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Insights

THE SUBJECTIVE OBJECTIVE THEORY OF CONTRACT INTERPRETATION AND GOOGLE

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As recently discussed, contract interpretation is, relatively, easy when the words are very clear. But once a potential ambiguity is identified, it becomes necessary to look at what makes commercial sense, as well as what has been described as the factual background, or the "matrix of fact" referred to in Prenn v Simmonds.

More recently, this was described as "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" (Rainy Sky v Kookmin Bank). Identifying the knowledge reasonably available to the parties seems easier than identifying what makes commercial sense, which I looked at in February.

When is knowledge reasonably available?

This was one of the issues in Lehman Brothers v Exotix Partners, a case that concerned the sale of a debt instrument (Peruvian Government global depository notes), executed orally over a recorded telephone line. The parties understood the sale to cover 'scraps' of such notes worth around $7,000 when in fact they were worth over $7million. The defendant sold the notes and kept the windfall. If you want to know how this came about, the judgment is certainly worth a read.

One of arguments concerned the interpretation of the agreement and whether the parties should be taken to know that each note was worth 1,000 Sol and not 1 Sol. Mr Justice Hildyard observed that:

> "…the question as to what knowledge or information is to be treated as being 'reasonably available' to the parties for the purposes of constructing the words they used remains, to my mind, a particularly difficult one. … the test of 'reasonable availability' is not always easy to apply and requires restraint in its application: and all the more so given the almost unlimited information and knowledge now available through the internet."

The point is that identifying what is reasonably available is not that easy, because the reality is that there is now a huge amount of accessible information available on the internet, all of which is arguably reasonably available. So are parties expected to know all that information or use internet search engines to look for every single piece of potentially relevant information?

Mr Justice Hildyard referred to guidance he provided in an earlier case, Challinor v Juliet Bellis, where he identified the following principles:

- If there is no direct evidence, the question is what knowledge a reasonable observer would have expected and believed both contracting parties to have had and each to have assumed the other to have had, at the time of their contract;
- This includes specialist or unusual knowledge or knowledge to be inferred, from the nature of the actions they have in fact undertaken;
- It does not include information that a reasonable observer would think that the parties merely might have known: that would open the gate too far to subjective or idiosyncratic speculation;
- The fact that material is readily available or notorious may support an inference as to what the parties actually knew;
- But (subject to the point below) where it is demonstrated that one or more of the parties did not in fact have knowledge of the matter in question such knowledge is not to be imputed; nor is the test what reasonable diligence would or might have revealed: in either case that would be inappropriately to introduce impermissible concepts of constructive notice or a duty (actionable or otherwise) to make inquiries or investigations;
- The exception is that a reasonable person cannot be assumed to be ignorant of clear and well known legal principles affecting or incidental to the contractual engagement in question.

The fifth point is the interesting one, as it suggests a subjective approach. Mr Justice Hildyard acknowledged that point and noted that it was referred to in Lewison on The Interpretation of Contracts 7th edition, which observed that:

> "It is not entirely clear how this proposition sits with the objective theory of interpretation."

His response was that the fact, as a matter of evidence, that a party was not aware of certain facts or circumstances was part of the matrix of fact which could therefore be taken into account when interpreting a contract.

Applying the subjective knowledge

Mr Justice Hildyard made the point that:

> "More generally in this context, it seems to me that the Court should take care not to import notions of reasonable care and negligence into questions of contractual construction. It is a slippery slope between identifying what the actual context of a contractual engagement was, and (by contrast) what parties exercising reasonable care might reasonably have been expected to seek to make enquiries about. The proposition that the admissible factual matrix

> should include information 'reasonably available' to the parties is not, in my view, intended to impose or connote a duty to enquire as to matters which on the basis of their shared understandings did not merit inquiry."

It is easy to see the type of argument that the judge was keen to avoid. It is possible to argue that with all the information that is available out there a party should make all necessary enquiries and be taken to have knowledge of all such information. What knowledge is regarded as reasonably available will therefore still have to be decided based on the facts in each case, but taking a pragmatic approach and looking at what the parties actually knew.

Subjective carelessness?

As he went on to point out, this means that:

> "The contractual intentions of careless parties should be honoured, and their bargains should not be corrected by reference to what they would or might have intended to do had they been less careless."

To be clear, this should not be seen in any way as encouragement for parties to be careless. Any party considering entering into a contract should review what information may assist it in understanding its obligations and what the contract means and take any investigations which would be prudent in the circumstances. The judge's point is that this should not mean engaging in endless enquiries into every possible avenue. All the more so when, especially with the benefit of hindsight, it is easy to identify a source of information which may have been reasonably available at the pre-contractual stage.

How to approach interpretation?

Determining the precise factual matrix is not as easy as it seems. In Chartbrook v Persimmon Homes, Lord Justice Hoffmann stated that "there are no conceptual limits to what can properly be regarded as background" before deciding pre-contractual discussions were excluded from the admissible factual background. However, a year later, in Oceanbulk v TMT Asia the Supreme Court held that without prejudice communication could be admissible as part of the factual background to assist interpretation. In this case, subjective knowledge was relevant as part of the factual background.

If identifying the relevant factual background is not so easy, and finding out what makes commercial sense creates its own difficulties, it is easy to see the attraction of limiting any arguments to the plain and ordinary meaning of the words used. Easier said than done, because as Lord Diplock eloquently stated in Slim v Daily Telegraph:

> "… words are imprecise instruments for communicating the thoughts of one man to another."

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