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Insurance Newsbites

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THE PRAGMATIC CONSTRUCTION AND RECTIFICATION OF DOCUMENTS – LORD HOFFMAN'S LAST HURRAH!

The House of Lords handed down judgment yesterday in *Chartbrook Ltd v Persimmon Homes Ltd*. They allowed Persimmon's appeal, upholding Lawrence Collins LJ's dissenting interpretation of the relevant contractual term in their favour. They did this unanimously as a question of simple construction, reorganising the syntax of the clause in question to give commercial sense to the agreement.

Lord Hoffman, with whom the other law lords agreed, went on to review the exclusionary rule by which evidence of pre-contractual negotiations is inadmissible as an aid to the construction of a contract. He concluded that there was no clearly established case for departing from the rule. He also considered obiter the requirements for a rectification claim and reframed the test to be applied. For the full judgment go to http://www.bailii.org/uk/cases/UKHL/2009/38.html.

In this issue:

- The House of Lords' decision
- Background
- Briggs J's decision
- The Court of Appeal's decision
- The House of Lords' decision

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The House of Lords' decision

In *Persimmon* the House of Lords has done three things:

1. reaffirmed and followed *Investors Compensation Scheme Ltd v West Bromwich Building Society* allowing courts in exceptional cases to to apply commonsense where the words used include an obvious mistake;
2. reaffirmed the "exclusionary rule" relating to the construction of documents, excluding from consideration pre-contract evidence; and
3. prompted an extension to the remedy of rectification in "consensus cases", adopting an objective test informed by evidence of pre-contractual negotiations.

Background

Chartbrook and Persimmon entered into a residential property development agreement in 2001. Chartbrook owned the site and Persimmon agreed to develop it. The dispute between them turned on the meaning of an element of the price defined as the "Additional Residential Payment" in a schedule to the agreement. It is apparent that this payment was intended to provide Chartbrook with a share of additional profit if sale prices exceeded those anticipated at the time of the agreement.

The clause in question read: "Additional Residential Payment (ARP) means 23.4 per cent of the price achieved for each residential unit in excess of the minimum guaranteed residential unit value (MGRUV) less the costs and incentives (C&I)." Chartbrook argued that it was entitled to 23.4 per cent of the net proceeds of sale of each residential unit in excess of the minimum guaranteed amount. The ARP on this basis, described as "super overage," amounted to £4.6 million.

Persimmon's case was that the ARP to which Chartbrook was entitled was the amount by which 23.4 per cent of the sales revenue exceeded the MGRUV. It argued that according to this interpretation the ARP was £900,000.

Briggs J's decision

Persimmon argued its case on the basis either of construction or rectification. It wished to rely on evidence of the parties' negotiations to support its interpretation of the meaning of ARP. The judge rejected Persimmon's construction of the clause and refused to have recourse to the pre-contractual negotiations or to use the so-called "private dictionary" exception to the general rule that evidence of negotiations is not admissible as an aid to contractual construction.

He also rejected Persimmon's claim for rectification. The burden was on Persimmon to prove that there was clear and unambiguous evidence that a mistake had been made in recording the parties' intention. Both parties need to have been mistaken about whether the written agreement reflected what their prior consensus had been. Where only one party has made a mistake, the other will be precluded from resisting a claim for rectification where it knew of the other's mistake.

The problem for Persimmon was that the judge was impressed by Chartbrook's witnesses. To allow the claim for rectification, he would have had to find that they had not honestly believed that the definition (as they claimed to have understood it) was what had been agreed and that they had behaved dishonourably by deceiving Persimmon and by lying to the court. He was unable to do this on the evidence he had heard and concluded therefore that Persimmon had failed to prove its claim for rectification.

The Court of Appeal's decision

The Court of Appeal, by a majority, upheld the judge's ruling on the construction of the clause. They concluded that the words used to define ARP were clear and unambiguous. Persimmon's interpretation required the clause to be radically redrafted as follows:

"ARP means *the amount (if any) by which* 23.4 per cent of the price achieved for each residential unit less the [C&I] is in excess of the MGRUV"

This redrafting could not be justified on the basis of other words in the agreement and by reference to the factual matrix. As for Persimmon's argument that the court should have recourse to the pre-contractual negotiations, they were unanimous that they were out of bounds in this case.

The Court of Appeal also dismissed the appeal on rectification. As the judge had found, it was an unusual and difficult case. On the face of it there was a strong case for rectification, since all the contemporary documents, excluding drafts of the agreement and every piece of paper which threw light on the commercial purpose of the provision supported Persimmon's case. But given the judge's careful findings based on the evidence before him, the court would not interfere with his decision.

The House of Lords' decision

In what is thought to be Lord Hoffman's last case as a law lord, the House of Lords unanimously allowed the appeal of Persimmon. The leading speeches were given by Lord Hoffman and Lord Walker of Gestingthorpe, with which the other law lords agreed.

Whilst accepting that the relevant words were clear and unambiguous, Lords Hoffman and Walker both concluded, by slightly different routes, that to interpret the definition of the ARP in accordance with the ordinary rules of syntax makes no commercial sense.

The earlier House of Lords' decision of *Investors Compensation Scheme Ltd v*

West Bromwich Building Society, in which the leading speech was made by Lord Hoffman, allows the courts in exceptional cases to apply commonsense where the words used include an obvious mistake, taking into consideration the background and context. Lord Hoffman states that "...this appears to be an exceptional case in which the drafting was careless and no one noticed".

Having consideration to the background and context, in particular a letter that set out the intention of the parties, the House of Lords construed the agreement to interpret the ARP as contended by Persimmon.

On reaching this conclusion it was unnecessary for the speeches to go further. Lord Hoffman chose to do so on the basis that two further important points of law were raised in argument and deserved consideration. These were (1) whether the "exclusionary rule", under which evidence of pre-contractual negotiations is not admissible in relation to the construction of documents and (2) whether Persimmon would have been entitled to rectify the document to reflect its contended meaning of the ARP (had the agreement not been construed as it contended).

As regards the exclusionary rule Lord Hoffman, after detailed consideration of relevant cases and academic opinion, stated that ".there is no clearly established case for departing from the exclusionary rule".

The position in relation to rectification is more interesting. Baroness Hale of Richmond endorsed the approach adopted by Lord Hoffman, which she summarised as follows:

"If the test of the parties' continuing intentions is an objective one, then the court is looking to see whether there was such a consensus and if so what it was. Negotiations where there was no such consensus are indeed 'unhelpful'. But negotiations where consensus was reached are very helpful indeed. If the language in the eventual contract does not reflect that consensus, then unless there has been a later variation of it, the formal contract should be rectified to reflect it. It makes little sense if the test for construing their prior consensus is different from the objective test for construing their eventual contract. This situation is, and should be, quite different from the situation where one part is mistaken as to its meaning and the other party knows this - the latter should not be permitted to take advantage of the former."

This approach appears to be an extension of the law relating to rectification. It provides that if a consensus has been reached but there is a dispute as to whether that consensus is reflected by the written agreement, evidence of the negotiations is admissible and may assist the court in reaching its objective conclusion. Lord Hoffman makes it clear that such evidence is likely to be witness evidence.

A fitting finale for Lord Hoffman, creative and influential to the end!