Contractual rectification in light of *FHSC Group Holdings Limited v GLAS Trust Corporation Limited [2019] EWCA Civ 1361* – where are we now?

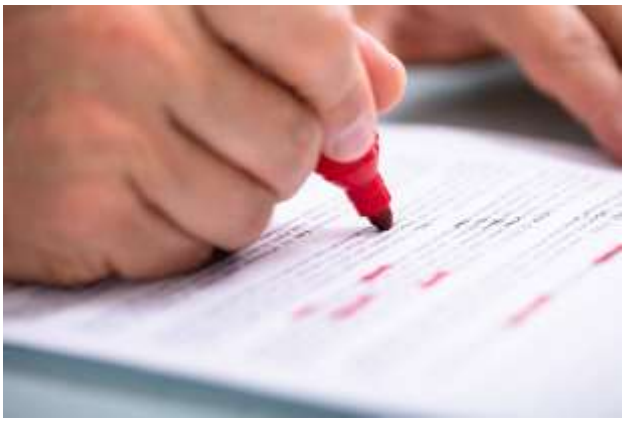
Michael Uberoi, *Outer Temple Chambers*

It has now been a little over a year since Leggatt LJ (as he then was) gave the Court of Appeal's judgment in FHSC Group Holdings Limited v GLAS Trust Corporation Limited [2019] EWCA Civ 1361, which altered the test for common intention when one party seeks to rectify a contract as a result of what it alleges was a mistake which was common to both parties.

The (high level) test for rectification means any party must demonstrate (i) that the parties had a common intention, which (ii) by mistake was not recorded in the contract, and that (iii) this is demonstrated by an "outward expression of accord"[1].

FSHC altered the test for assessing the parties' common intention (i.e. the first requirement, above). This assessment had previously been by way of an objective test, as a result of the judgment of Lord Hoffman in Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38, meaning that (as with contractual construction) the court would look at the language used in the documents and determine what that language should reasonably be understood to mean (rather than enquiring what, if anything, the parties subjectively meant).

After a detailed exposition of the preceding case law and academic commentary, in FHSC Leggatt LJ rejected the objective test articulated by Lord Hoffman in Chartbrook (which Leggatt LJ said had been obiter). He found instead that it was necessary to show that "*each party to the contract had the same actual intention with regard to the relevant matter*".[2]



What did Leggatt LJ mean by the parties' "actual" intention, and why does it matter?

FHSC was a case about a security instrument which was intended to fill a gap in a series of financing documents by granting security over certain assets. However, by mistake, the party granting the security entered into a range of additional (far more onerous) contractual obligations which were incorporated into the document in error.

It can be seen from the above that, in the key paragraph where Leggatt LJ delivered his coup de

[1] This third requirement is not always necessary, depending upon the subject matter of the application.

[2] See ¶176 of the judgment. The objective test remained unaltered if there had been a prior concluded contract.

grace to the objective test, he spoke of replacing it with a test which focused upon whether the parties had the same "actual" intention. Elsewhere in his reasoning, Leggatt LJ spoke of a "subjective" test (in contradistinction to Lord Hoffman's objective test in Chartbrook), and throughout his judgment the terms "subjective" and "actual" are used almost interchangeably. See, for example, the following extracts from the judgment:

a. Paragraph 254: "*The justification for rectifying a contractual document to conform to a "continuing common intention" is therefore not to be found in the principle that agreements (as objectively determined) must be kept. It lies elsewhere. It rests on the equitable doctrine that a party will not be allowed to enforce the terms of a written contract, objectively ascertained, when to do so is against conscience because it is inconsistent with what both parties in fact intended (and mutually understood each other to intend) those terms to be when the document was executed. This basis for rectification is entirely concerned with the parties' subjective states of mind*.[3]"
b. Paragraph 149: "*English law proceeds on the assumption that the words used have a single specific meaning (the "proper interpretation" or "true construction" of the contract) which is established objectively by asking what the language should reasonably be understood to mean rather than by enquiring into what, if anything, the parties subjectively meant*."
c. Paragraph 153: "*…there is in our view no anomaly in applying an objective test where rectification is based on a prior concluded contract and a subjective test where it is based on a common continuing intention. Different principles are in play*."
d. Paragraph 154: "*We have reviewed the history of the doctrine of rectification and seen that, in cases where the court is not simply enforcing a contractual obligation to execute a document in particular terms, the doctrine has always been understood and justified as an equitable remedy to correct an actual common mistake – that is to say, an inadvertent failure to give effect to what the parties actually intended*."
e. Paragraph 161: "*His judgment [the judgment of Hobhouse LJ in Britoil Pls v Hunt Overseas Oil Inc [1994] C.L.C 561) cannot fairly be read as suggesting that the actual intentions of the parties were irrelevant or that what matters is what an objective observer would have thought their intentions to be. Quite the reverse.*"
f. Paragraph 164: "*To apply an objective test of intention where the claim is to rectify a written contract is also inconsistent with the law that applies to the rectification of unilateral documents – where it remains well settled that it is a party's actual intention that matters. For example, as mentioned earlier, in Day v Day [2013] EWCA Civ 280; [2014] Ch 114 the Court of Appeal confirmed that, on a claim to rectify a voluntary settlement, what is relevant is the subjective intention of the settlor*."
g. Paragraph 173: "*Allowing those terms to be altered to reflect an objectively ascertained common intention, even though one party to the contract (or even both parties) actually intended to be bound by the terms of the document as executed, does not adequately protect the certainty and security of commercial transactions*."

FHSC therefore stated that the test for assessing the parties' intention (and whether this intention, by mistake, was inaccurately recorded) was a subjective one, which scrutinised actual intention – but what should practitioners take these phrases to actually mean?

One possibility involves far greater focus being placed upon evidence given in the witness box during a trial. In the course of discussion before the Court in FHSC itself, a hypothetical scenario was discussed whereby the Parent company had satisfied the contractual obligation it intended to enter into (the assignment of its interest in a shareholder loan as security) by the alternative route of executing a unilateral document

[3] Emphasis has been added to these paragraphs to demonstrate how the words "actual" and "subjective" are used almost interchangeably in the judgment.

giving notice of the assignment. As was pointed out by Flaux LJ in the course of FSHC's argument,[4] if that alternative course had been adopted, there could have been no argument over any objective test and the Court would only have been interested in the Parent's subjective intention. This is because (even at the time of Chartbook, and surviving through to FSHC) the law that is applied to the rectification of a unilateral document / voluntary settlement looks solely to the party's actual intention[5]. There have also been some (early) cases where rectification of a unilateral document was ordered on the uncontradicted affidavit evidence of the party making the application, despite there being no supporting written evidence to demonstrate or verify the assertion which the applicant came before the court to make[6]. Was this type of "subjective" test relevant to the Court's thinking in FSHC itself? Attaching greater emphasis to the oral evidence of witnesses during rectification trials for bilateral contracts would have the potential to get very complicated. If an individual's intention could no longer be persuasively (if not conclusively) inferred from for example, board minutes or board papers, then trials will be greatly prolonged and far harder to predict.

There would also be an irony involved if FSHC resulted in far greater attention being paid by judges to the witness evidence of the parties. This is because it was Leggatt J (as he then was) who stated in Gestmin SGPC v Credit Suisse Securities (Europe) Limited [2013] EWHC 3560 (Comm) that, in light of the unreliability of human memory, "*the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts*."[7]

How are the courts applying FSHC?

In the judgments which are now emerging which apply FSHC, it would appear that there is no appetite to place any greater emphasis upon the witness evidence. Rather, the courts are applying a holistic approach and looking first to the written / contemporaneous documents, before moving to a second stage analysis of whether the witness evidence is consistent with that documentation, before finally making an overall assessment of 'actual' intention (which places by far the greatest weight upon the contemporaneous documentation). One can immediately see that this is not very far removed from what most judges will have been doing for years. Three recent cases applying FSHC are:

a. Manolete Partners Plc v Robin Ellis [2020] EWHC 1674 (Ch) – a case involving argument over whether a repayment clause was intended by the parties to survive the execution of a new £10.2 million loan facility. Richard Spearman QC (sitting as a Deputy Judge of the Chancery Division) firstly assessed the contemporary documents (at ¶256), before then (at ¶257) assessing the oral evidence of the parties, and then reaching his conclusions in the round;

b. Univar v Smith & Ors [2020] EWHC 1596 (Ch) – a case involving pension scheme documentation which had altered the basis of increases being applied to pensions in payment (and being applied to the revaluation of such pensions between the conclusion of service, and retirement), which alteration meant the increases were guaranteed to match any increase in the Retail Prices Index. Trower J described the approach which he had adopted, at ¶237, in the following terms:
"*I have [had] regard both to the contemporaneous documentation and to the oral evidence of the witnesses. As I have already said, it is not surprising that much of the oral evidence was not very clear on the question of the relevant witness' actual state of mind because memories had faded. Nonetheless, there were many respects in which the witnesses were able to elucidate the documentation in a manner which was helpful, but in the end, I think that the documents as so elucidated were a secure route to establishing the necessary subjective intent*."

c. In PBS Energo A.S v Bester Generacion UK Ltd [2020] EWHC 223 (TCC) it was concluded by Cockerill J that the overall evidence (i.e. the written evidence of the negotiations, and the oral

[4] As described on the face of the judgment, at ¶166.
[5] See Day v Day [2013] EWCA Civ 280 for a relatively recent reassertion of this.
[6] See Hanley v Pearson (1879) 13 Ch. D 545, and its discussion in the case of AMP (UK Plc) v Barker [2001] Pens L.R 77, at ¶66.
[7] Gestmin SGPC v Credit Suisse Securities (Europe) Limited [2013] EWHC 3560 (Comm), at ¶22.

evidence of a key party about "*the lack of attention which he gave to the draft contract in advance of the meeting*") meant that in that case, "*nothing turns on the degree of clarity needed. The evidence comes nowhere near to establishing that the parties had a common intention…*"[8]

The courts are therefore interpreting the "new" subjective test in such a way as to take reassurance from what the witnesses say in the witness box when it coincides with the contemporaneous documentation, and set it aside when it does not. In so doing they continue to listen to what the witnesses are saying, but are able to give overall primacy to the contemporaneous documentation. Such an approach is clearly the correct one, and to attempt otherwise would have created the scope for a great deal of confusion in rectification actions. However, this is probably not the stuff of a "subjective" test. Rather, it is an objective test with a gloss (which gloss makes little difference in practice).

Exclusion orders under CPR 32.1(1)(c)

Whatever the precise boundaries of the new subjective test, there is undoubtedly some greater role to be played by the witness evidence (as opposed to when an objective test prevailed). Parties may therefore be well advised to keep in mind the potential for an application to be made (most appropriately at any Pre-Trial Review) for witnesses to be excluded from court when other witnesses give their evidence. The court has the power to make such an order under either CPR 32.1(1)(c)[9], or 3.1(2)(m)[10], and such an application was (successfully) made in the Univar case mentioned above. The basis of the application need only be that there is a risk that the witness' individual account may be influenced (either consciously, or subconsciously) by sitting and listening to what his or her colleagues or fellow board members say they intended with regard to a document / transaction (pertaining to which memories may be of poor quality, particularly if the document was signed or executed many years previously). Even if this sort of subconscious influence does not in fact occur, there is a real risk of its appearance (in the event of, for example, the witnesses all offering evidence in strikingly similar terms, one after the other). Arguably, there is no real downside to such an application being granted by the Court. If strikingly similar evidence is received from the witnesses about their intention, notwithstanding that they were not present in court to hear their colleagues offer their own evidence, then so much the better for the entity involved. But the risk of any cross-contamination will have been removed, and the court will be able to be satisfied that it has received wholly independent evidence and has decorrelated any errors.

It should be noted that different considerations will apply, and the court will be less likely to grant an application to exclude witnesses from court, where the witness is also a party.

Conclusion

In response to FSHC's imposition of a subjective test for common intention, the Courts are in reality using the contemporaneous documentation in order to determine the "actual" intention of the parties. Where the witness evidence diverges from the documentation, the Court's decision will be harder, and it will have to choose between (i) disregarding that witness evidence (attributing it perhaps to faulty memory, or minimising its significance if the views of the witness were not shared with fellow decision-makers), and (ii) holding that the documentation remains the most secure indicator of contemporaneous intention. Absent unusual circumstances, a Court is likely to side with the documentation.

MICHAEL UBEROI
Outer Temple Chambers
6th October 2020

michael.uberoi@outertemple.com

Postscript: The material in this paper is for general information only, and is not intended to provide legal advice.

[8] See PBS Energo A.S v Bester Generacion UK Ltd [2020] EWHC 223 (TCC), at ¶109.
[9] The power of the court to control the way in which evidence is placed before it.
[10] The Court's general case management power, under which it may take any other step or make any other order for the purpose of managing the case and furthering the overriding objective.