



MERGERS AND ACQUISITIONS

Is The Commercial Context Relevant When Interpreting Contracts?

by **James Byrne, Jennifer McGuire**

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When asked to interpret a contract, a Court's first step will be to consider the natural and ordinary meaning of words (textualism), but if the natural meaning remains unclear, a Court may consider the commercial context (contextualism) in order to determine the meaning.

The UK Supreme Court recently contended with textualism and contextualism when deliberating on the interpretation of an indemnity in a share purchase agreement (SPA) in *Wood v Capita Insurance Services*. The facts of the case highlight the difficulties that can arise when poor drafting gives rise to competing interpretations of a contractual provision.

BACKGROUND

In April 2010, Capita Insurance Services Ltd (Capita) purchased Sureterm Direct Ltd (Sureterm) from Mr Wood under an SPA.

One of the terms of the SPA required Sureterm's former owner, Mr Wood, to indemnify Capita for "all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and all fines, compensation or remedial action or payments imposed on or required to be made by the Company **following and arising out of claims or complaints registered with the FSA**" (emphasis added). No time limit was applied to this indemnity.

Mr Wood also gave a warranty to the effect that the Company had conducted its business in accordance with the relevant laws and was not aware of any claims against it. Mr Wood's liability under this warranty was limited to two years after completion of the purchase.

An issue arose after the two year warranty period had expired when Sureterm discovered it had substantially overcharged some customers for their insurance. It proceeded to report itself to the FSA, who found that Sureterm would have to compensate those customers affected through a remediation scheme costing approximately £2.5 million.

Capita argued that they were entitled to recover under the indemnity on the basis that the wording of the indemnity was broad enough to cover a loss incurred where there was no claim or complaint made but rather the issue was self-reported, and that there was no time limitation for recovery pursuant to the indemnity.

Mr Wood argued that the remediation scheme imposed by the FSA fell outside the scope of the indemnity, as the scheme arose due to self-reporting to the FSA, rather than from a claim or complaint being made to the FSA.

THE COURTS

The Commercial Court initially found in favour of Capita, reasoning that the circumstances triggering the FSA investigation should not relieve Mr Wood of the obligation to indemnify, concluding that self-reporting fell within the scope of the indemnity.

However, the Court of Appeal overturned this decision, stating that Mr Wood was not liable under the indemnity unless a claim or complaint was registered with the FSA as this was not within the language of the clause in question. Clarke LJ opined the indemnity naturally appears to require Mr Wood to indemnify Capita for any loss suffered, but with the qualification that the losses suffered derive out of claims or complaints registered with the FSA, and not, as in the present case, from Sureterm's self-reporting.

The Supreme Court upheld the Court of Appeal's decision, accepting that the indemnity was "avoidably opaque". The Supreme Court noted that the common law allows a variety of methods to be used when interpreting a contract where the natural meaning is unclear, with the correct approach depending upon the circumstances of the case. The Supreme Court acknowledged that contextualism could assist in identifying the purpose of the indemnity, emphasising that it is not just "... a literalist exercise focused solely on analysing the wording of a particular clause", but rather the commercial context could be taken into account when interpreting the language used.

Therefore, the Supreme Court assessed the scope and meaning of the indemnity clause with guidance from the factual matrix of the case. With reference to the interaction between the indemnities and warranties in the SPA, the Supreme Court concluded that the additional protection provided for by the indemnity in question could only be triggered in the very specific circumstances referred to therein.

COMMENT

The *Wood v Capita* decision confirms the UK Supreme Court's approach in *Arnold v Britton* and *Rainy Sky v Kookmin Bank* in that a Court may seek guidance from the commercial context in which a contract was drafted (contextualism), in addition to the language of the clause in question (textualism), in order to decipher the objective meaning, when presented with competing interpretations.

Similarly, Irish case law suggests that a Court in Ireland would not just look at the words in isolation but would seek guidance from the factual matrix and the circumstances in which a contract was drafted. However, care must be taken against placing too much emphasis on giving effect to commercial efficacy. As Robert Clark, an expert in contract law and the author of *Contract Law in Ireland* (8th Ed., Round Hall 2016), has warned, it is not the job of the Court to impose contractual terms that were not intended and "there can be a fine line between interpreting a contract in a way that fixes a meaning that is commercially sensible and adjusting the meaning to improve the contract."

Essentially, *Wood v Capita* highlights the importance of reflecting the intentions of the parties through clear and consistent drafting, providing clarification where there may be any risk of ambiguity. The issues in that case could have been avoided if such an approach had been taken. In addition to expanding the scope of the indemnity itself to include self-reported issues, we would normally also include the following provision to address any ambiguity:

The voluntary or unprompted disclosure to a Competent Authority by the Purchaser or the Company (or on its behalf) of any matter in relation to which the Company may have a liability shall not prejudice or limit the ability of the Purchaser to make any claim or to recover under this Agreement.

If you have any questions in relation to issues raised in this article, please contact [Jennifer McGuire](#), Partner, or [James Byrne](#), Associate Solicitor.

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