The Interpretation Of Contracts:
The Rules Re-Written For Modern Times

a presentation by

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at 39 Essex Street
Wednesday 31st March 2004

Introduction...........................................................................................................2

The Modern Rules of Contractual Interpretation..................................................5

What is the scope of Lord Hoffman’s Five Principles of interpretation?.........9

(a) The First Principle: The Intention of the Parties Is Objective...............................9
(b) The Second Principle: The ‘Matrix of Facts’ ......................................................12
(c) The Third Principle: The Exclusions From the ‘Matrix of Facts’ ..........................14
(d) The Fourth Principle: The Words Of A Contract Do Not Necessarily Mean what They Say 17
(e) The Fifth Principle: Something Must Have Gone Wrong With the Language ..........18

The Five Principles and Exclusion Clauses..........................................................19
Introduction

The conflict between literalism and purposiveness

Disputes about the meaning of contracts are one of the largest sources of contractual litigation. Throughout the 20th century the clash in such litigation was often between the literal and purposive approach to the construction of contracts. The literal approach held sway. Even when such an influential figure such as Lord Wilberforce firmly placed himself in the purposive school of interpretation the principles of interpretation, which had prevailed since the middle of the 1800, retained a strong following.

It is perhaps surprising that literalism held sway for such a long period. The truth is that no words have a fixed or settled meaning. Language is inherently uncertain. The plain meaning of a writing can almost never be plain except in a context. This point was graphically illustrated by Holmes J. in *Towne v Eisner*¹ where he stated that “A word is not a crystal, transparent and unchained, it is the skin of the living thought and may vary greatly in colour and content according to the circumstances and time in which it is used”.

In the last few years the ‘rules of construction of contract have ... begun to experience seismic disturbances at the hands of the House of Lords”². This ‘seismic disturbance’ has marked a shift away from the ‘literalist approach’ to interpretation to the ‘purposive’ approach.

What is literalism?

Two examples.

C The tyrant Temures promised the garrison of Sebastia that no blood would be shed if

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¹ 245 US 418, 425 (1918)
² PV Baker (1998) 114 LQR 55
they surrendered to him. He shed no blood. He buried them alive.³

Hankey v Clavering⁴. Under the terms of a lease for 21 years from December 25, 1935 either party could determine the lease at the end of seven years on giving six months’ notice. The landlord gave the tenant a notice as from June 21, 1941, purporting to determine the lease on December 21, 1941. In holding the notice invalid, Lord Greene M.R. said:

“The whole thing was obviously a slip on [the landlord’s] part, and there is a natural temptation to put a strained construction on language in aid of people who have been unfortunate enough to make slips. That, however, is a temptation which must be resisted, because documents are not to be strained and principles of construction are not to be outraged to do what may appear to be fair in individual cases”

and

“It is perfectly true that in construing such a document as in construing all documents, the court in a case of ambiguity will lean in favour of reading the document in such a way as to give it validity, but I dissent entirely from the proposition that where a document is clear and specific, but inaccurate on some matter, such as that of date, it is possible to ignore the inaccuracy and substitute the correct date or other particular because it appears that the error was inserted by a slip”.

The meaning of a contract was to be found within its four corners. This approach had its advantages. First, there was certainty: the task of the court was to consider the contract and the meaning of the words and adjudicate upon the meaning of those words. Secondly, resolution of the dispute was quick and inexpensive: extrinsic evidence was not permissible to explain the meaning of the words. The dispute was resolved on the basis of the contractual documents alone.

The remnants of literalism have now, however, been swept away by a trilogy of cases in the House of

Lords which establish the predominance of the purposive approach. These cases are *Mannai Investment Co Ltd. v Eagle Star Assurance Co. Ltd*[^4], *Investors Compensation Scheme Ltd. v West Bromwich Building Society*[^5] (which was handed down 6 weeks after *Mannai*) and *Bank of Credit and Commerce International SA v Ali*[^6]. The effect of these decisions is that ‘Almost all the old intellectual baggage of “legal” interpretation has been discarded”[^8].

With hindsight the movement from literalism to purposiveness is to be found in *Prenn v Simmonds*[^9]. The dispute between the parties was as to the meaning of the word ‘profit’ in an agreement concluded under seal. Lord Wilberforce, who gave the only reasoned judgment, said:

> “In order for the agreement ... to be understood, it must be placed in context. The time has long passed when agreements, even those under seal, were isolated from the matrix of the facts in which they were set and interpreted purely on internal linguistic considerations ... We must ... inquire beyond the language and see what the circumstances were with reference to which words were used, and the object, appearing from those circumstances, which the person using them had in view ... In my opinion, then... evidence should be restricted to evidence of the factual background known to the parties at or before the date of the contract, including evidence of the ‘genesis’ and objectively the ‘aim of the transaction’.

Lord Wilberforce returned to the issue in *Reardon Smith Line v Hansen-Tangen*[^10] where he said:

> “No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as the ‘surrounding circumstances’ but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right 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

[^4]: [1942] 2 K.B. 326
[^5]: [1997] 2 W.L.R. 945
[^6]: [1998] 1 W.L.R. 896
[^8]: *Investors Compensation Scheme Ltd v West Bromwich Building Society* op.cit. per Lord Hoffman at p.912.
are operating... What the court must do must be to place itself in thought in the same factual matrix in which the parties were.”

The purpose of this talk is to explore the modern rules as now formulated by the House of Lords.

The Modern Rules of Contractual Interpretation

In *Investors Compensation Scheme Ltd. v West Bromwich Building Society* Lord Hoffman sought to re-state the principles by which contractual documents are to be interpreted. He first emphasised the ‘fundamental change’ that had overtaken this branch of the law, ‘particularly as a result of *Prenn v Simmonds* and *Reardon Smith Line Ltd v Hansen-Tangen*. It was his view that this change had not always been sufficiently appreciated. He went on to re-state the principles as follows:

“The principles may be summarised as follows:

1. 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.

2. The background was famously referred to by Lord Wilberforce as the ‘matrix of fact’, but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

3. The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy.
and, in this respect only, legal interpretation differs from the way we would interpret
utterances in ordinary life. The boundaries of this exception are in some respects
unclear. But this is not the occasion on which to explore them.

(4) The meaning which a document (or any other utterance) would convey to a
reasonable man is not the same thing as the meaning of its words. The meaning of
words is a matter of dictionaries and grammars; the meaning of the document is what
the parties using those words against the relevant would reasonably have been
understood to mean. 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 (see Mannai Investment Co. Ltd. v
Eagle Star Life Assurance Co Ltd ...)

(5) The ‘rule’ that words should be given their ‘natural and ordinary meaning’ reflects
the commonsense proposition that we do not easily accept that people have made
linguistic mistakes, particularly in formal documents. On the other hand, if one
would nevertheless conclude from the background that something must have gone
wrong with the language, the law does not require judges to attribute to the parties an
intention which they plainly could not have had.

So stated, the ‘background’ or ‘surrounding circumstances’ or ‘matrix of facts’ assumes an important
position in the interpretation of contracts. It is this ‘background’ that gives colour and meaning to the
words of a contract and which is capable of transforming a seemingly clear contract into one with
many different shades and meaning.

*Investors Compensation Scheme* is a striking example of the application of the principle that the
courts will have regard to what the parties agreed, as opposed to what the words of the document
state. The case had at its heart the construction of a clause in claim form. The clause (which has now
been abandoned) formed part of the terms upon which the victims of mis-selling “Home Income
Plans” could obtain compensation. Home Income Plans had been marketed by financial advisers in
conjunction with certain building societies during the late 1980's. It involved the owners mortgaging their homes with such building societies to secure advances, at enhanced rates of interest, which were then invested in equity-linked bonds. The subsequent fall in equities and house prices and the rise in interest rates caused the owners severe losses. The financial advisers having become insolvent, the investors lodged claims for compensation with Investors Compensation Scheme Ltd. The scheme’s claim form (drafted by ICS) required the investor to assign to the ICS all rights arising out of the transaction against the financial advisers and anyone else. However, section 3(b) of the claim form excepted from assignment

“Any claim (whether sounding in rescission for undue influence or otherwise) that you have or may have against the West Bromwich Building Society in which you claim an abatement of sums which you would otherwise have to pay to that Society in respect of sums borrowed by you from that Society in connection with the transaction and dealings giving rise to the Claim (including interest on any such sums).”

The ICS also provided an explanatory note to the claim form, the relevant part of which stated:

“4. You also agree that I.C.S. should be able to use any rights which you now have against anyone else in relation to the claim. Examples might be directors of the firm or other persons also responsible for causing loss for which you are being compensated. You give up all those rights and transfer them to I.C.S...”

The investors brought proceedings against the West Bromwich Building Society (“WBBS”) seeking damages for negligence, misrepresentation and rescission of their mortgages. ICS also commenced proceedings against WBBS in which it asserted that the investors had assigned to it all their claims against WBBS. The question arose whether section 3(b) meant there had not been a valid assignment of investors’ rights against the building society.
Both Lord Lloyd, dissenting in the House of Lords, and the Court of Appeal were of the opinion that it was impermissible to resort to surrounding facts to alter the intention of the parties as ascertained from the words of the claim form. In his view the plain meaning of the clause was that all claims against the building society were excepted, so the claims against the WBBS had been retained by investors, and the commercial result of his interpretation was consonant with the terms of the Claim form. He stated\textsuperscript{12}:

quote
“I know of no principle of construction ... which would enable the court to take words from within the brackets, where they are clearly intended to underline the width of ‘any claim’, and place them outside the brackets where they have the exact opposite effect ... Purposive interpretation of a contract is a useful tool where the purpose can be identified with reasonable certainty. But creative interpretation is another thing altogether. The one must not be allowed to shade into the other.”

endquote

Lord Hoffman (with whom the majority agreed) concluded that all claims for damages and compensation had been validly assigned to ICS. His view was that the phrase ‘Any claim (whether sounding in rescission for undue influence or otherwise) was actually used by the parties to mean ‘Any claim sounding in rescission (whether undue influence or otherwise)’. Thus ICS, and not the investors, could bring a claim for damages but the investors had retained the right to claim rescission of the mortgages. Lord Hoffman stated his reasons as follows:

quote
“... First, the claim form was obviously intended to be read by lawyers and the explanatory note by laymen. It is the terms of the claim form which govern the legal relationship between the parties. But in construing the form, I think that one should start with the assumption that a layman who read the explanatory note and did not venture into the claim form itself was being given an accurate account of the effect of the transaction. It is therefore significant that paragraph 4 of the note says categorically and without qualification that the investor gives up all his rights against anyone else and transfers them to..."

endquote

\textsuperscript{12} op. cit. at 105.
ICS. If the effect of the claim form was that the investor retained his claim against the building society, paragraph 4 of the note was very misleading. Secondly, this leads to the conclusion that section 3(b) was intended only to deal with the possibility that a lawyer might argue that some right was a ‘claim’ when it would not be regarded as a claim by a layman. This is a fair description of the possibility of a reduction of the mortgage debt as part of the equitable taking of accounts upon rescission, which would not result in the investor receiving any money but merely having to pay less to WBBS. Thirdly, any lawyer would think it extremely odd for the ICS to take an assignment of the investor’s claim for damages against the solicitors and leave the investor with a claim for the same damages against WBBS. He would be likely to wonder whether this was conceptually possible and, as I shall explain, I think that his doubts would be well founded. The investor and the ICS could not between them recover more than the loss which the investor had actually suffered. As a matter of common sense, one would therefore expect that the ICS either had a right to damages or it did not. It would seem eccentric to leave this question to be decided (if such a thing were possible) by a race to judgment. Fourthly, no lawyer in his right mind who intended simply to say that all claims against WBBS were reserved to the investor would have used the parenthesis. Nor, unless he intended to limit the reservation to the amount, if any, which happened to be outstanding on the mortgage, would have described them as claims ‘in which you claim an abatement of the sums which you would otherwise have to repay’. And it is difficult to think of any reason for such an arbitrary limitation.’

What is the scope of Lord Hoffman’s Five Principles of interpretation?

(a) The First Principle: The Intention of the Parties Is Objective

The courts are concerned with ascertaining the intention of the parties. The starting point for this inquiry is: what would the document (or any other utterance) convey to a reasonable man? Generally the law is not concerned with the subjective expectations of a party. The understanding of the agreement which will be protected by the courts, will be that, which, in an objective sense, is common to both parties. The objective intention of the parties is to be ascertained from the document itself (or utterance, if the contract is oral) and the admissible background knowledge which could reasonably
have been available to the parties in the situation in which they were at the time of the contract. This approach to ascertaining the objective intention of the parties means that a particular clause might be said to have a plain meaning. The context, the commercial objective of the contract and its contractual matrix, however, may point away from that meaning. If examination of the objective contractual context indicates that the intention of the parties is other than the plain meaning of the agreement the court will give effect to that intention even if this involves departing from or qualifying particular words used: see for example *ICS v West Bromwich*.

The objective approach is further demonstrated by *Mannai Investment Co. Ltd. v Eagle Star Assurance Co. Ltd* in which the literal approach to contractual notices established by *Hankey v Clavering* was overruled. Two leases were granted in 1992 for fixed terms ‘of 10 years subject to the provisions of Clause 7(13) hereof from and including 13 January 1992 from and including 13 January 1992’. Clause 7(13) of each of lease provided as follows:

> “The tenant may by serving not less than six months notice in writing on the landlord or its solicitors such notice to expire on the third anniversary of the term commencement date determine this lease and upon expiry of such notice this lease cease and determine and have no further effect...”

After grant of the lease market rents fell substantially and the tenant decided to terminate the leases. By letters dated 24 June 1995, the tenant gave notices in the following form:

> “Pursuant to clause 7(13) of the lease we as tenant hereby give notice to you to determine the lease on 12 January 1995.”

In specifying January 12 as the date of termination the tenant made a mistake, confusing the date of termination of the first three years (12 January) with the third anniversary of its term commencement date (13 January). The Court of Appeal allowed the landlord’s appeal, holding that a notice stated to...
take effect on 12 January could not operate to determine the lease on 13 January and that the notices served on the tenant were ineffective. In the House of Lords, Lord Goff and Lord Jauncey saw no reason from departing from the literalist approach adopted by the Court of Appeal in *Hankey v Clavering*. However, the majority held that the latter case no longer represented the law. Lord Steyn, rejecting the Court of Appeal’s literalist approach, stated:

“...the inquiry is objective: the question is what reasonable persons, circumstanced as the actual parties were, would have in mind. It follows that one cannot ignore that a reasonable recipient of the notices would have had in the forefront of his mind the terms of the leases.”

Applying that test, Lord Steyn concluded:

“Crediting a reasonable recipient with knowledge of the terms of the lease and third anniversary date (13 January), I venture to suggest that it is obvious that a reasonable recipient would have appreciated that the tenant wished to determine the leases on the third anniversary date of the leases but wrongly described it as the 12th instead of the 13th. The reasonable recipient would not have been perplexed in any way by the minor error in the notices.”

Lord Steyn described this approach as “a shift towards commercial interpretation”:

“The reason for this approach is that a commercial construction is more likely to give effect to the intention of the parties. Words are therefore interpreted in the way in which a reasonable commercial person would construe them. And the standard of the reasonable commercial person is hostile to technical interpretations and undue emphasis on the niceties of language. In contrast to the modern approach Lord Greene M.R.’s judgment in *Hankey v Clavering* ... is rigid and formalistic.”

14 Op cit.
15 op cit. at 770G-H
Lord Hoffman’s approach\(^{16}\) was similar to that of Lord Steyn’s:

“In the case of commercial contracts, the restriction on the use of background has been quietly dropped. There are certain special kinds of evidence, such as previous negotiations and express declaration of intent which for practical reasons which it is unnecessary to analyse, are inadmissible in aid of construction. They can be used only in an action for rectification. But apart from these exceptions, commercial contracts are construed in the light of all the background which could reasonably have been expected to have been available to the parties in order to ascertain what would objectively have been understood to be their intention...”

\(\textbf{(b) The Second Principle: The ‘Matrix of Facts’}\)

Under the second principle heading the task is to ascertain the intention of the parties by considering the disputed contractual term in its contextual dimension. Thus, undue emphasis should not be placed upon a particular word, phrase, sentence or clause of a contract.

First, the terms of a contract should be considered within the context of the contract as a whole, including recitals.

Secondly, even where the words of the contract are capable of literal application there is no obstacle to a party adducing evidence to show that, construed in the light of the factual background to the making of the contract, the words bear a different meaning to a reasonable person. Indeed, it would appear that there is an onus on the court to consider the words within the context of the surrounding circumstances. In \textit{R (Westminster City Council v National Asylum Service}\(^ {17}\), Lord Steyn\(^ {18}\) emphasised this point:

“The starting point is that language in all legal texts conveys meaning according to the circumstances in which it was used. \textit{It follows that the context must always be identified and considered before the}}
process of construction or during it. It is therefore wrong to say that the court may only resort to

evidence of the contextual scene when ambiguity has arisen... In Investors Compensation Scheme Ltd v
West Bromwich Building Society... Lord Hoffman made crystal clear that an ambiguity need not be
established before surrounding circumstances may be taken into account.” [emphasis added]

The scope of the admissible background evidence has, however, been the most controversial aspect of
the Five Principles laid down by Lord Hoffman in ICS v West Bromwich.

In ICS v West Bromwich Lord Hoffman was of the view that “Subject to the requirement that it should
have been reasonably available to the parties [the admissible background facts] ... includes absolutely
anything which would have affected the way in which the language of the document would have been
understood by a reasonable man.”

In Bank of Credit and Commerce International v Ali Lord Hoffman clarified what he meant by
‘absolutely anything’ when considering the admissible background facts. He stated that:

“I did not think it necessary to emphasise that I meant anything which a reasonable man would have
regarded as relevant. I was merely saying that there is no conceptual limit to what can be regarded as
background. It is not, for example, confined to the factual background but can include the state of the
law (as in cases in which one takes into account that the parties are unlikely to have intended to agree to
something unlawful or legally ineffective) or proved common assumptions which were in fact quite
mistaken ... I was certainly not encouraging a trawl through ‘background’ which could not have made
reasonable person think that parties must have departed from conventional usage.”

This approach is consonant with that adopted six weeks earlier in Mannai. In the latter case Lord
Steyn was of the view that:

19 [2002] 1 A.C. 251
20 op. cit. at paragraph 39
21 op. cit.
“...what is *admissible* as a matter of the rules of evidence...is what is arguably relevant. But admissibility is not the decisive matter. The real question is what evidence of surrounding circumstances may ultimately be allowed to influence the question of interpretation. That depends on what meanings the language read against the objective contextual scene will let in.”

Lord Steyn therefore appears to envisage a three stage process. First, *relevant* contextual evidence must be identified. Against that background the possible meanings of language is determined. Finally, the court determines the evidential weight to be given to the relevant evidence to determine which meaning a reasonable person would have had in mind.

At the third of these stages the overall commercial purpose of the parties with respect to a particular transaction (or with respect to a particular term) or the reason why a particular obligation was undertaken will be important in the weight given to the meaning a reasonable person would have in mind. However, only if a commercial purpose can be objectively ascertained will it have a role to play in determining the meaning that would be accorded to a term or the contract by a reasonable person.

**(c) The Third Principle: The Exclusions From the ‘Matrix of Facts’**

Lord Hoffman’s third principle excludes from the admissible background, first, the previous negotiations of the parties and, secondly, their declarations of subjective intent. The second of these two exclusions presents little difficult. It is clear that to ascertain the intention of the parties the court does not inquire into the parties’ subjective states of mind but makes an objective judgment based on the background materials identified.

However, where is the line to be drawn between what amounts to prior negotiations and the admissible ‘matrix of fact’?
In *I.C.S. v West Bromwich* Lord Hoffman observed that “The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them”. In *Bank of Credit and Commerce International v Ali*\textsuperscript{22} Lord Nicholls observed that the exclusion of pre-contract negotiations was based on reasons of practical policy. He continued:

> “Whether these reasons of practical policy still hold good today in all circumstances has become increasingly the subject of debate in recent years. The debate is still continuing...This is not the moment to pursue this topic, important though it is, because the point does not arise on this appeal. I desire, however, to keep the point open for careful consideration on a future occasion.”

In *Yoshimoto v Canterbury Golf International Ltd*\textsuperscript{23}, Thomas J in the Court of Appeal of New Zealand supported his construction of the contract in dispute by considering the provisions in earlier drafts, contrary to the rule that pre-contract negotiations should not be admitted as part of the ‘matrix of facts’. Thomas J forcefully argued that where there is reliable evidence of conduct or communications between the parties, within the course of negotiations or afterwards, which lends support to the conclusion that they attached a particular meaning to the words in dispute at the time of the contract, or at least one of them did and the other knew or had reason to know that meaning, such evidence would assist in ascertaining the intentions of the parties. Where such evidence was available it should be admissible, leaving the court to decide what weight should attached to it.

On appeal to the Privy Council\textsuperscript{24}, Lord Hoffman was not inclined to take the opportunity to reconsider this area of the law. He was of the view that the case did not provide a ‘suitable occasion’ for re-examination of the admissibility of pre-contractual negotiations.

\textsuperscript{22} [2002] 1 A.C. 251 at para. 31
\textsuperscript{23} [2000] NZCA 350
\textsuperscript{24} *Canterbury Golf International Ltd. v Yoshimoto* [2002] UKPC 40
The rationale for the exclusion of pre-contractual negotiations is based upon reasons of ‘practical policy’. First, contractual interpretation seeks to ascertain the objective intentions of the parties. The exclusion seeks ‘...to discourage curial exploration of the unfathomable depths of subjective intentions’\(^{25}\). Secondly, the parties negotiating positions may change from time to time during the course of negotiation for reasons which cannot be fully understood from contemporary documents. To admit such documents would introduce uncertainty and unpredictability into dispute resolution. Thirdly, to permit such evidence would be to admit self-serving statements made to be used in the event of a dispute.

The rationale is, however, difficult to support. First, it is difficult to reconcile the exclusion with the modern broad approach to contractual interpretation: ICS should be pursued to its logical conclusion. Secondly, the exclusion is inflexible and may work injustice where credible evidence exists of a prior consensus between the parties which would render some questions of interpretation straightforward. Thirdly, the existence of escape routes from the exclusionary rule in the form of rectification for prior negotiations and estoppel by convention for subsequent conduct demonstrates the incoherence of the rule. Fourthly, there exists considerable uncertainty as to the boundaries of the rule. This uncertainty has resulted in the admission of evidence of pre-contractual negotiation in certain circumstances. In *Prenn v Simmonds*\(^{26}\) Lord Wilberforce appears to concede that if there is evidence in the prior negotiations which may supply a commercial purpose for the agreement, and that purpose would be frustrated by a suggested interpretation of the contract, such evidence would be admissible as part of the matrix of facts.\(^{27}\) In *Partenreederei M.S. Karen Oltman v Scarsdale Shipping Co. Ltd.*\(^{28}\) evidence of pre-contractual negotiations was admitted to show that the parties negotiated on an agreed basis that certain words used in the final document bore a particular meaning.

\(^{25}\) *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman Associates Pty Ltd* (1994) 35 NSWLR 227 at 234.
\(^{26}\) [1971] 1 W.L.R. 1381
\(^{27}\) at p.1385
\(^{28}\) [1976] 2 Lloyd’s Rep. 708, 712
Dunedin Property Investment Co.,\textsuperscript{29} the Court of Session admitted pre-contractual negotiations relating to a loan transaction to establish the state of both parties’ knowledge of the surrounding circumstances at the time of contracting.

The admissibility of pre-contractual negotiations looks set to receive further judicial attention in the near future. Whilst the rule is unlikely to be abrogated in its entirety, there is a real likelihood that some flexibility will be introduced with the weight to be attached to such evidence being the relevant consideration.

\textbf{(d) The Fourth Principle: The Words Of A Contract Do Not Necessarily Mean what They Say}

Lord Hoffman’s Fourth Principle requires the court to look beyond merely the words used in the contract. The task of the court is to construe the contract in the light of all the background which could reasonably have been expected to have been available to the parties in order to ascertain what would have objectively have been understood to be their intention. The fact that the words are capable of literal application is no obstacle to evidence which demonstrates what a reasonable person with knowledge of the background would have understood the parties to mean, even if this compels the court to say that they used the wrong words. ‘In this area, we no longer confuse the meaning of words with the question of what meaning the use of words was intended to convey.’\textsuperscript{30} Lord Steyn\textsuperscript{31} characterises this approach as a commercial construction, which is more likely to give effect to the intention of the parties. ‘Words are to be interpreted in the way in which a reasonable commercial person would construe them. And the standard of the reasonable commercial person is hostile to technical interpretations and undue emphasis on the niceties of language’.

\textsuperscript{29} 1998 S.C. 657
Following *I.C.S v West Bromwich*, Lord Hoffman’s Fourth Principle was greeted by the courts with disquiet\(^3\). However, the Five Principles have been affirmed by the House of Lords\(^3\). In *Westminster City Council v National Asylum Service*\(^3\) Lord Steyn emphasised that even where the words of a document are clear the court must interpret those words against the objective surrounding circumstances known to the parties at the time they entered into the contract.

**(e) The Fifth Principle: Something Must Have Gone Wrong With the Language**

Lord Hoffman’s Fifth Principle provides that if the conclusion from the background evidence is that something must have gone wrong with the language, the law does not require the courts to attribute to the parties an intention they did not have. It should be emphasised that even where the document on its face does not indicate that the parties have made a linguistic mistake, it is, nevertheless, open to either of them to contend that the ‘matrix of facts’ indicate that there has been an error, with the result that the contract does not truly represent the intention of the parties. *Investors Compensation Scheme v West Bromwich* itself demonstrates this proposition. Lord Lloyd, dissenting, was clearly of the opinion that section 3(b) of the claim form was clear in its meaning. Nevertheless, the other members of the House of Lords concluded that, taking into account the matrix of facts, it was clear that the words used in section 3(b) did not represent the true intention of the parties.

This is an approach to be welcomed. First, a party will not be entitled to benefit from a mistake which was not part of the benefit for which he had bargained. Secondly, it gives effect to the true intentions of the party.

\(^3\) See for example *National Bank of Sharjah v Dellborg* (9 July 1997, unreported) where Saville LJ (as he then was) criticised the rule as creating uncertainty in the law of contract.

The Five Principles and Exclusion Clauses

In *Bank of Credit and Commerce International v Ali*35 Lord Hoffman expressed the view that when he referred in *I.C.S.* to the disappearance of artificial rules of construction this was meant to encompass also the rules relating to the construction of exemption or exclusion clauses. It appears that this aspect of the effect of the five principles has not yet been fully appreciated. There is, however, some evidence that the courts are beginning to apply the Five Principles to exclusion clauses36. Following Lord Hoffman’s recent statement in *BCCI v Ali* it is to be expected that the extent to which the principles are applied in this area will receive focussed judicial attention in the forthcoming months and years.

35 *op cit.* at para. 62