates an ambiguity which cannot be solved otherwise",[13] the requirement for ambiguity can be read as a general requirement for a lack of clarity as to the meaning of a contractual term rather than anything more specific. Certainly, the facts of that case suggest this to be so.[14] "Ambiguity" is itself an ambiguous expression, and thus an undesirable basis for a legal rule.[15]

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[7] RIPL, Pt 5.
[8] See the table above para 3.3 above.
[9] RIPL, paras 2.12-2.14.
[10] The DCFR makes no mention of any ambiguity prerequisite. For the Hoffmann approach, see paras 4.3-4.4.
[11] RIPL, para 2.13.
[12] Ibid, para 2.12.
[13] *Multi-Link Leisure Developments Ltd v North Lanarkshire Council* [2010] UKSC 47, para 11.
[14] Ambiguity in this wide sense is by no means limited to contracts. An example of the need to interpret a patent error in a court decision can be seen in Lord Hoffmann's opinion in *S of S for Social Security v Remilien* [1997] 1 WLR 1640 (HL), where he refers at 1657G to certain paragraphs of Sch 9 to the Immigration Act 1971. There is no such Schedule, though it is clear from the context that Sch 2 is meant. For a discussion of the interpretative questions which arise, see Ilanah Simon, "There's glory for you! – when judges do not say what they mean" (2001) 8 UCL Juris Rev 66-83. To the discussion of linguistic philosophy in that article, Lord Sands' dictum in *Assessor for Aberdeen v Collie* 1932 SC 304 at 311-12 may be added: "[T]here is one thing that is binding upon us and that is the law, and the House of Lords is an infallible interpreter of the law. A batsman who, as he said,

7.9 In order to gauge opinion on the desirability of legislating for the general rule, we ask the following question:

> **4. Should there be a legislative statement of the general rule of interpretation? The general rule would state that the meaning of an expression in an agreement is that which would reasonably be given to it in its context, taking account of the parties' common intention (determined objectively), the surrounding circumstances, and the nature and purpose of the agreement (again, both determined objectively). Ambiguity would not be a pre-requisite for consideration of the surrounding circumstances and the nature and purpose of the agreement. But a court would only consider surrounding circumstances where invited to do so by a party.**

(a) Parties' statements of individual intention

7.10 RIPL recommended that parties' individual and direct statements of intent should not be admissible as evidence of the meaning of a contract. Our preference for the common intention of the parties as the goal of the interpretation process means that we continue to support the thrust of this recommendation in that one party's unilateral statement of intention, standing in isolation, cannot be determinative of the parties' shared intention (even where the search for that shared intention is conducted on a subjective basis). The DCFR does not include such individual statements amongst the "relevant matters" to which regard may be had in seeking out the parties' common intention. Such statements can only contribute to the determination of the parties' common intention if in conjunction with other material they tend to show that the parties reached consensus on the intention (or meaning) initially set out by only one of them (or, perhaps, to confirm that the parties agreed that a particular meaning was not to apply). Below we discuss further the case also set out in RIPL, namely the admissibility of a party's statement of the meaning it attributed to a particular expression where the other party knew or could reasonably be assumed to have known that the expression was being used with that sense but did not object to that.[16] This is, however, a quite clear instance of a way of determining the parties' common intention, rather than a way of giving effect to nothing more than an individual statement.

7.11 It might be thought that all this is so self-evident that it does not need to be set out in legislative form.[17] But we think that an express rule could serve the useful purpose of focusing advisers' minds on the need for relevance to the matter actually in dispute and help

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had been struck on the shoulder by a ball, remonstrated against a ruling of l.b.w.; but the wicket keeper met his protest by the remark: "It disna' matter if the ba' hit yer neb; if the umpire says yer oot yer oot." Accordingly, if the House of Lords says "this is the proper interpretation of the statute," then it is the proper interpretation. The House of Lords has a perfect legal mind. Learned Lords may come or go, but the House of Lords never makes a mistake. That the House of Lords should make a mistake is just as unthinkable as that Colonel Bogey should be bunkered twice and take 8 to the hole. Occasionally to some of us two decisions of the House of Lords may seem inconsistent. But that is only a seeming. It is our frail vision that is at fault." (This quotation featured in an address given in 2009 by Lord Rodger, reproduced as "Humour and Law" 2009 SLT 33, 202-213: see 206-207.)

[15] We wonder whether had his source material been, not English poetry, but formal legal documents, the literary critic Sir William Empson would have confined himself to *Seven Types of Ambiguity* (the title of his most famous work, first published 1930, 2nd ed 1949).

[16] See paras 7.16-7.17.

[17] See, e.g., *Luminar Lava Ignite Ltd v Mama Group plc and Mean Fiddler Holdings Ltd* [2010] CSIH 01; 2010 SLT 147 at paras 31 and 46 per Lord Hodge, dismissing a statement made by a party early in pre-contractual negotiations as merely a statement of that party's individual intention. See also paras 6.19-6.23 above.

to avoid the heaping of a mass of irrelevant material for a judge to sift through every time an interpretation dispute comes before a court. We therefore ask:

5. Should there be express legislative provision that a party's individual and direct statement of intention may be used as evidence of the meaning to be attributed to a contract only where, together with other relevant material, it contributes to the determination of the parties' common intention?

(b) Pre-contractual negotiations

7.12 In the light of the DCFR and the discussion in Chapter 6 above of policy objectives in this area of the law, RIPL and the current rules may be seen as too restrictive with regard to the material that may be taken into account in determining the meaning of a contract (the exclusion of individual declarations apart, as just discussed). In particular, the exclusion of pre-contractual negotiations may deny the courts use of evidence that is potentially relevant to the question of interpretation, and thus possibly go against the fourth policy objective stated in RIPL (i.e. that all relevant evidence should be admissible).[18] Before the *Chartbrook* case there were powerful challenges to the exclusionary rule in England, primarily on the grounds that the courts may be denying themselves access to the best evidence as to the meaning of the contract as understood by the parties.[19] The *Chartbrook* decision itself has already been the subject of cogent academic criticism.[20] Comparative study shows the common law courts of New Zealand also moving in the direction of admitting evidence of pre-contractual negotiations for purposes of determining the parties' contractual intention,[21] while the Supreme Court of Appeal in South Africa appears to be in favour of a wide approach to admissibility of evidence of prior negotiations for purposes of interpretation, albeit to be "used as conservatively as possible".[22] The position appears to be similar but longer established in the USA[23] and Canada.[24] The DCFR position is therefore not out of line with what appears to be a trend in at least some parts of the common law world.[25]

7.13 There is also possible inconsistency in the present law in enabling reference to such material for the purpose of establishing the surrounding circumstances known to both parties at the time of contracting but not for establishing their contractual intentions. The distinction between referring to pre-contractual negotiations to determine the content of admissible surrounding circumstances and doing so in order to interpret the contract may be a rather fine and difficult one to draw. What we seem to have as a result is a rule saying that pre-contractual negotiations cannot be used as direct evidence in the interpretation of a contract,

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[18] See para 6.1.
[19] See e.g. Gerard McMeel, "Prior negotiations and subsequent conduct – the next step forward for contractual interpretation?" (2003) 119 LQR 272; Donald Nicholls, "My kingdom for a horse: the meaning of words" (2005) 121 LQR 577; David McLauchlan, "Contract interpretation: what is it about?" (2009) 31(5) Sydney LR 5.
[20] See e.g. David McLauchlan, "*Chartbrook Ltd v Persimmon Homes Ltd*: commonsense principles of interpretation and rectification?" (2010) 126 LQR 8; David McLauchlan, "Interpretation and rectification: Lord Hoffmann's last stand" [2009] NZLR 431; Catherine Mitchell, "Contract interpretation: pragmatism, principle and the prior negotiations rule" (2010) 26 Jnl of Contract Law 134; Janet O'Sullivan "Say what you mean and mean what you say: contractual interpretation in the House of Lords" (2009) 68 CLJ 510.
[21] See para 4.16.
[22] See *KPMG Chartered Accountants (SA) v Securefin Ltd* 2009 (4) SA 399 (SCA), para 39 per Harms DP.
[23] See para 4.14.
[24] See para 4.16.
[25] Australia stands out as the exception to the trend, and indeed has gone less far than England with the "contextual" approach.

but can be used as evidence of surrounding circumstances, which can then be used in the interpretative process. Such a distinction between the two kinds of use may however be rather a difficult one to effect in practice. We think that this is particularly well illustrated by the leading case of *BoS v Dunedin*.[26] Again, once a court has embarked upon investigation of the pre-contractual negotiations in order to determine the relevant surrounding circumstances, must it simply ignore any material also to be found there tending to show that the parties had a shared understanding of the meaning of their words?

7.14 The evidence of the parties' pre-contractual negotiations may also be considered, in full and without question, in the event that a party seeks rectification of the contract rather than (or as well as) arguing a case on the basis of interpretation. While the exclusion serves to mark a boundary between contextual interpretation and rectification, the need for boundaries between interpretation and rectification may be questioned. The fuzziness of the boundary is apparent in so far as the process of interpretation allows the judge to look beyond the contractual document and use the extrinsic material to adjust the wording of the contract. Rectification may only be necessary to avoid injustice in a system otherwise committed to interpretation on the basis of the written contract alone.[27] It is not clear otherwise why the law should have to draw a distinction between types of mistaken or inadequate drafting for purposes of deciding whether it is to be remedied by way of interpretation or rectification and, accordingly, about what kind of evidence may be admitted for consideration by a court. As Professor Eric Clive has commented, "the objection to admitting this type of [pre-contractual] evidence turns out to be procedural rather than substantive".[28]

7.15 The existence of rectification and the consequent judicial power to rewrite a contract to make the written record conform to the parties' common intention makes the DCFR's statement that "a contract is to be interpreted according to the common intention of the parties even if this differs from the literal meaning of the words" a little less shocking to the traditional legal eye in the United Kingdom.[29] As Sir Richard Buxton has observed in a note on *Chartbrook*, that decision is likely to encourage direct resort to rectification in more cases simply because the remedy permits relatively unfettered resort to evidence about pre-contractual negotiations.[30] The present overlap between "contextual" interpretation and rectification may therefore be seen as unsatisfactory, possibly encouraging strategic behaviour in litigation, and certainly forcing parties and their advisers to consider which option to pursue, if not both at the same time. Unless we are to return to a world of interpretation based solely on the contents of the contractual document, a simpler approach might be to allow courts to consider all relevant pre-contractual evidence when the meaning of a contractual document is in dispute. We accordingly ask the following question:

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[26] 1998 SC 657, discussed above at paras 5.2-5.4.

[27] See Andrew Burrows, "Construction and rectification", in Burrows and Peel, pp 77-99 ("rectification has not merely been rendered less important by modern developments in the law of construction but is on the point of being rendered largely superfluous").

[28] Eric Clive, "Interpretation", in Hector MacQueen and Reinhard Zimmermann (eds), *European Contract Law: Scots and South African Perspectives* (2006), pp 176-202 at p 183.

[29] DCFR II.-8:101(1). See the table above para 3.3 and also the discussion at paras 6.24-6.28.

[30] Sir Richard Buxton, "'Construction' and rectification after *Chartbrook*" (2010) 69 CLJ 253. Sir Richard, however, argues in favour of a narrower approach to interpretation, making the boundary between that process and rectification better defined.

6. Should the courts be enabled to take account of relevant evidence about the parties' pre-contractual negotiations in determining their common intention under the contract?

(c) One party's meaning known to the other party and not objected to

7.16 Were pre-contractual negotiations to be generally admissible as evidence about the meaning of a contract, it might be thought unnecessary to have the "special rule" proposed in RIPL, namely that any expression forming part of the contract used by one party in a particular sense (whether or not used in that sense by any other party) should be interpreted in that sense if every other party at the time of contracting knew, or could reasonably have been assumed to know, that it was being used in that sense. Such a scenario would be most likely to emerge from the evidence about the parties' pre-contractual negotiations, and would simply be an example of how a court might infer objectively a common intention as to the meaning of the expression in question. The DCFR, however, states a parallel rule even though pre-contractual negotiations may generally be considered under its interpretation rules, allowing for the possibility that one party's awareness of the other's particular meaning for an expression arose otherwise than in their contractual negotiations, for example, from their previous or concurrent dealings with each other, or from trade custom or usage.[31] However, in the DCFR the rule is not a special exception but rather an example of its general rule that the aim of the interpretation process is to establish the parties' common intention.

7.17 Lord Hoffmann's rejection of a version of the special rule in *Chartbrook* was specifically because it created too great a hole in the general exclusion of pre-contractual negotiations as evidence of meaning. His approach can be criticised, however, on the grounds that, in order to protect the integrity of a rule that is avowedly pragmatic in nature rather than principled, the court must overlook what the parties actually agreed and try to find some objective meaning of the contract through some other route. In *The Karen Oltmann*,[32] for example, Kerr J was able, apparently by consideration of the general commercial background, to reach an objective conclusion as to the meaning of the words which was the same as that discovered by way of the parties' telexes. But that approach would have been much more difficult for the court in, say, *Houldsworth v Gordon Cumming*,[33] where giving "the estate of Dallas" the only alternative meaning of "all the lands to which the seller has a registered title and which are together known as 'Dallas'" would have led to an outcome other than that to which the parties had actually agreed, albeit that agreement was not precisely expressed in their contract. We think therefore that Lord Wilberforce overstated the difficulties when he remarked in *Prenn v Simmonds*: "Far more, and indeed totally, dangerous is it to admit evidence of one party's objective – even if this is known to the other party. However strongly pursued this may be, the other party may only be willing to give it partial recognition, and in a world of give and take, men often have to be satisfied with less than they want."[34] It seems to us that there can be little objection to the "special rule" having an explicit place in a scheme which admits the evidence of the parties' pre-contractual negotiations, being possibly the strongest example of where a court could

[31] DCFR II.-8:101(2). See the table above para 3.11.
[32] See para 4.12 for a discussion of this point.
[33] See para 2.8 for a fuller discussion.
[34] *Prenn v Simmonds* [1971] 1 WLR 1381 (HL) at 1385.

objectively and reasonably infer a common intention as to the meaning of a particular expression in the contract. But in order to ascertain views we ask:

7. Should there be a rule that in determining the common intention of the parties to a contract any expression forming part of the contract used by one party in a particular sense (whether or not used in that sense by any other party) should be interpreted in that sense if every other party at the time of contracting knew, or could reasonably have been assumed to know, that it was being used in that sense?

(d) Parties' subsequent conduct

7.18 The justification offered by the courts and in RIPL for the exclusion of parties' subsequent conduct from consideration in the interpretative process is that otherwise the interpretation of a contract would vary over time. We find Lord Nicholls' rejection of this justification convincing.[35] If it is clear that to be relevant the evidence must show conduct of both parties from the time the contract was formed that is consistent with a particular meaning of the contract, then there can be no question of meanings changing with the passage of time.[36] Evidence about subsequent conduct is in any event likely to be less voluminous and less exposed to the possible canvassing of irrelevant or unhelpful material than evidence about negotiations. Again the comparative material from Canada, New Zealand, the USA and South Africa suggests that the admissibility of this kind of evidence is not a specific characteristic of a Continental European approach incapable of taking root in a common law system.[37] Having discussed this question with our Business Advisory Group, we think that admitting subsequent conduct might be particularly helpful in the interpretation of contracts intended to last for long periods or those using broad and open-ended language, especially where these involve the development and exploitation of new and emerging technologies.[38] One further advantage of an approach to subsequent conduct as an aspect of interpretation is that the contract could be specifically enforced according to that interpretation, whereas personal bar and waiver, the other possibly helpful tools with regard to parties' subsequent conduct, merely preclude a party from exercising or enforcing rights it would otherwise have.[39] In order to ascertain views we ask:

8. Should there be a rule that in determining the common intention of the parties to a contract evidence of any conduct of the parties subsequent to the conclusion of the contract showing a common understanding of the meaning of the contract should be admissible for the purpose of interpreting that contract?

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[35] See para 4.19.

[36] Compare the doctrine of "explanatory possession" in conveyancing, discussed in RIPL at para 7.7. Kenneth Reid, *The Law of Property in Scotland* (1996), para 197 notes that one may appeal to extrinsic evidence to interpret a conveyancing deed and "the most satisfactory extrinsic evidence is evidence of possession." See also Lord President Hope in *Melville v Douglas's Trs* (1830) 8 S 841 at 842: "The best interpretation of the contract is to be found in the subsequent possession of the respective parties, openly assumed soon after its date."

[37] See para 4.18.

[38] In Australia, where subsequent conduct is not presently admissible to assist in the interpretation of a contract, Finn J has recently noted that "criticisms of this view are, in the main, directed at its inflexibility particularly in relational contract settings": *Australian Medic-Care Co Ltd v Hamilton Pharmaceutical Pty Ltd* [2009] FCA 1270, para 119.

[39] Elspeth Reid and John Blackie, *Personal Bar* (2006), para 5.21.

Certainty and cost?

7.19 Such a liberal approach to the admissibility of extrinsic evidence does, however, raise questions about its consistency with the policy objective identified in our preceding discussion, the provision of certainty, the avoidance of confusion, and the containment of costs.[40] On certainty and avoiding confusion, we would expect the judiciary to continue to give considerable weight to the apparent meaning of written documents drawn up with professional advice as a statement of the parties' rights and duties, and to have regard to extrinsic evidence only if it was clearly relevant and helpful in determining objectively what the parties intended under their contract. In the Commercial Court the judges' case management powers may be used alongside the rules of relevancy to control the amount of evidence to be considered, while more generally, as Professor McBryde notes, "the Scottish system of written pleadings requires averment of the surrounding circumstances to be relied upon (other than matters of common knowledge) and the relevancy of averments can be tested at debate".[41] Further, the judicial discretion to make orders about the expenses of litigation is available to deal with any party who chooses to deluge the court with material without having ensured its relevance to the issue in dispute.

7.20 As already noted,[42] it is unlikely that there will be absolutely clear-cut or explicit evidence of a common intention in pre-contractual negotiations that has not found its way into the contractual documents. We have found no examples of this in recent case law on either interpretation or rectification. While this means that judges will of necessity be drawing their conclusions by inference when material from the parties' negotiations is placed before them, we do not think this will give rise to any more uncertainty than is usual in any litigation, or involve significantly more preparation or court time than is already required. Present law and practice allows examination of surrounding circumstances including pre-contractual negotiations for certain purposes, so that such a review of the evidence must currently be taking place in the preparation of many if not most cases on the subject. Relaxing the law's restrictions would mean that the search would be for relevant evidence, and it would not be necessary also to form a view on its admissibility or not under any peremptory rule; this might even be a saving in both case preparation and court time.

7.21 The *Multi-Link* case may also illustrate the potential for savings if the rules on extrinsic evidence were liberalised in the manner suggested.[43] While a great deal of money was at stake in that case (around £5 million), it must have been costly to take it all the way to the Supreme Court. We do not know why no attempt was made to lead extrinsic evidence in that case: perhaps there was no potentially helpful material, or perhaps the parties were advised that the material which existed was inadmissible, or perhaps again the parties were seeking to limit the amount of court time and other expense that would have been involved in

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[40] See paras 6.10-6.11.
[41] McBryde, *Contract*, para 8.27, citing Lord Drummond Young's comments on the importance of the requirement of relevancy as a tool of judicial control over evidence to be used in relation to surrounding circumstances (in *MRS Distribution Ltd v DS Smith (UK) Ltd* 2004 SLT 631 at 638). See also Lord Glennie's comments in *Timeshare Management Services Ltd v Loch Rannoch Highland Club* [2011] CSOH 23 at para 131, drawing attention to para 16 of the Commercial Actions Practice Note (No 6 of 2004) which requires parties to prepare, for the court's use. a "working bundle in which the documents are arranged chronologically or in other appropriate order without multiple copies of the same document".
[42] See para 6.21.
[43] See paras 5.5-5.9 and 5.16.

trying to have such evidence admitted.[44] But if relevant evidence had been available and not inadmissible, then it might never have been necessary to go to court at all. In this connection we note with interest Donald Reid's observation, made from the standpoint of a practitioner, that many parties who would otherwise seek to benefit from errors in contractual expression can be warded off by the threat of a rectification petition based on the extrinsic evidence to be used in the action.[45]

7.22 We further think that, even without an explicit legislative direction to this effect, the judges will certainly be alive to the irrelevance of one party's declarations about its own intentions in contracting unless there is other evidence to show that these were known to and accepted (or, at least, not objected to when there was an opportunity to do so) by the other party. The *Luminar Lava* case is a good example of the court recognising the irrelevance of individual declarations of intention during pre-contractual discussions,[46] while *BoS v Dunedin* provides, it is suggested, a modern example where the evidence of the negotiations showed that a party knew of and did not object to the other party's understanding of a particular clause in their contract.[47] Similarly, with parties' subsequent conduct, we think that the judges would have little difficulty in identifying the kind of conduct on both sides that tends to show from the outset of performing a contract a shared understanding of its meaning, as distinct from the conduct which would amount to variation or waiver of the contract, or, in some cases, simply breach by one of the parties. In any event, as already noted,[48] evidence of subsequent conduct is likely to be significantly less voluminous than pre-contractual material even where the conduct in question involves correspondence. Finally, we would expect that parties, especially commercial ones, and their advisers will be alive to considerations of cost and expediency and so will exercise appropriate self-discipline in searching for possible evidence.[49] We therefore ask:

9. What are the views of consultees on the issues of costs and certainty discussed in the preceding paragraphs (7.19-7.22)? Are there factors which that discussion does not consider, or to which it gives too much or too little weight? Is there any further specific information on these issues which would be helpful in developing our tentative views in any way?

Contracting out of the new scheme

7.23 Concerns about certainty and costs are, however, unlikely to be entirely allayed by the comments in the previous paragraph. They do not address the concerns that have nothing to do with litigation, for example about the costs of due diligence processes.[50] We think, however, that such concerns can be accommodated within the overall scheme in a

[44] The speed of dispatch from the case being decided by the Lord Ordinary on 31 July 2009, the Inner House on 30 December 2009, and the UK Supreme Court on 17 November 2010 should be noted. The parties fell into dispute at the end of 2008. One of the factors relevant to this rapid disposal was the parties' election to argue the interpretation point by reference to the contract alone at debate, without a proof.
[45] Donald Reid, "Rectification of Deeds: Part 1" (2009) 103 *Property Law* 1, at 2.
[46] See paras 5.18-5.19.
[47] See paras 5.2-5.4.
[48] At para 7.18.
[49] Indeed, as has been impressed on us by members of our Advisory Groups, businesses tend to use the courts only as a very last resort to resolve their disputes. Consequently, any major rule changes to contractual interpretation will probably be unlikely to result in any significant increase in the use of the courts in any event.
[50] See para 6.12.

manner suggested by the DCFR itself and for which we also have a possible precedent within the Contract (Scotland) Act 1997. In Chapter 3 above we noted that the DCFR allowed contracts to have clauses which excluded or restricted the rule permitting the use of pre-contractual statements in interpretation ("merger clauses"), so long as such clauses were individually negotiated.[51] We also drew attention to a possible parallel with section 1(3) of the 1997 Act, which gives conclusive effect to a term in a document stating that it comprises all the express terms of a contract or a unilateral voluntary obligation (an "entire agreement clause").[52] Section 1(3) follows the abolition in previous sub-sections of the parole evidence rule in so far as it prevented courts from going outside a contract document for any further terms. Thus, party autonomy on this issue replaced what had been a legal rule; parties became free to contract out of the new, more liberal evidential regime created elsewhere by the Act and to contain any search for express contractual terms within the document alone.

7.24 The DCFR suggests that a similar approach of allowing contracting-out is possible if the general law on admissibility of extrinsic evidence to aid in the interpretation of written contracts is further liberalised along the lines suggested in the preceding paragraphs. We have already noted Lord Hodge's obiter remark that such contracting-out is already possible within the existing law, although he would "expect clear words to manifest such an intention".[53] Professor McBryde has also raised the possibility of contracting out of the Hoffmann approach, while questioning the feasibility of altering a rule of law, whether of interpretation or of evidence.[54] But the English Court of Appeal has recognised the possibility of contracting out of the rules of evidence in relation to interpretation, although dealing directly only with the case of the parties agreeing to a wider range of material being considered by the court than the law presently allows.[55] Academic analysis in England has also supported this approach and argued that the parties can by their contract direct the courts on what evidence may or may not be used in the process of interpretation.[56]

7.25 As a matter of fact, contracts commonly spell out the approach to be taken in their interpretation, most obviously in the commonplace interpretation and definition clauses, but also in the use of phrases such as "Without prejudice to the generality thereof", designed to negate any effects from the *ejusdem generis* rule of preference. Another example might be a clause purporting to restrict the court's use of context by providing that each clause in the document is to be construed separately and independently, severable from all or any of the other provisions.[57] We have, however, found only one Australian example of an entire agreement clause which additionally sought to exclude the operation of rules of evidence

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[51] DCFR II.-4:104(3). See para 3.18.
[52] On the definitions of, and distinctions between "entire agreement" and "merger" clauses, see the works of Catherine Mitchell cited at para 3.15, fn 18.
[53] See para 3.18.
[54] McBryde, *Contract*, para 8.27.
[55] *ProForce Recruit Ltd v Rugby Group Ltd* [2006] EWCA Civ 69, para 54. We have been told that at least one large commercial organisation operating throughout the UK normally includes in its contracts a schedule containing all the correspondence exchanged by the parties during their (often lengthy) negotiations, with the express purpose of ensuring that this material is available for the contract's subsequent interpretation.
[56] Ewan McKendrick, "Interpretation of contracts and the admissibility of pre-contractual negotiations" (2005) 17 SAcLJ 248, paras 36-37; Catherine Mitchell *Interpretation of Contracts: Current Controversies in the Law* (2007), ch 5. See also the latter author's articles: "Entire agreement clauses: contracting out of contextualism" (2006) 22 Jnl of Contract Law 222; "Contract interpretation: pragmatism, principle and the prior negotiations rule" (2010) 26 Jnl of Contract Law 134 at 156.
[57] Example from Hector MacQueen and Joe Thomson, *Contract Law in Scotland* (2nd ed, 2007), para 3.71.

related to the determination of the contract's meaning. The relevant part of the clause ran as follows:

> "In the absence of manifest error no course of prior dealings between the parties or their officers, employees, agents or affiliates shall be relevant or admissible to supplement, explain, or vary any of the terms of this Lease and acceptance of, or acquiescence in, a course of performance rendered under this Lease or any prior agreement between the parties or their affiliates shall not be relevant or admissible to determine the meaning of any of the terms of this Lease."[58]

The judge did not have to consider the effect of this specific part of the clause, however, before deciding that as a whole it was ineffective to exclude an implied term.

7.26 Section 1(3) of the Contract (Scotland) Act 1997 is so drafted as to avoid in Scotland some of the difficult questions which have arisen in England about the scope and effect of entire agreement clauses.[59] It gives conclusive effect only to clauses saying that the document comprises all the express terms of a contract: thus, as discussed in Chapter 3 above, such a clause does not prevent the possibility that there are additional implied terms, or reference to extra-contractual material to make claims for fraud or misrepresentation.[60] It has been specifically held that such a clause does not prevent resort to rectification.[61] It seems fairly clear that the standard sort of entire agreement clause presently in use would not be held to prevent a judge going outside a contractual document for admissible material to assist in its interpretation. As Lord Hodge's obiter dictum suggests,[62] it would therefore require clear words additional to those found in the standard entire agreement clause to achieve the latter effect. We accordingly think that adoption of the overall scheme of enabling the courts to consider all relevant evidence in interpreting a contract while also enabling parties to contract out of that regime will make it vital for the relevant legislation to follow the example of the Contract (Scotland) Act 1997 and give drafters reasonably clear guidelines on what language will be given conclusive effect with regard to the exclusion of extrinsic evidence.

7.27 An approach of enabling the draftsman to choose from a menu of possible exclusions might be adopted in such guidelines. For example, pre-contractual negotiations, parties' subsequent conduct, and evidence about the meaning attached to an expression by one of the parties and not objected to by the other could be specifically listed as items that might competently be excluded by a clause. A member of our Judicial Advisory Group expressed concern about allowing blanket exclusions of all material from outside the contractual document to include the "commercial background" or "factual matrix" permissible under the present law, suggesting that such exclusions might make the judicial task in interpreting contracts impossible.[63] We ourselves find it difficult to see how a judge might proceed without any inkling of the nature and purpose of the contract beyond what might be gleaned from the contractual documents. An English academic commentator, Catherine Mitchell,

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[58] *Kavia Holdings Pty Ltd v Bevillesta Pty Ltd* [2006] NSWSC 633, para 35.
[59] E.g. whether such a clause can give rise to an estoppel. For a discussion of this see the writings referred to at para 3.15, fn 18.
[60] See para 3.17.
[61] *Macdonald Estates plc v Regenesis (2005) Dunfermline Ltd* [2007] CSOH 123; 2007 SLT 791 (and see para 3.17).
[62] See para 3.18.
[63] See also McBryde, *Contract*, para 8.27: "Even if it is feasible to alter this rule of law, it may be dangerous to attempt to do so; the background circumstances may have relevance to make sense of the contract."

has, however, suggested that judges left without any context with which to determine meaning "would simply have to do the best they could", also pointing out "the possibility that the parties may have preferred the phrase to be interpreted by the judge in a court, and to have the judge's meaning attributed to it." She notes decided cases "where there is judged to be 'no context'", commenting that then "the judge may fall back on natural meaning as the relevant default, or else rely on their 'commercial instinct'."[64] The *Multi-Link* case provides a Scottish example of this kind of approach (although also showing the great difficulties in which it puts the judge). The parties there may have wished a decision to be reached as speedily as possible, and one short-cut, saving money as well as time, may have been to do without the expense of a proof. The strategy worked in that less than 18 months elapsed between Lord Glennie's decision in the Outer House and the final disposal of the case in the Supreme Court.[65] A contractual exclusion of extrinsic evidence might be seen as paving the way for achieving a similar benefit should that become necessary. We would therefore at this consultative stage not rule out the possibility of a clause having completely exclusionary effects with regard to evidence from outside the written contract, but instead invite comment upon the possibility:

10. Should parties be free to contract out of the proposed general default rule that all relevant evidence (including pre-contractual negotiations and parties' subsequent conduct) is admissible for the purpose of interpreting a contract? How might a rule allowing such contracting-out be framed?

7.28 A further question is whether any room should be left for escape from the conclusive effects of exclusionary clauses, whether or not they purport to exclude all or merely some extrinsic evidence. In the DCFR regime, the clause must be individually negotiated to be effective, and a party may be precluded by statements or conduct from asserting it to the extent that the other party has reasonably relied on those statements or conduct – a form of personal bar, in other words, which we think would also be recognised in Scots law.[66]

7.29 The requirement of individual negotiation is more difficult. In the DCFR it appears to apply specifically to the clause in question, and not necessarily to the whole contract. The requirement seems to be drawn from the law regulating the fairness of standard form consumer contracts, under which a term is to be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term.[67] The policy perception is that an un-negotiated clause will most probably be adverse to the interests of the consumer. Whether similar considerations apply in the commercial transactions which are the main focus of this Discussion Paper is far from clear. Given that under our suggested scheme it would be quite likely for such clauses to become "boilerplate" in nature – that is, part of the standard armoury of drafters of commercial contracts, pulled out and included in contracts as a matter of course rather than negotiation – a requirement of individual negotiation for enforceability

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[64] Catherine Mitchell, *Interpretation of Contracts: Current Controversies in the Law* (2007), pp 142-143, citing *Deutsche Genossenschaftsbank v Burnhope* [1995] 1 WLR 1580 (HL) and *Sinochem International Oil (London) Co Ltd v Mobil Sales and Supply Corporation* [2000] 1 Lloyds Rep 339, para 24 per Mance LJ.

[65] See paras 5.5-5.9 for a discussion of the case and para 7.21, fn 43 for the dates of the various judgments.

[66] Compare the general principles of bar stated in tabular form by Elspeth Reid and John Blackie, *Personal Bar* (2006), para 2.03.

[67] See the Unfair Contract Terms Directive (93/13/EEC), art 3, implemented in the UK by the Unfair Terms in Consumer Contracts Regulations 1999, reg 5. See also DCFR II.-1:110.

might become a generator of disputes and therefore cost, quite contrary to the general objectives of enabling such clauses to be effective. In commercial contracts between parties of roughly equal bargaining power, we think there is much to be said for taking such a clause at face value, however it found its way into the written agreement. As has been remarked in a New Zealand case on an entire agreement clause, "commercial people acting in good faith when entering into substantial transactions should be able to achieve certainty by agreeing to exclude liability for prior statements".[68] Any actual unfairness can be left to the regulation provided by other legislation on unfair contract terms.[69] Since our present proposal would give conclusive effect to the clauses only in relation to interpretation of the contracts in which they are contained, it will not prevent the application of unfair contract terms law. Likewise it will not prevent an action for rectification of the contract; indeed, this might be one of the few functions left for the rectification regime in relation to contracts if our general scheme was adopted. In order to gauge opinion, we ask:

11. Should there be a requirement that a clause excluding the use of extrinsic evidence (whether in whole or in part) in the interpretation of a contract must be individually negotiated in order to have conclusive effect on the matter?

Other issues in the new scheme

(1) Third party reliance: the position of assignees

7.30 We discussed in Chapter 6 the general policy of RIPL that third parties should be protected from "secret" meanings of a written contract not discernible from a reading of the document itself, and noted that our Advisory Groups had suggested that an application of this policy would see assignees of the original contracting parties included amongst such third parties.[70] The reasoning behind this suggestion was the cost that, it was said, would be imposed upon prospective assignees (who would include both purchasers of the rights involved as well as those taking security rights over them) carrying out due diligence ahead of any transaction in order to be as certain as possible about the risks involved. This can also be tied into the further policy consideration of containing costs in general and maximising certainty in commercial transactions generally.

7.31 On the other hand we have also seen that in 1997 our predecessors thought that assignees should not count as third parties, seemingly on the view that assignees are parties to the contract, not third parties.[71] The DCFR is strongly of the view that the assignee must take the risk of how the courts will subsequently interpret the contract, and is better protected by the rights it has against the assignor under the contract of assignment. The meaning of a contract should not be subject to change as the result of a transfer of the rights under the contract. Wilson J of the Supreme Court of New Zealand has also robustly rejected any need to protect assignees or, indeed, those lending on the security of a contract.[72] Lord Hoffmann's position on the subject may, however, be seen as somewhat

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[68] *Leigh v The Macennovy Trust Ltd* [2010] NZHC 577, para 28 per Harrison J, referring to *Brownlie v Shotover Mining Ltd,* CA181/87, 21 February 1992, at 31-33.
[69] E.g. the Unfair Contract Terms Act 1977, s 17. In New Zealand there is specific provision in the Contractual Remedies Act 1979, s 4.
[70] See paras 6.12-6.18.
[71] See para 6.13.
[72] *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, para 129, quoted at para 4.16.

equivocal, accepting that the argument for the protection of third parties has strength, but seemingly doubtful about how often practical problems arise in this area.[73]

7.32 Our provisional view is that assignees should not count as third parties and that they should be as bound as the original contracting parties would have been by the meaning which emerges from the contract documents read against the background of the admissible extrinsic evidence. While we see the force of the Advisory Group's point about adding to the costs of normal commercial transactions, we note that as the law stands today courts already take account of material external to a contract in determining its meaning without this seeming to have led to complaints of consequential excessive costs for parties performing due diligence. Nor is it clear in our view why the original parties' reasonable understanding of the contract should be replaced by a different meaning because one of them has assigned its part of the contract to a third person. This does not seem consistent with the fundamental principle in assignations that *assignatus utitur jure auctoris*,[74] nor does it seem particularly fair to the remaining original party, whose reasonable understanding of the contract may be set at naught by the other original party's assignation. There may also be difficulties for interpretation where rights under a contract are assigned only in part. The position might conceivably be more difficult where both the original parties had assigned to different third parties, but how often such a situation arises in practice we do not know. It would, however, be unsatisfactory, we think, if there was a period of limbo in the interval between each side's assignations, especially if the first assignee were to be unaware of the later assignation. We note too that assignees may be able to seek protection from their cedents by way of express provision in the contract of assignation.[75] The suggestions for reform which we have made above in relation to "entire agreement" clauses may also provide a way in which the risk perceived by our Advisory Groups could be minimised, if not altogether removed.[76]

7.33 The importance which our Advisory Groups attached to the protection of assignees, however, persuades us that the question should be put up for consultation. But we think that the question must be framed in the light of our re-casting of the relevant policy objective as being, not protection from secret meanings, but rather protection for those who rely upon apparent meaning. The policy objective would need to be framed in general legislative terms along the lines suggested in RIPL and the DCFR, that is to say, preventing reference to extrinsic material in questions with a third party where that party had reasonably relied on an apparent meaning and so covering the clear cases for protection of this kind such as negotiable instruments and *ius quaesitum tertio*.[77]

7.34 The difference such a general rule might make in the case of assignations would be that the assignee would have to show that an apparent meaning had been taken into account at the time of the assignation, as could be the case by way of examination of the contract documents during due diligence. Moreover, if due diligence meant that in fact the assignee knew about the extrinsic material affecting the meaning of the rights transferred,

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[73] See para 4.11.
[74] This principle will be discussed further in a forthcoming Discussion Paper on Moveable Transactions which we anticipate will be published later in 2011.
[75] We doubt whether the cedent's implied warranties that the assignation confers upon the assignee everything necessary to make the assignation effectual, that the debt assigned is subsisting, that the document of debt assigned cannot be reduced and that the cedent has right to the debt, can cover the situation under discussion.
[76] See paras 7.23-7.29.
[77] See paras 6.14 and 6.17-6.18.

then reliance upon the apparent meaning would be unreasonable and not protected.[78] We do not consider that, in practice, successful pleas by assignees as to their reasonable reliance on apparent meaning will be at all common. To give an illustration, an intra-group transfer of contractual rights by companies carried out for tax purposes might not involve any reliance at all by any of the parties on the apparent meanings of the contracts concerned; and equally the knowledge of the cedent company might well pass on to the assignee company by way of overlapping personnel. In neither case, in other words, would the court interpreting the contract be limited to its apparent meaning. Again, the assignee who simply acquired a large quantity of contractual rights without even checking the documentation (perhaps a debt factor, for example) would be bound by whatever meaning was subsequently given to them by a court.

7.35 In considering the most suitable policy in this commercially sensitive and important area, we are mindful that both RIPL and the DCFR do not allow assignees to claim reliance on the apparent meaning of a contract; they are treated as if they were contracting parties in this regard. This has the virtue of certainty, with the attendant practical benefit of precluding the need to investigate whether, in any given case, there was reliance on an apparent meaning. But it may not be universally regarded as fair. In order to ascertain views, we ask:

12. (a) Should there be a general rule stating that, where a third party has reasonably relied upon the apparent meaning of a written contract, a court may not make use of extrinsic evidence to determine the meaning of the contract in a question with that third party? We have already mentioned (at paragraphs 6.17-6.18 and 7.33) that such third parties may include those covered by *ius quaesitum tertio* and those taking rights under negotiable instruments; are any other categories to be included? (We deal below with assignees.)

(b) Do consultees agree with our provisional view (at paragraph 7.32) that an assignee is not a third party for the purpose of any such general rule? If you do not agree, we would appreciate specification of any reasonable reliance which an assignee might make on a contract's apparent meaning, and an indication of why the assignee should benefit from the general rule.

(2) Rules of preference

7.36 RIPL considered but in the light of consultation ultimately rejected enactment of "rules of preference" such as the *contra proferentem* rule and others. Some of these rules are, however, restated in the DCFR. It has been suggested judicially that the operation of the rules of preference should be reconsidered in the light of the contemporary approach to interpretation of contracts. In *Credential Bath Street Ltd v Venture Investment Placement Ltd*,[79] Lord Reed referred to "the various traditional canons of construction […] such as the *contra proferentem* principle and the principle that guarantees should be narrowly construed", and went on:

[78] This is stated explicitly in the DCFR: see paras 3.11-3.14 above.
[79] [2007] CSOH 208.

> "Canons of that kind require in my opinion to be reconsidered, and in some cases reformulated or discarded, in the light of the modern approach to the construction of contracts. As Lord Hoffmann observed in the *Investors Compensation Scheme* case at page 912, "Almost all the old intellectual baggage of 'legal' interpretation has been discarded." I note what was said by Arden LJ in *Egan v Static Control Components (Europe) Ltd* [2004] 2 Lloyds Rep 429, rejecting (at para 37) a submission that a guarantee should be construed *contra proferentem*: 'There is no reason of public policy why guarantees should not in general be construed in accordance with the principles enunciated in *Prenn v Simmonds* [1971] 1 WLR 1381 and the *ICS* case.'"[80]

7.37 An English commentator, Edwin Peel, has, however, suggested that the *contra proferentem* rule still:

> "has a role to play as a rule of last resort in cases where, after the ordinary rules of interpretation have been applied, there is an unresolved ambiguity. … [Also] it is permissible, for the purposes of interpretation only, to identify certain clauses as seeking to derogate from one party's 'basic obligation, or any common law duty which arises apart from contract' and to require of them a sufficiently clear indication that it was the parties' intention so to derogate."[81]

Another example where the rule is already found as enacted law is in favour of the consumer in the un-negotiated standard form contract the content of which the consumer has had no opportunity to influence.[82]

7.38 Thus in Mr Peel's view the *contra proferentem* rule at least should not be discarded. But non-enactment (as distinct from abolition) would still leave the rule (or principle, or canon of construction) and most of the other like rules available for use should appropriate cases continue to arise. It is anyway beyond the scope of the present exercise to propose repeal of the statutory version of the rule currently protecting consumers. We note that the Economic Impact Group on the DCFR believes that the rules are favoured by commercial parties and lower transaction costs.[83] We have therefore not been persuaded that there are strong arguments either for putting the rules of preference into legislative form or for abolishing them and their use outside the consumer protection field. We accordingly propose:

13. The rules of preference listed in the DCFR and RIPL, or some or any one of them, should not be put into legislative form.

7.39 We have noted above, however, that one of the DCFR's rules of preference, on which of different language versions of a contract is to be the governing document in case of discrepancies between them, may be seen as reflecting something of the realities of the international market place and not as a traditional rule established in the existing case law.[84] Specific enactment might therefore be helpful in this particular case as an indication that Scots law is not hostile to non-Anglophone business.

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[80] Ibid, para 38.
[81] Edwin Peel, "Whither *contra proferentem*?", in Burrows and Peel, pp 53-75.
[82] See para 7.29.
[83] See para 3.22.
[84] See para 3.21.

7.40 We therefore ask:

14. Should the suggested rule of preference on which of different language versions of a contract is to govern in the event of discrepancies between them be enacted?

(3) Unilateral juridical acts and statements

7.41 In Chapter 3 we noted that probably if the rules on interpretation of contracts were to be amended the relevant legislation would, like the DCFR, have to extend the new rules to the interpretation of unilateral juridical acts connected to contracts, such as statements made by individual parties in concluding contracts (offers, acceptances and so on), and also to unilateral promises.[85] Reference to common intention would, however, be otiose in relation to unilateral juridical acts. We would therefore propose:

15. The general rule of interpretation (that any statement is to be given the meaning reasonably to be given to it in its context having regard to the surrounding circumstances and the nature and purpose of the juridical act) should be applied *mutatis mutandis* to unilateral juridical acts.

7.42 In addition, we would welcome views on whether it is also necessary to apply this rule (again, *mutatis mutandis*) to the interpretation of statements forming part of either the negotiations leading up to a contract, or of the parties' conduct subsequent to the conclusion of the contract, even although these are not juridical acts. The significance of this would be to emphasise that the examination of such material is to establish not the parties' subjective intentions but what a reasonable person would have concluded from the statements in question. We therefore ask:

16. Ought the general rule of interpretation also to be applied (*mutatis mutandis*) to statements made by parties either during the course of pre-contractual negotiations or as part of conduct subsequent to the formation of a contract between them, when these statements are being considered as evidence relevant to the interpretation of the contract, even although these statements are not in themselves juridical acts?

(4) Rectification and personal bar

7.43 We have discussed in Chapter 5 certain aspects of the law of rectification and the law of personal bar, but only insofar as these topics might relate to any reforms of the law of interpretation;[86] specifically the extent to which the present law on rectification of documents provides a safety mechanism against injustice where the exclusionary rules of interpretation prevent the use of pre-contractual negotiations as evidence about the meaning of contractual expressions; and whether the law of personal bar can be developed to provide a further safety mechanism (akin to the English estoppel by convention) in cases where injustice may result from the exclusion of evidence either of pre-contractual negotiations or of parties' conduct after the formation of their contract.

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[85] See para 3.23.
[86] See paras 5.20 and 5.25-5.27.

7.44 A full examination of rectification and personal bar is, however, clearly beyond the scope of the current project. The reach of rectification extends far beyond contracts, while the scope of personal bar is even wider. To seek to reform either branch of the law in relation to only one of the areas upon which it touches would be ill-advised, and likely to result in un-necessary confusion. Indeed, it is not clear that the law of personal bar requires substantive reform at all. In consultation with our Advisory Groups, no representations have been made in favour of any reform in this area of law.

7.45 It does strike us, however, that, were a new scheme of interpretation to be implemented for contracts, rectification might be largely superseded as a legal remedy, as much evidence currently admissible only for purposes of rectification would become admissible for purposes of interpretation. We have also noted some uncertainty and division of opinion on whether rectification is available as a remedy in cases of unilateral error (as is the case in England).[87]

7.46 Therefore, in order to allow us to assess further the need for reform in these areas, we ask the following, final question:

17. Is it desirable to address in more depth aspects of either the law of rectification and/or the law of personal bar, and their implications for contractual interpretation (and, in particular, rectification for unilateral error)?

[87] See para 5.26.

Chapter 8 Questions and proposals

1. Do you have information or comments on any potential impacts either of the current law relating to the interpretation of contract or of reform of the law?

(Paragraph 1.21)

2. Do you (i) agree with, (ii) disagree with, or (iii) have anything to add to the views expressed in paragraphs 6.3 to 6.5?

(Paragraph 6.30)

3. Do you (i) agree with, (ii) disagree with, or (iii) have anything to add to the policy objectives expressed in paragraphs 6.8 to 6.29?

(Paragraph 6.30)

4. Should there be a legislative statement of the general rule of interpretation? The general rule would state that the meaning of an expression in an agreement is that which would reasonably be given to it in its context, taking account of the parties' common intention (determined objectively), the surrounding circumstances, and the nature and purpose of the agreement (again, both determined objectively). Ambiguity would not be a pre-requisite for consideration of the surrounding circumstances and the nature and purpose of the agreement. But a court would only consider surrounding circumstances where invited to do so by a party.

(Paragraph 7.9)

5. Should there be express legislative provision that a party's individual and direct statement of intention may be used as evidence of the meaning to be attributed to a contract only where, together with other relevant material, it contributes to the determination of the parties' common intention?

(Paragraph 7.11)

6. Should the courts be enabled to take account of relevant evidence about the parties' pre-contractual negotiations in determining their common intention under the contract?

(Paragraph 7.15)

7. Should there be a rule that in determining the common intention of the parties to a contract any expression forming part of the contract used by one party in a particular sense (whether or not used in that sense by any other party) should be interpreted in that sense if every other party at the time of contracting knew, or could reasonably have been assumed to know, that it was being used in that sense?

(Paragraph 7.17)

8. Should there be a rule that in determining the common intention of the parties to a contract evidence of any conduct of the parties subsequent to the conclusion of the contract showing a common understanding of the meaning of the contract should be admissible for the purpose of interpreting that contract?

(Paragraph 7.18)

9. What are the views of consultees on the issues of costs and certainty discussed in the preceding paragraphs (7.19-7.22)? Are there factors which that discussion does not consider, or to which it gives too much or too little weight? Is there any further specific information on these issues which would be helpful in developing our tentative views in any way?

(Paragraph 7.22)

10. Should parties be free to contract out of the proposed general default rule that all relevant evidence (including pre-contractual negotiations and parties' subsequent conduct) is admissible for the purpose of interpreting a contract? How might a rule allowing such contracting-out be framed?

(Paragraph 7.27)

11. Should there be a requirement that a clause excluding the use of extrinsic evidence (whether in whole or in part) in the interpretation of a contract must be individually negotiated in order to have conclusive effect on the matter?

(Paragraph 7.29)

12. (a) Should there be a general rule stating that, where a third party has reasonably relied upon the apparent meaning of a written contract, a court may not make use of extrinsic evidence to determine the meaning of the contract in a question with that third party? We have already mentioned (at paragraphs 6.17-6.18 and 7.33) that such third parties may include those covered by *ius quaesitum tertio* and those taking rights under negotiable instruments; are any other categories to be included? (We deal below with assignees.)

(b) Do consultees agree with our provisional view (at paragraph 7.32) that an assignee is not a third party for the purpose of any such general rule? If you do not agree, we would appreciate specification of any reasonable reliance which an assignee might make on a contract's apparent meaning, and an indication of why the assignee should benefit from the general rule.

(Paragraph 7.35)

13. The rules of preference listed in the DCFR and RIPL, or some or any one of them, should not be put into legislative form.

(Paragraph 7.38)

14. Should the suggested rule of preference on which of different language versions of a contract is to govern in the event of discrepancies between them be enacted?

(Paragraph 7.40)

15. The general rule of interpretation (that any statement is to be given the meaning reasonably to be given to it in its context having regard to the surrounding circumstances and the nature and purpose of the juridical act) should be applied *mutatis mutandis* to unilateral juridical acts.

(Paragraph 7.41)

16. Ought the general rule of interpretation also to be applied (*mutatis mutandis*) to statements made by parties either during the course of pre-contractual negotiations or as part of conduct subsequent to the formation of a contract between them, when these statements are being considered as evidence relevant to the interpretation of the contract, even although these statements are not in themselves juridical acts?

(Paragraph 7.42)

17. Is it desirable to address in more depth aspects of either the law of rectification and/or the law of personal bar, and their implications for contractual interpretation (and, in particular, rectification for unilateral error)?

(Paragraph 7.46)

Appendix A

Interpretation in private law

In this appendix we set out the material contained in the tables in Chapter 3, but without any intervening commentary.

DCFR	***RIPL***	***PICC 2004***
II.-4:104 Merger clause (1) If a contract contains an individually negotiated term stating that the document embodies all the terms of the contract (a merger clause), any prior statements, undertakings or agreements which are not embodied in the document do not form part of the contract. (2) If the merger clause is not individually negotiated it establishes only a presumption that the parties intended that their prior statements, undertakings or agreements were not to form part of the contract. This rule may not be excluded or restricted. (3) The parties' prior statements may be used to interpret the contract. This rule may not be excluded or restricted except by an individually negotiated term. (4) A party may by statements or conduct be precluded from asserting a merger clause to the extent that the other party has reasonably relied on such statements or conduct.	**Clause 2 of the draft Bill**: 2 Evidence of any description relevant to the interpretation of a juridical act shall be admissible notwithstanding that it is extrinsic evidence. **Contract (Scotland) Act 1997, section 1** **Extrinsic evidence of additional contract term etc** 1(3) … where one of the terms in the document (or in the documents) is to the effect that the document does (or the documents do) comprise all the express terms of the contract or unilateral voluntary obligation, that term shall be conclusive in the matter.	**2.1.17 Merger clauses** A contract in writing which contains a clause indicating that the writing completely embodies the terms on which the parties have agreed cannot be contradicted or supplemented by evidence of prior statements or agreements. However, such statements or agreements may be used to interpret the writing.

II.-8:101 General rules (1) A contract is to be interpreted according to the common intention of the parties even if this differs from the literal meaning of the words. **II.-8:102 Relevant matters** (1) In interpreting the contract, regard may be had, in particular, to: (a) the circumstances in which it was concluded, including the preliminary negotiations; (b) the conduct of the parties, even subsequent to the conclusion of the contract; (c) the interpretation which has already been given by the parties to terms or expressions which are the same as, or similar to, those used in the contract and the practices they have established between themselves; (d) the meaning commonly given to such terms or expressions in the branch of activity concerned and the interpretation such terms or expressions may already have received; (e) the nature and purpose of the contract; (f) usages; and (g) good faith and fair dealing. (3) In a question with a person, not being a party to the contract or a person who by law has no better rights than	**General rule (Schedule to draft Bill)** 1(1) Any expression which forms part of a juridical act shall have the meaning which would reasonably be given to it in its context; and in determining that meaning, regard may be had to - (a) the surrounding circumstances; and (b) in so far as they can be objectively ascertained, the nature and purpose of the juridical act. (2) For the purposes of this rule the surrounding circumstances do not include – (a) statements of intention; (b) instructions, communings or negotiations forming part of the process of preparation of the juridical act; (c) conduct subsequent to the juridical act. (3) The rule set out in sub-paragraph (1) above is referred to in this Schedule as "the general rule".	**4.1 Intention of the parties** (1) A contract shall be interpreted according to the common intention of the parties. (2) If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the circumstances. **4.3 Relevant circumstances** In applying Articles 4.1 and 4.2, regard shall be had to all the circumstances, including (a) preliminary negotiations between the parties; (b) practices which the parties have established between themselves; (c) the conduct of the parties subsequent to the conclusion of the contract; (d) the nature and purpose of the contract; (e) the meaning commonly given to terms and expressions in the trade concerned; (f) usages.

such a party, who has reasonably and in good faith relied on the contract's apparent meaning, regard may be had to the circumstances mentioned in paragraphs (a) to (c) above only to the extent that those circumstances were known to, or could reasonably be expected to have been known to, that person. **II.-8:105 Reference to contract as a whole** Terms and expressions are to be interpreted in the light of the whole contract in which they appear.		**4.4 Reference to contract or statement as a whole** Terms and expressions shall be interpreted in the light of the whole contract or statement in which they appear.
II.-8:101 General rules (2) If one party intended the contract, or a term or expression used in it, to have a particular meaning, and at the time of the conclusion of the contract the other party was aware, or could reasonably be expected to have been aware, of the first party's intention, the contract is to be interpreted in the way intended by the first party. (3) The contract is, however, to be interpreted according to the meaning which a reasonable person would give to it: (a) if an intention cannot be established under the preceding paragraphs; or (b) if the question arises with a person, not being a party to the contract or a person who by law has no better rights than such a party, who has reasonably and in good faith	**Contracts** 2(1) Any expression which forms part of a contract shall be interpreted in accordance with the general rule unless the rule in sub-paragraph (2) below has effect. (2) Subject to sub-paragraph (3) below, any expression forming part of a contract which is used by one party in a particular sense (whether or not it is also used in that sense by any other party) shall be interpreted in that sense if every other party at the time of contracting knew, or could reasonably have been assumed to know, that it was being used in that sense. (3) Sub-paragraph (2) above does not apply – (a) to a contract which is	**4.2 Interpretation of statements and other conduct** (1) The statements and other conduct of a party shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention. (2) If the preceding paragraph is not applicable, such statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.

relied on the contract's apparent meaning. **II.-8:102 Relevant matters** (3) In a question with a person, not being a party to the contract or a person who by law has no better rights than such a party, who has reasonably and in good faith relied on the contract's apparent meaning, regard may be had to the circumstances mentioned in paragraphs (a) to (c) above only to the extent that those circumstances were known to, or could reasonably be expected to have been known to, that person.	recorded, or intended by the parties to be recorded, in the Register of Sasines or which is presented, or is intended by the parties to be presented, in support of an application for registration in the Land Register; or (b) in any question with a person, not being a party to the contract, who has reasonably relied on the meaning which would be given to the expression by the application of the general rule.	
II.-8:103 Interpretation against supplier of term or dominant party (1) Where there is doubt about the meaning of a term not individually negotiated, an interpretation of the term against the party who supplied it is to be preferred. (2) Where there is doubt about the meaning of any other term, and that term has been established under the dominant influence of one party, an interpretation of the term against that party is to be preferred.	(2) Where, in an onerous juridical act, terms supplied by one party are unclear, there is a preference for their interpretation against that party.	**4.6 *Contra proferentem* rule** If contract terms supplied by one party are unclear, an interpretation against that party is preferred.
II.-8:104 Preference for negotiated terms Terms which have been individually negotiated take preference over those which have not.	(6) A construction which gives effect to separately negotiated terms is preferred to one which gives effect to standard terms not separately negotiated.	

II.-8:106 Preference for interpretation which gives terms effect An interpretation which renders the terms of the contract lawful, or effective, is to be preferred to one which would not.	(1) A construction of the juridical act which gives effect to all its terms is preferred to one which does not. (9) There is a preference for a construction which leads to results which are lawful, fair and reasonable.	**4.5 All terms to be given effect** Contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect.
II.-8:107 Linguistic discrepancies Where a contract document is in two or more language versions none of which is stated to be authoritative, there is, in case of discrepancy between the versions, a preference for the interpretation according to the version in which the contract was originally drawn up.	(10) Where a juridical act is executed in two or more linguistic versions, and where it does not itself provide a rule for resolving discrepancies between them, there is, in case of discrepancy, a preference for construction according to the version in which the act was originally drawn up.	**4.7 Linguistic discrepancies** Where a contract is drawn up in two or more language versions which are equally authoritative, there is, in case of discrepancy between the versions, a preference for the interpretation according to a version in which the contract was originally drawn up.
Interpretation of other juridical acts **Article II.-8:201: General rules** (1) A unilateral juridical act is to be interpreted in the way in which it could reasonably be expected to be understood by the person to whom it is addressed. (2) If the person making the juridical act intended the act, or a term or expression used in it, to have a particular meaning, and at the time of the act the person to whom it was	**[NB From draft Bill annexed to Scot Law Com No 144,[1] not RIPL]** 3(1) … statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was. 3(2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a	**4.2 Interpretation of statements and other conduct** (1) The statements and other conduct of a party shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention. (2) If the preceding paragraph is not applicable, such statements and other conduct shall be interpreted according to

[1] Report on Formation of Contract: Scottish Law and the United Nations Convention on Contracts for the International Sale of Goods (Scot Law Com No 144, 1993).

addressed was aware, or could reasonably be expected to have been aware, of the first person's intention, the act is to be interpreted in the way intended by the first person. (3) The act is, however, to be interpreted according to the meaning which a reasonable person would give to it: (a) if neither paragraph (1) or paragraph (2) applies; or (b) if the question arises with a person, not being the addressee or a person who by law has no better rights than the addressee, who has reasonably and in good faith relied on the contract's apparent meaning. **II.-8:202: Application of other rules by analogy** The provisions of Section 1, apart from its first Article, apply with appropriate adaptations to the interpretation of a juridical act other than a contract.	reasonable person of the same kind as the other party would have had in the same circumstances. 3(3) In determining the intent of a party or the understanding that a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.	the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.

Appendix B

Advisory Groups

I Practitioners and academics

Neil Anderson, Solicitor
Garry Borland, Faculty of Advocates
Professor Eric Clive, University of Edinburgh
Joyce Cullen, Solicitor-Advocate
Chris Dun, Solicitor
Laura Macgregor, University of Edinburgh
James McLean, Solicitor
Lindy Patterson QC, Solicitor-Advocate
Donald Reid, Solicitor
Kenneth Robertson, Solicitor
Sean Smith, Faculty of Advocates
Carolina Viola, Solicitor
James Wolffe QC, Faculty of Advocates

II Judges

The Hon Lord Glennie
The Hon Lord Hodge
The Rt Hon Lord Reed

III Business interests

Gordon Bathgate, Scott Wilson Construction Ltd
Colin Borland, Federation of Small Businesses in Scotland
Donna Brown, In-House Legal Counsel, RES Ltd
Nick Brown, Wood Group Engineering (North Sea) Ltd
Vic Emery, Glasgow Chamber of Commerce
Ken Graham, Head of Legal & Democratic Services, Renfrewshire Council
Professor Russel Griggs OBE, Confederation of British Industry
Professor Nick Kuenssberg OBE, Horizon Co-Invest Ltd
Iain Moore, Scottish Procurement Directorate, Scottish Government
Angela Salmons, Head of Procurement, Scottish Borders Council
Derek Waddell, Edinburgh Research and Innovation Ltd
Steve Weatherley, Commercial Counsel, William Grant & Sons Ltd

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Professor Bénédicte Fauvarque-Cosson, University of Paris II, France
Mme Juliette Gest, Ministry of Justice, France
James Mure QC, Faculty of Advocates
Professor Tjakie Naude, University of Cape Town, South Africa

Dr Eoin O'Dell, Trinity College Dublin, Ireland
Professor Jacques du Plessis, University of Stellenbosch, South Africa
Anna Spies, Australian Law Reform Commission
Peter Webster, Judicial Assistant, UK Supreme Court

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