Different Approaches to Commercial Contract Interpretation in New York and in the UK

The interpretation of commercial contracts is a pre-eminent issue in commercial litigation and arbitration. Commercial clients in the UK with business interests in the US should understand how disputes over the meaning of contractual terms will be resolved where US law applies, as the governing law of the contract or of an arbitration agreement or both. The most common state jurisdiction invoked in commercial contracts between US and UK parties is (in my experience) New York, followed by Delaware and California. There are important differences between the approaches to contract interpretation in these states on the one hand and in England and Wales on the other. In this note I will focus on the general common law approaches to the construction of a commercial contract between New York and the UK, and leave other issues, such as implied obligations of good faith and fair dealing, unconscionability and statutory intervention, to a later note.

Both New York and UK courts adopt the objective theory of contract interpretation, and profess to have the same overriding aim when construing a commercial contract; namely to give effect to the expressed intentions of the parties: see Klos v. Polskie Linie Lotnicze, 133 F.3d 164, 168 (2d Cir.1997) and BCCI v Ali [2001] 1 AC 251, 259. These jurisdictions illustrate, however, the two contrasting approaches to the performance of the exercise of construction employed in common law jurisdictions, described as textualist and contextualist1.

Under the textualist approach, applied in New York (and Delaware as well as many other US states, with the notable exception of California), courts do not consider the context (or factual matrix) of a written commercial contract unless there is first a finding of ambiguity. Textualist jurisdictions apply what is referred to as a ‘hard’ parol

evidence rule, prohibiting the admission of extrinsic evidence to interpret a contract if the contractual language is clear and unambiguous on its face. Courts in textualist states are more likely to enforce the language of the contract as written, without wondering if there is some testimony or other evidence which could cause them to read the language differently. A textualist court presumes merger or integration clauses in a contract (referred to in the UK as entire agreement clauses) to have conclusive effect, and even in their absence, the court will presume that the contract is fully integrated if it appears final and complete on its face.

By contrast, the contextualist approach as embraced by UK courts, especially following the influential contributions of Lord Hoffman in such cases as Investors Compensation Scheme v West Bromwich Building Society [1998] 1 WLR 896 and Chartbrook Limited v Persimmon Homes Ltd [2009] 1 AC 1101, involves a consideration of the contract in the context under which is was made. As Lord Hoffmann himself said:

“… it was not necessary to find an ‘ambiguity’ before one could have any regard to background and … the meaning which the parties would reasonably be taken to have intended could be given effect despite the fact that it was not, according to conventional usage, an ‘available’ meaning of the words or syntax which they had actually used.”

Lord Bingham described the English approach to contract interpretation in BCCI v Ali [2001] 1 AC 251, 259 as follows:

“To ascertain the intention of the parties the court reads the terms of the contract as a whole, giving the words used their natural and ordinary meaning in the context of the agreement, the parties’ relationship and all the relevant facts surrounding the transaction so far as known to the parties. To ascertain the parties’ intentions the court does not of course inquire into the parties’ subjective states of mind but makes an objective judgment based on the materials already identified.”

New York

In a dispute over the meaning of a contract, the threshold question under New York law is whether the contract is ambiguous: Krumme v. WestPoint Stevens Inc., 238 F.3d 133, 138 (2d Cir.2000). Ambiguity is a question of law determined by looking within the four corners of the document, in the absence of extrinsic evidence. New York
courts tend to take a narrow view of what constitutes ambiguity, even where there is disagreement about its meaning. When a contract is found to be unambiguous on its face, it must be enforced according to the plain meaning of its terms: *South Rd. Assocs., LLC v. IBM*, 826 N.E.2d 806, 809 (N.Y.2005).

It is well settled that a contract is unambiguous if the language it uses has a definite and precise meaning, as to which there is no reasonable basis for a difference of opinion: *White v. Cont'l Cas. Co.*, 878 N.E.2d 1019, 1021 (N.Y.2007). In determining whether a contract is ambiguous, the court will read the agreement “as a whole”: *Law Debenture Trust Co. of N.Y. v. Maverick Tube Corp.*, 595 F.3d 458, 468 (2d Cir 2010). Where the document as a whole “makes clear the parties' over-all intention, courts examining isolated provisions should then choose that construction which will carry out the plain purpose and object of the [agreement].” *Kass v. Kass*, 696 N.E.2d 174, 180 (N.Y.1998)). Extrinsic evidence will be admitted in a New York court if and so far as the contract terms, considered in the context of the agreement as a whole, are found to be ambiguous.

As for the admissibility of parol (or extrinsic) evidence, New York, Delaware and California apply some version of the exclusionary parol evidence rule, but with important differences. The ‘hard’ parol evidence rule applied in New York and Delaware prohibits the introduction of any extrinsic evidence to interpret a contract if the contractual language is integrated and clear and unambiguous on its face. Courts in those states will more likely enforce the language of the contract as written, without enquiry as to whether other evidence would indicate a different interpretation.

By contrast, California courts, on the other hand, apply a ‘soft’ rule as to the admissibility of parol evidence in the first instance, to determine whether the contract language is ambiguous and/or reasonably susceptible to a different interpretation. If it is, then the court will use extrinsic evidence when determining what the parties intended.
England and Wales

In England and Wales the contextual approach to resolving disputes about contractual interpretation can be seen from Lord Hoffmann's speech in *Investors Compensation Scheme v West Bromwich Building Society*, where he said (in summary) that the interpretation of a contract involved the ascertaining of the meaning which the document would convey to a reasonable person having all the relevant background knowledge which would reasonably have been available to the parties at the time the contract was made, with the exception of evidence of previous negotiations or declarations of subjective intention.

According to this technique, a document’s meaning as would be conveyed 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 background would reasonably have been understood to mean. The background may not merely enable the reasonable person to resolve ambiguities, but even (as happens in ordinary life) to conclude that the parties have used the wrong words or syntax. To say that words should be given their ‘natural and ordinary meaning’ simply suggests that will not easily be accepted that people have made linguistic mistakes in a formal written document. But if the background indicates that something must have gone wrong with the language, the court will not attribute to the parties an intention which it believes they could not have had.

The exclusion of pure statements of subjective intention is central to the objective theory of contract which remains common to the US and the UK, and (for that matter) to most other common law jurisdictions. In England, however, the operation of the traditional parol evidence rule is significantly ‘softer’ than California and other US jurisdictions that have tempered the rigour of the historical rule, so much so that the last remnant of the rule in England appears to be the exclusion of evidence of pre-contractual negotiations.
Entire agreement clauses also have a different impact on contractual interpretation in the UK. In particular, they are generally assumed to exclude consideration of circumstances surrounding the creation of the contract. In *Intrepeneur Pub Co. v East Crown Ltd* (2000) 41 EG 209, Lightman J described what he considered to be the effect of entire agreement clauses, being that they:

“... preclude a party to a written agreement from threshing through the undergrowth and finding in the course of negotiations some (chance) remark or statement (often long forgotten or difficult to recall or explain) on which to found a claim............to the existence of a collateral warranty.” In *Energy Venture Partners Ltd v Malabu Oil and Gas Ltd* [2013] EWHC 2118 Gloster LJ upheld an implied oral variation to a written contract notwithstanding the existence of an entire agreement clause providing (*inter alia*) that “no additions, amendment to or modifications of this Agreement shall be effective unless it is in writing duly signed on behalf of the parties.” As to the entire agreement clause, Gloster LJ said that “In many cases, such as *United Bank Ltd v Asif* (where the relationship between the parties was a formal banking relationship) the factual matrix of the contract and other circumstances may well preclude the raising of an alleged oral variation to defeat an entire agreement clause … In others, the evidence may establish on the balance of probabilities that the parties by their oral agreement and/or conduct have varied the basis of their contractual dealings, and have effectively overridden a written clause excluding any unwritten modification. Such a situation might well arise in circumstances where, as in the present case, there are effectively only two individuals negotiating a variation to, and subsequently operating under, the terms of an unusual agreement in unusual circumstances.” In other words, entire agreement clauses will not, without more, affect the general application of the basic contextualist approach to the contract construction.

**Conclusion**

Parties to written commercial agreements and their domestic advisers need to consider carefully which jurisdiction, or choice of law, is likely to prevail in resolving any ambiguity or dispute as to what their contract means and how it is intended to operate. In some US states, such as New York, a party might find itself clutching little more
than the document itself in seeking to persuade the court or arbitrator(s) of its version of its contractual relationship, whereas in England the same party might find itself surrounded by reams of rival material, possibly including expert evidence of common commercial practices, alleged to constitute the relevant background knowledge necessary for the reasonable person to understand the meaning of the words contained in the document.

Teresa Rosen Peacocke
Barrister and New York attorney
3 Stone Buildings
London and New York