

Avoiding Uncertainty in Contract Drafting: Key Principles of Contract Interpretation and the “Best v Reasonable” Endeavours Obligation

Glenn Kangisser,
glenn.kangisser@haynesboone.com
Partner, Haynes and Boone CDG

haynesboone

Importance of clear words in contract drafting

“Arctic III” LOGIC Form (amended)

Clause 20 – Consequential Loss

... loss or deferment of production, loss of product, **loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided by contractors or subcontractors of every tier or by third parties)**, loss of business and business interruption, loss of revenue (which for the avoidance of doubt shall not include payments due to [Transocean] by way of remuneration under this CONTRACT), loss of profit or anticipated profit, ...

English court's approach to contractual interpretation



The court is concerned to identify the intention of the parties by reference to what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean.



It does so by focusing on the meaning of the relevant words in their documentary, factual and commercial context.



That meaning has to be assessed in the light of the natural and ordinary meaning of the clause, any other relevant provisions of the contract, the overall purpose of the clause and the contract, the facts and circumstances known or assumed by the parties at the time that the document was executed and commercial common sense, but disregarding the subjective evidence of the parties' intention.

English court's approach to contractual interpretation

- ▶ While commercial common sense is a very important factor to be taken into account, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed.
- ▶ The meaning of a clause is usually most obviously to be gleaned from the language of the provision.
- ▶ Where the parties have used unambiguous language, the court must apply it; if there are two possible constructions, the court is entitled to prefer the construction consistent with common sense and to reject the other.

Apache North Sea Limited v Euroil Exploration Limited
[2020] EWCA Civ 1397

10 key principles of contract interpretation

1

Words used by parties in agreement are critical

2

Context / Factual matrix

3

Commercial purpose of contract or provision being construed

4

Importance of the ordinary meaning of words

5

Amendments to standard forms given more weight

10 key principles of contract interpretation

6

Reasonableness but not to rescue a party from a bad bargain

7

Business Common Sense

8

Consider the whole contract

9

Preference for a meaning that does not render document void or meaningless

10

Give effect to every clause but reject inconsistent clauses if they defeat the purpose of the contract

Arguments with minimal effect on interpretation



Market practice



Prior negotiations or events post-contract



Deleted text



Precedent cases



Actual or subjective intentions



Events after the contract was made

Endeavours clauses



Contractor shall [re-contract the Rig]



Contractor shall use **best endeavours** to [re-contract the Rig]



Contractor shall use **all reasonable endeavours** to [re-contract the Rig]



Contractor shall use **reasonable endeavours** to [re-contract the Rig]

Endeavours clauses

- ▶ What is the extent of the endeavours obligation?
- ▶ Where does the obligation start and where does it end?
- ▶ What lengths must a party go to?
- ▶ Highly fact sensitive
- ▶ Compliance assessed by reference to the circumstances at the time of performance

Reasonable endeavours

- ▶ Less stringent than “best endeavours”
- ▶ Implies a reasonable balance between your obligation to others against your own financial interests; no requirement to sacrifice your own commercial interests (*P&O Property Holdings Limited v Norwich Union Life Insurance Society* [1993] EGCS 69)
- ▶ If a number of reasonable courses of action could be taken, only one course of action is required
- ▶ The chance of achieving the result is of prime importance

Best endeavours



Does not mean “second-best” endeavours! Creates an obligation to “leave no stone unturned, within the bounds of reason” (*Sheffield District Railway Co v Great Central Railway Co* [1911] 27 TLR 451)



Requirement to take all those steps in a party’s power which are capable of producing the desired result being steps which a prudent, determined and reasonable person, acting in his own interest and desiring to achieve that result, would take (*IBM United Kingdom v Rockware Glass Ltd* [1980] FSR 335)



May require significant expenditure but not to the point of “financial ruin” or in “utter disregard” of shareholders’ interests

All reasonable endeavours

- ▶ Conflicting case law on this issue which demonstrates that each case turns on the particular facts
- ▶ Probably a middle position somewhere in between best and reasonable endeavours, implying something more than reasonable endeavours but less than best endeavours (*UBH (Mechanical Services) Ltd v Standard Life Assurance Company, The Times, 13 November 1986*)
- ▶ Does not require a party to sacrifice its own commercial interests (*CPC Group Ltd v Qatari Diar Real Estate Investment Company [2010] EWHC 1535*)
- ▶ May require expenditure but not if “substantial sums” are required

Obligation to re-contract rig (highly fact sensitive)

Obligations	Reasonable Endeavours	Best Endeavours
Actively market the rig for work during the relevant period	Yes	Yes
Give priority over other uncontracted units	Likely unless subject to greater obligation	Likely
Offer the unit at below market rates or less favourable terms	Unlikely	Likely
Incur expenditure including reasonable equipment upgrades	Unlikely	Likely
Substitute cancelled rig for a rig committed to another operator (pre-commencement)	Unlikely	Unlikely
Rig condition during relevant period	Possibly warm but not cold stacking	Ensure ready to work throughout

Endeavours clauses - drafting tips



Does the obligation require costs to be incurred and can these be limited in any way?



Can the obligation be limited by time?



Can any activities be excluded?



Is the obligation limited by the parties' own interests?



Does the obligation require legal action through to a final unappealable decision?

Impermissible grounds for withholding consent



Even where a contractual provision imports a standard of reasonableness, the court must still construe the contract as a whole to establish what the party providing consent is entitled to do under the relevant clause



If an agreement contains a provision that consent must not be unreasonably withheld, it will usually not be reasonable for the consent-provider to impose a condition that is designed to increase or enhance its rights under the agreement in question



However, a condition may be permissible if:

- it provides a mechanism for addressing a legitimate concern
- the result obtained is compensatory or mitigatory

Apache North Sea Limited v INEOS FPS Limited [2020] EWHC 2081 (Comm)

Any questions?

<https://www.haynesboone.com/people/k/kangisser-glenn>

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