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ENGLISH CONTRACT LAW FOR SPANISH LAWYERS. ARTICLE ONE - ENGLISH LAW CONTRACTUAL INTERPRETATION

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Derecho Inglés de los Contratos para Abogados españoles – Artículo uno – La Interpretación de los Contratos en Derecho Inglés

Presentamos el primer artículo, de una serie de tres, que pretenden ser una aproximación a los principios generales del Derecho Inglés de los Contratos y a su relevancia en el marco de operaciones societarias, mercantiles y financieras en el mercado español e internacional. Este artículo ofrece una introducción general a la elección del derecho inglés como ley aplicable, y proporciona un análisis del enfoque que adoptan los tribunales ingleses en relación con la interpretación de los contratos y la importancia que ello puede tener en la revisión de contratos sujetos a ley inglesa, o al adaptar un precedente sujeto a esta ley.

PALABRAS CLAVE:

INTERPRETACIÓN DE LOS CONTRATOS, DERECHO INGLÉS.

English Contract Law for Spanish Lawyers. Article one - English law contractual interpretation

The first in a series of three Articles that will seek to provide an introduction to certain key principles of English contract law and its relevance in the context of Spanish/international corporate, commercial and financial transactions. The Article provides a general introduction to the choice of English governing law, and provides an analysis of the approach taken by the English courts to the interpretation of contracts and the implications for civil lawyers reviewing English law governed contracts, or adapting English law governed precedents.

KEY WORDS:

CONTRACTUAL INTERPRETATION, ENGLISH LAW.

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1. Introduction

This is the first in a series of three Articles that will seek to provide an introduction to certain key principles of English contract law and its relevance in the context of Spanish/international corporate, commercial and financial transactions.

Given the prevalence of English law as a governing law of choice in a variety of corporate, commercial and financial transactions, it will be useful for Spanish lawyers working on such transactions to have a basic grounding in these key principles as:

- i. it is likely that at some stage in their career they will be required to review and understand English law governed agreements in their day to day work; and
- ii. they may well be required to adapt English law governed precedents to produce Spanish law governed agreements.

This **first Article** will provide a general introduction to the choice of English law on cross-border transactions, as well as an analysis of the approach taken by the English courts to the interpretation of contracts and the implications for civil lawyers reviewing English law governed contracts, or adapting English law governed precedents.

The following two articles, which will be released in subsequent editions of *UM Juridica*, will cover:

Article two - the absence of any general doctrine of “good faith” under English law and the consequences of that regarding the drafting and interpretation of English law governed contracts; and

Article three - specific differences/issues that come up for Spanish lawyers when reviewing English law agreements and points to bear in mind when using an English law governed precedent as the starting point for drafting a contract under Spanish law.

2. Why choose English governing law?

Parties to any commercial or financial transaction may choose to agree that it should be governed by English law and that any disputes in connection therewith be resolved by the English Courts, even if neither the contract, nor its subject matter nor the parties have any particular connection

with the UK. There may be many reasons for choosing English law to govern a particular transaction - for example:

- i. **Confidence in the English Courts** and their reputation for speed, quality and neutrality;
- ii. **Freedom of contract and certainty of interpretation** - the ability of the parties to contract on the terms and in the manner that they choose, without the risk of unforeseen consequences derived from the application of codified statutes;
- iii. **English language** - international commercial and financial transactions, both in Spain and in many other countries, are frequently documented in the English language. If neither party has a strong preference to the contrary, this may sometimes lead to the parties opting for English law and the jurisdiction of the English Courts by default;
- iv. **England as a centre for arbitration** - London is home to a large range of arbitral bodies with high quality practitioners enabling international parties to resolve their legal disputes amicably without the need to litigate. Similarly, the UK is party to a number of international reciprocal arrangements, including the New York Convention, allowing for mutual recognition and enforceability of arbitral awards; and
- v. **Historical factors** - in the late 19th century, the British empire had widespread global reach that extended from Australia and New Zealand through the Far-East to embrace parts of Africa, Canada and the Caribbean. As a result, English law is well understood in these jurisdictions and often becomes a natural choice when parties from such countries are involved in international transactions.

3. Interpretation of English law governed agreements

What is distinctive about English law governed contracts and the way in which they are interpreted by the English Courts?

3.1. Freedom of contract and certainty of interpretation

There are certain basic requirements that must be observed in order to create a legally binding contract under English law including offer, acceptance, consideration (more on which in **Article three**), intention to create legal relations and sufficient certainty of terms. In a commercial transaction, documented in writing between professionally advised commercial parties, generally speaking these requirements do not give rise to particular difficulties. It will normally be clear at what point a contract has come into existence, and on what terms.

Aside from these basic technical requirements, in most respects under English contract law the parties are free to contract on the terms and in the manner that they choose. The scope for the application of "good faith" principles, or rules or terms derived from codified statutes, which may

have unforeseen or unintended consequences in each case, is accordingly significantly reduced when compared to the position in Spain and other civil law regimes.

This “freedom of contract” does however carry with it certain risks and responsibilities - the English Courts typically adopt a strict approach to the interpretation of contracts. The terms that the parties agree to will, generally, be enforced just as the parties agreed, regardless of whether that enforcement might lead to an unfair or unjust outcome. Under English law, more often than not, fairness is assumed to be part of the assessment made by the parties when they decide what terms to contract on, and not *ex post* depending on later factual circumstances. For that reason, English courts have consistently refused to resolve questions of contractual interpretation by reference to any general doctrine of “good faith” - which we will explore more in **Article two**. This means that the drafting used in an English law governed contract, the exact words used, carries even more weight than it would in an equivalent Spanish law governed agreement underpinned by the *Código Civil* and other statutes and subject to the doctrine of “good faith” in its interpretation by the Spanish Courts.

3.2. Textual and contextual approach

The approach of the English Courts to the interpretation of contracts is to focus on:

“the meaning [that the clause in question would have] 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” (Investors Compensation Scheme Ltd West Bromwich Building Society (No 1) [1998] 1 WLR 896).

This means that the English Courts will look at the drafting of the applicable provisions and the contract generally to construe the objective meaning of the words that the parties have used to express their intention. The Court will also consider the broader context: *“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”* - but only to a limited extent.

Note that **the test is objective**; the English Courts will generally ignore subjective evidence of what the parties may actually have intended, an attitude that clearly departs from that of the Spanish Courts.

3.3. What elements will the English Courts take into consideration?

The English Courts will start with the ordinary meaning of the applicable provisions of the contract, seeking to construe the objective meaning of the words on the page in the context of other objective elements which may serve to assist their interpretation, such as:

- i. other relevant provisions of the contract;
- ii. the objective of the contract;

- iii. facts and circumstances that would reasonably have been available to the parties at the time that they entered into the contract; and
- iv. applicable commercial customs and practices.

Note that the English Courts view contractual interpretation as an iterative process - the Court takes the ordinary meaning of the applicable provisions, and if the objective meaning is clear in the context of these objective elements listed above, then the Court will not seek to construct an alternative interpretation.

3.4. What elements will the English Courts not take into consideration?

As mentioned, the English Courts will generally not take into consideration subjective evidence of what the parties may have actually intended, or other subjective elements such as pre-contractual communications or negotiations or the subsequent conduct of the parties after the contract has been entered into. In addition, the English Courts will *not* apply any general principle of “good faith” to resolve doubts, gaps or ambiguities in the drafting of an English law governed agreement (See, for example, *MSC Mediterranean Shipping Company S.A. v Cottonex Anstalt* [2016] EWCA Civ). Both of these represent fundamental differences from the civil law approach, including that of the Spanish Courts.

3.5. How do the English Courts justify this approach?

This approach is justified on a two-fold basis. First, it is the natural consequence of the freedom of the parties to contract on whatever particular terms they agree to. Second, interpreting contracts in this manner promotes greater certainty as to how contractual provisions will be interpreted and, as a consequence of that certainty, reduces the extent to which disputes may arise and have to be resolved through litigation or other dispute resolution processes.

A premium is therefore placed on English law governed contracts being clear, comprehensive and lacking in ambiguity. Accordingly, such agreements tend to be long and detailed and in some respects cover points which may be thought to be obvious or remote (the “*what happens if*” scenario).

4. Contrast with the approach taken to CONTRACTUAL Interpretation by the Spanish Courts

4.1. How does this differ from the approach applied by the Spanish Courts?

The goal of contractual interpretation under Spanish Law is to determine the meaning of the contract that is faithful to the common intention of the parties when they agreed to the contract. To that effect, they may use a number of interpretive criteria and tools. Among them, the Spanish

Courts will have regard to the doctrine of “good faith” in their interpretation of the contract, which doctrine is not capable of being excluded by the parties. To ascertain the common intention of the parties, the Spanish Courts will take into account such subjective elements as:

- i. pre-contractual communications or negotiations;
- ii. evidence of the actual intention of the parties; and
- iii. the subsequent behavior of the parties.

Such elements are in addition, of course, to the objective elements listed in the previous section in relation to English law contractual interpretation, which will also be available to the Spanish Courts to assist the process of contractual interpretation.

4.2. Do the differences matter in practice?

If an agreement is well drafted and contains no doubts, gaps, ambiguities or inconsistencies in the drafting, the varying approach to interpretation between the English and the Spanish Courts will likely not lead to significantly different interpretations.

However, where provisions of a contract are ambiguously or loosely drafted, or are inconsistent or incomplete, difficulties may arise and the two approaches may produce different results. As a result, a working knowledge of English law rules of contractual interpretation and an understanding of the greater emphasis placed on clear, precise and unambiguous drafting by the English Courts is very useful for any lawyer (English or otherwise) reviewing English law governed agreements, adapting an English precedent to Spanish law, or generally dealing with drafting-obsessed English lawyers.

5. Wood v Capita - An example of where the differences did matter

The English Courts’ approach to contractual interpretation is illustrated by the recent judgement of the Supreme Court of England and Wales in *Wood v Capita Insurance Service Ltd* [2017] UKSC 24.

5.1. Wood vs Capita - background and facts

In that case, Capita acquired an insurance company from Wood by way of a share acquisition. Subsequently it became apparent that the target company acquired had, prior to the acquisition, engaged in mis-selling insurance products to customers. This issue was self-reported to the appropriate regulatory authority, which then approved a compensation scheme for affected customers. Capita sued Wood, wishing to recover the losses suffered.

The Share Purchase Agreement (the “SPA”) entered into by Wood and Capita contained a warranty which would, it appears, have covered the mis-selling activities, but the two year time limit for bringing claims under such warranty had already expired. As a result, the warranty was of no use to Capita.

In addition, the SPA contained an indemnity which was not subject to the two year time limit. The wording of the indemnity was as follows:

*“The Sellers undertake to pay to the Buyer an amount equal to the amount which would be required to indemnify the Buyer and each member of the Buyer’s Group against 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, the Financial Services Ombudsman or any other Authority against the Company, the Sellers or any Relevant Person** and which relate to the period prior to the Completion Date pertaining to any mis-selling or suspected mis-selling of any insurance or insurance related product or service.” (bold emphasis added for the purposes of this Article)*

This indemnity clause was not well drafted, and it is not entirely clear what losses, exactly, it was intended to cover. In particular, it was very unclear whether the reference to “arising out of claims or complaints registered with the FSA” could cover the facts of the present case where Capita had self-reported the mis-selling activities.

5.2. What did the Supreme Court decide?

Ultimately, the Supreme Court interpreted the indemnity (with particular reference to the words in bold highlighting) as applying only in the case of “claims or complaints” being made to the authorities by customers, and not in instances of self-reporting. This finding was made despite the fact that the indemnity did not expressly mention that the “claims or complaints” needed to be registered with the FSA, i.e., by customers.

For the Supreme Court, the loss had been suffered by Capita as a direct result of the self-reporting to the relevant authorities and not through claims, complaints or other actions by customers. Accordingly, there was no valid claim under the indemnity.

While the judgement does not directly address the point, it should be noted that under English law contractual interpretation principles, the fact that Capita had presumably acted properly in reporting the matter to the authorities and had possibly prevented the need for claims to be made by individual customers - which might well have given rise to a claim under the indemnity - was not relevant for the Supreme Court in the question as to how the indemnity should be interpreted and applied.

At first glance this decision seems harsh for Capita - so how, if at all, is the decision of the Supreme Court justified?

5.3. How was that decision reached?

First, the Supreme Court noted that two years after the Agreement had been entered into was a reasonable period within which to discover mis-selling issues - and during that two-year period Capita would have had recourse under the applicable warranty. Second, it was not contrary to commercial common sense for the Agreement to have contained broad warranties which were limited in time and also a specific indemnity which was not subject to the same time limit but which was more limited in scope. Third, it was not the role of the Court to go against the ordinary meaning of the words chosen and used by the parties in the indemnity clause so as to improve what had turned out to be a bad bargain for one of the parties.

However, if the same issue had arisen on the same facts but in connection with a Spanish law governed contract, it is very possible that the Spanish Courts would have decided the question the other way. In particular, the application of the doctrine of good faith, or the availability of evidence relating to the common intention could have allowed much greater latitude in reaching the conclusion that the actual intention of the parties was that the indemnity should apply in these circumstances.

6. Conclusions and practical advice

If English law is chosen as the governing law for a commercial or financial transaction, care must be taken to understand how the English law rules of contractual interpretation will affect the drafting and negotiation process and the manner in which the client's objectives may be achieved.

Freedom of contract has many advantages, but also some disadvantages - the strict approach of the English Courts (and arbitral tribunals) to the interpretation of contracts which are subject to English law imposes responsibilities on the parties and their legal advisers which may not be immediately apparent to those used to operating in civil law jurisdictions.

Key points for Spanish lawyers to consider when reviewing an English law agreement or adapting English law precedents include:

- i. **precise drafting is essential:** given the approach of the English Courts to contractual interpretation, there is greater pressure on the drafting employed in English law governed agreements. Drafting must be as precise as possible to eliminate potential ambiguities or uncertainties;
- ii. **deal with the "what if" scenario because the English Courts won't do it for you:** an English law agreement will need to be drafted in such a way so as to cover all eventualities which may reasonably be foreseen at the time of entering into the contract. The English Courts have far less scope to employ interpretive criteria that are not linked to the contract and to objective elements, including considerations of "good faith", to resolve outcomes that have not been provided for in the contract;

- iii. **English law precedents are helpful for Spanish lawyers:** the requirements for precise drafting and that all possible eventualities be addressed (as set out in *i* and *ii* above), together with the fact that the English language used in the precedent is likely to be of a high standard, mean that an English law precedent is often a good starting point for a Spanish lawyer producing an English language Spanish law governed agreement, provided that it is correctly adapted for Spanish governing law. **Article three** will explore in detail certain peculiarities of English law which should be taken into account when adapting English law governed precedents;
- iv. **be very careful using Spanish precedents as a base for English law contracts:** for exactly the equivalent and opposite reasons, Spanish lawyers should think twice before adapting a Spanish law precedent to produce an English law governed document; and
- v. **English law contracts should always be drafted in the English language:** given the focus of the English Courts on the precise wording of the contract, it will rarely, if ever, make sense for a contract which is drafted in a language other than English to be subject to English law. For these reasons, the UM IEC Team would never recommend that a client enter into an English law governed contract drafted in a language other than English. If it is necessary for the document to be subsequently translated into Spanish or any another language, it will be important to establish that the English language version prevails over any such other versions.