Journal of Business Law

2015

Case Comment

TAEL One Partners: contractual interpretation as an iterative process

Konrad Rodgers

Joe-han Ho[*]

Subject: Banking and finance

Keywords: Contracts; Interpretation; Loan Market Association

Case: TAEL One Partners Ltd v Morgan Stanley & Co International Plc [2015] UKSC 12; [2015] Bus. L.R. 278 (SC)

*J.B.L. 393 Abstract

This article examines Tael One Partners within the framework of the iterative process to contractual interpretation. We explain the importance of the iterative process, and argue that the case demonstrates the Supreme Court's implicit affirmation and practical application of the iterative process, and discuss its implications for the lending industry.

Introduction

The Loan Market Association (LMA) is an influential trade association which publishes model legal documents that are widely used across the lending industry.[1] These documents are the outcome of a rigorous consultation and drafting process, which explains why it is rare to come across litigation over the interpretation of an LMA model legal document.

Nevertheless, such litigation does occur, as can be seen from the recent Supreme Court decision in *Tael One Partners Ltd v Morgan Stanley & Co International Plc* (*Tael One Partners*).[2] This is a rare insight into the judicial approach to contractual interpretation in the specific context of an LMA model legal document. Given the scarcity of litigation in this area, *Tael One Partners* provides valuable guidance for future disputes over the interpretation of an LMA model legal document. Owing to the broad harmonisation of contractual terms in the lending *J.B.L. 394 industry,[3] litigation involving issues of contractual interpretation have an industry-wide effect.

We argue that *Tael One Partners* is best understood as a faithful application of the iterative process to contractual interpretation. The iterative process assists the understanding of the legal principles and jurisprudence relating to contractual interpretation, and is an invaluable tool in drafting, testing and reviewing contractual interpretation analysis. Given the voluminous body of case law involving contractual interpretation, reconciling the different legal principles is not always straightforward, and the iterative process is particularly helpful in this regard. In the context of *Tael One Partners*, it allows us to see *how* and *why* the Supreme Court disagreed with the reasoning of the courts below. The influence of the iterative process is attested to by its endorsement at all levels of the judiciary, and has been extolled by Lord Grabiner and Lord Justice Lewison.[4]

Below, we analyse the application of the iterative process by focusing on three themes which were considered by the court in *Tael One Partners*, namely (1) the natural and ordinary meaning of the words; (2) the commercial context; and (3) the argument against redundancy. We suggest that this analysis shows that it was through the application of the iterative process that the Supreme Court decided the case. Even if this was not made explicit, it is what the court was doing.

In recent times, there has been a great deal of focus on the issue of the commercial context in light of *Rainy Sky SA v Kookmin Bank*,[5] but this has sometimes obscured other important principles of contractual interpretation and led lawyers and judges to neglect the iterative process. This is exactly what happened in *Tael One Partners* before the High Court and the Court of Appeal; the judges intensely scrutinised the commercial context but neglected the iterative process.[6] There is therefore

much value in keeping the iterative process at the forefront of the contractual interpretation exercise.

The facts

The LMA is an influential trade association which counts major banks, institutional investors and rating agencies as its members.[7] Its key objective is to facilitate the proper functioning of the lending industry in Europe, the Middle East and Africa. To this end, it seeks to establish sound and widely accepted market practice, and publishes model legal documents for its members' use, with these documents produced after extensive consultation with leading loan practitioners and law firms so as to represent an agreed common view of documentation structures.[8] This ***J.B.L. 395*** standardisation of documents is intended to allow lenders and borrowers to focus on and tailor the more important commercial aspects of their individual transactions.[9]

These LMA model legal documents are of excellent quality and their widespread use reflects the trust reposed in them by market participants. From a macro-economic perspective, the availability of these documents allows broad harmonisation of contracts used across the lending industry, and thereby improves legal certainty while reducing transaction and agency costs. It also reduces the incidence and costs of litigation, while improving the robustness of the judgments.[10] All these factors promote commercial certainty.

However, on the downside, a consequence of using standardised boilerplate (i.e. basing contracts on LMA model legal documents) is that market participants may place limited thought into such clauses beyond the broad industry understanding of their effect, which can make the court's assessment of these clauses in a dispute difficult. *Tael One Partners* was such a case.

In *Tael One Partners*, the claimant (Tael) held a $32 million participation share as a lender in a $100 million syndicated loan. The loan facility was for 24 months, and provided for payment of interest at a rate of 11.25 per cent per annum, accruing daily but payable three months in arrears. The loan facility also provided for a "payment premium" to be paid by the borrower at the same time as repayment of the capital of the loan. This enhanced the rate of return to the lenders to a total of 20 per cent per annum (or in some circumstances, depending on when or how the loan was repaid, 17 per cent per annum).

In January 2010, Tael transferred an $11 million participation share (out of its total $32 million participation share) to the defendant (Morgan Stanley).[11] This was documented in a transfer certificate subject to the terms of an LMA trade confirmation which incorporated the LMA Terms. It was agreed that payment would be made on the settlement date of January 14, 2010.

In March 2010, Morgan Stanley sold its entire $11 million participation share to a third party (Spinnaker). On December 16, 2010, the $100 million loan was repaid, and the borrower paid the payment premium to the relevant lenders. Those lenders included Tael (which still held a $21 million participation share) and Spinnaker. It did not include Morgan Stanley, which had already divested its entire participation share to Spinnaker.

Tael then commenced proceedings against Morgan Stanley, alleging that the LMA Terms required Morgan Stanley to pay over that proportion of the payment premium in respect of Tael's $11 million participation share which had (purportedly) accrued as at the settlement date. The dispute ultimately turned on the interpretation of condition 11.3(a) and condition 11.9 (the Conditions) of the LMA Terms: ***J.B.L. 396***

- Condition 11.3(a) was headed "Paid on Settlement Date". The condition provided:

  (a) "… the Buyer shall pay to the Seller on the Settlement Date an amount equal to the amount of any interest or fees *accrued up to* but excluding the Settlement Date in respect of the Purchased Assets (other than (i) PIK Interest and (ii) the fees referred to in paragraph (b) of Condition 11.9 (Allocation of interest and fees) which are payable after the Trade Date)."

- Condition 11.9 was headed "Allocation of interest and fees". The condition provided:

  "Unless these Conditions otherwise provide …

  (a) "any interest or fees (other than PIK Interest) which are payable under the Credit Agreement in respect of the Purchased Assets and which are *expressed to accrue by reference to the lapse of time* shall, to the extent they *accrue in respect of* the period before (and not including) the Settlement Date, *be for the account of the Seller* and, to the extent they accrue in respect of the period after (and including) the Settlement Date, be for the account of the Buyer; and

  (b) all other fees shall, to the extent attributable to the Purchased Assets and payable after the Trade Date, be for the account of the Buyer."

  (Emphasis added.)

In the legal proceedings, it was common ground between Tael and Morgan Stanley that the facility agreement provided for the payment premium to be paid at the same time as, and together with, repayment of the principal in all circumstances (including acceleration due to default).[12] It was also common ground that at the settlement date, the quantum of the payment premium which would ultimately be referable to the period prior to the settlement date was not capable of calculation.[13]

In construing the LMA Terms, the court focused on two issues, both of which Tael needed to prove for its claim to succeed[14]:

1. The payment premium fell within condition 11.9(a), or to put this another way, the payment premium was "expressed to accrue by reference to the lapse of time" (the Descriptive Issue); and

2. Condition 11.9 conferred a right to payment which was *additional* to condition 11.3(a) (the Additional Payment Issue). ***J.B.L. 397***

The decision of the Supreme Court

Tael succeeded at first instance, but Morgan Stanley successfully appealed to the Court of Appeal. Upon Tael appealing to the Supreme Court, the judges in a unanimous decision upheld the decision of the Court of Appeal and dismissed the claim. The leading judgment was delivered by Lord Reed SCJ, whose starting point to the Descriptive Issue was to consider the natural and ordinary meaning of the words. Based solely on a textual reading, Lord Reed SCJ considered it "clear" that the payment premium was not "expressed to accrue by reference to the lapse of time".[15]

His Lordship agreed with the courts below that "accrue" meant the coming into being of a right or obligation, and considered how some interest or fees accrued by reference to the lapse of time. But this did not apply to the payment premium because it accrued on a defined event.[16] Lord Reed SCJ supported this reasoning by drawing on the commercial context. His Lordship affirmed the Court of

Appeal's reasoning that the absence of contractual mechanisms for the consequences of Tael's interpretation was telling.[17] If Tael were correct, the court would have had to fill this lacuna by implying terms into the assignor-assignee contract(s).[18] This would be commercially unexpected and surprising.

Lord Reed SCJ also considered the standard practice and industry expectations in the lending industry,[19] and concluded that a court would not readily infer that a contract for the sale of a loan in a market of that nature was intended to create continuing rights and obligations between the parties to that contract, in respect of payment, which might exist over a substantial period of time. It was more natural, in such circumstances, to expect the potential value of the right to receive the payment premium to be reflected in the consideration for which the loan was transferred.[20]

Finally, Lord Reed SCJ turned to the argument against redundancy, which had featured in the lower courts. His Lordship found that, on a proper analysis of the LMA Terms as a whole, and in light of the conclusions of his judgment, there was no redundancy.[21] His Lordship concluded that the Conditions could be construed to be components of a unitary whole which had to be taken together to work. To determine the amount or amounts to be paid in respect of interest and fees, condition 11.2(a) required the buyer to pay to the seller, promptly on receipt, any interest or fees accrued prior to the settlement date, other than (1) PIK (Payment-In-Kind) interest and (2) fees not falling within condition 11.9(a), which were payable after the date when the contract was concluded.[22] Condition 11.3(a) required the buyer to pay to the seller, on the settlement date, any interest or fees accrued prior to the ***J.B.L. 398*** settlement date, subject to the same exceptions.[23] And so conditions 11.2(a) and 11.3(a) (and also condition 11.4) could only be applied together with conditions 11.9(a) and (b).[24]

Having disposed of the claim, Lord Reed SCJ nevertheless proceeded to analyse the Additional Payment Issue, and roundly rejected Tael's submissions. His starting point was again the natural and ordinary meaning of the words, and while he acknowledged that the difference in phraseology between the Conditions suggested different legal consequences, his Lordship was persuaded that the language used elsewhere in the LMA Terms indicated that condition 11.9 was not intended to confer an additional right to payment.[25] There were two markers for this. The first marker was the absence from condition 11.9 of any provision for payment.[26] This was analysed in light of the heading ("Allocation of interest and fees"), and the language "for the account of", when read together with other conditions which imposed an obligation to "pay" (or in the case of condition 11.6, clarified that no such obligation was imposed).[27] The second marker was the absence of any provisions addressing the possibility of default by the borrower, given that such provisions could be found in conditions 11.2(b) and 11.3(c).[28] On this basis, Tael's arguments regarding the Additional Payment Issue failed.

The iterative process of contractual interpretation

Before proceeding to analyse *Tael One Partners* within the framework of the iterative process, some explanation is required of what the iterative process means.

In *Re Sigma Finance Corp (In Administration.)*,[29] Lord Neuberger, in a dissenting speech, stated the following under the heading "The approach to construction":

"The inevitable point [to start the contractual interpretation] is the language of the provision itself … where the interpretation of a word or phrase is in dispute, the resolution of that dispute will normally involve something of an iterative process, namely checking each of the rival meanings against the other provisions of the document and investigating its commercial consequences." [30]

This obiter dictum proved influential and was endorsed in subsequent case law at all levels of the judiciary. It was affirmed in the Supreme Court in *Rainy Sky*,[31] applied in the Court of Appeal,[32] and "wholeheartedly endorse[d]" in the High Court.[33] These unanimous judicial endorsements made crystal clear the considerable influence of the iterative process before the courts.

The iterative process was elaborated upon by Lord Justice Lewison in the Court of Appeal: ***J.B.L. 399***

"The iterative process thus described is not confined to textual analysis and comparison. It extends also to placing the rival interpretations within their commercial setting and investigating (or at any rate evaluating) their commercial consequences … where possible, the court should test any interpretation against the commercial consequences. That is part of the iterative exercise of interpretation. It is not

merely a safety valve in cases of absurdity." [34]

The importance of the iterative process was also amplified by Lord Grabiner, who wrote in an article that

"Lord Neuberger's iterative process is fundamental … It is [the commercial purpose of a contract] that will reveal whether the parties used the particular words correctly or not. It is critically important that the "commercial purpose" of the transaction is derived from the contract as a whole and from an accurate understanding of the way in which the various provisions interact".[35]

The iterative process therefore neatly encapsulates the fundamentals of contractual interpretation—to always begin with the language used, compare rival interpretations, test alternative formulations against other provisions, and investigate the commercial consequences. These are all helpful guidelines for the singular purpose of ascertaining the meaning which the document would convey to a reasonable person having all the background knowledge that would reasonably have been available to the parties in the situation in which they were at the time of contracting.[36]

We argue that the iterative process is an invaluable analytical tool in drafting, testing and reviewing contractual interpretation analysis for at least four reasons.

First, it emphasises that the principles of contractual interpretation are really a collection of general truths.[37] These "principles" are not rigid rules, but are guidance to point towards the true meaning of the contract. When applying these principles to complex facts, and where the principles exist in a state of tension, the danger arises that a particular principle may be erroneously regarded as having primacy. The iterative process reduces this risk by placing these principles at the forefront of the mind without giving undue prominence to any factor. The commercial context informs the analysis, but it does not predominate.[38] The starting point is still the actual words used in the contract.

Secondly, it underscores the expansive objective approach to contractual interpretation, which represents the modern position of English law. The expansiveness of the modern position was famously explained by Lord Hoffmann ***J.B.L. 400*** in *ICS* [39] where, subject to two exceptions,[40] the factual matrix includes "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man".[41] This expansive tenor is seen in the emphasis on the commercial setting and the investigation of the commercial consequences. As Lewison LJ stated, the iterative process applies to *all* exercises in contractual interpretation; it is not "merely a safety valve in cases of absurdity".[42] The days of literalism are long gone. The iterative process is a powerful reminder that while a balanced inquiry is required, ambiguity is not required to look beyond the disputed clause, and that one must not be lured to think that contractual interpretation is confined to the dictionary meaning of words.

Thirdly, it focuses the mind on the proper understanding and role of the commercial context. This is closely related to the previous two reasons, but is sufficiently important and distinct to be an independent reason. Lord Grabiner has warned of the

"temptation to turn the process of construction on its head and a party seeking to circumvent clear wording will inevitably encourage the court to look for (and 'find') the commercial purpose not in those clear words, but in the background to the transaction or in broader notions of (supposed) commercial common sense".[43]

This must be firmly resisted, and the iterative process is a guiding compass here. In applying the iterative process, the contract must be read as a whole, the way the various provisions intended to interact must be accurately understood, and the commercial context properly characterised. This feeds into how the "principles" of construction are really a collection of general truths, and while they have probative value in indicating the correct answer, they must be properly framed in the commercial context. The commercial context cannot be an abstract factor which comes in merely as evidence of the background or as broad notions of commercial reasonableness. Rather, it must always be rooted in the terms of the contract.[44]

Fourthly, it emphasises the need to systematise the approach to contractual interpretation. The one true meaning of the contract is the "best fit" interpretation, or put another way, the least worst interpretation. The process is therefore both competitive and holistic. It is competitive because rival interpretations vie as candidates for the one true interpretation, while the benchmark is holistic in that each rival interpretation is tested against the contract (and the admissible background) as a whole. This systematic aspect of the iterative process makes it a powerful tool to draft, test and review

contractual interpretation analysis.

There are of course criticisms which may be levelled at the iterative process. On one level, the iterative process may be critiqued as an incantation of trite law and of little assistance to resolving complex contractual interpretation issues. There is additionally a deluge of academic literature on contractual interpretation. But that is to miss the point. The value of the iterative process, as elucidated in the ***J.B.L. 401*** four reasons above, is as an analytical tool to guide the application of the relevant legal principles. It is helpful in obtaining a proper understanding of the legal principles and jurisprudence relating to contractual interpretation, and is an invaluable aid in drafting, testing and reviewing contractual interpretation analysis. The value which a lawyer brings to proceedings is in the analytical and advocacy skills deployed to apply the principles correctly to particular facts. Indeed, the complexity of modern commercial disputes and the deluge of academic literature mean that a succinct and effective analytical tool will be all the more useful to cut through the complexity. While the iterative process may appear at first blush to be beguiling simple, that belies its very considerable influence and persuasiveness before the courts, as attested to by its endorsement at all levels of the English judiciary.

On another level, the iterative process may be critiqued as unhelpful given the ambiguity which inevitably plagues genuine contractual construction issues. There is more force to this concern, and there are two answers to this. First, such ambiguity is inherent in the nature of language, where meaning is conventional and constantly evolving.[45] The circumstances which lead to commercial litigation also exacerbate the difficulties, for it is impossible for commercial men to foresee all the vicissitudes of commercial fortune, and business bargains are often struck under great pressure of events and time.[46] There is no magical panacea to this, and the law does the best that it can. On a second and related note, and more importantly, commercial law works hard to promote maximum certainty and mitigate this problem, and the iterative process is a key aspect of this mitigation. Given that English law views every contract as having only one correct meaning, the iterative process is an invaluable analytical tool in guiding the analysis to the correct answer.

The importance of the iterative process as an analytical tool cannot be overstated. In an age where commercial litigation involves ever larger sums of money and increasingly labyrinthine facts, a guiding lodestone is invaluable to cut through the complexity and achieve a principled outcome. This is done by constantly drafting, testing and reviewing the analysis using an iterative approach. Already, Lord Grabiner has observed how it is increasingly frequent for authorities to be cited in support of arguments on contractual interpretation that are

"in truth no more than an invitation to the court to rewrite the contract because the result that might otherwise be produced by an iterative analysis is unattractive".[47]

We argue that the iterative process is imperative to maintain clarity of thought. Its proper application is the hallmark of rigorous analysis, and this is seen from the ***J.B.L. 402*** manner in which the Supreme Court approached the interpretation issues in *Tael One Partners*.

Framing Tael One Partners within the iterative process

Now that the iterative process has been explained, an analysis of *Tael One Partners* within its framework may be undertaken. Below, we conduct this analysis by focusing on three themes which the court considered in *Tael One Partners*, namely (1) the natural and ordinary meaning of the words; (2) the commercial context; and (3) the argument against redundancy.

Analysis of the judgments—the natural and ordinary meaning of the words

In the judgments, the uniform starting point was the natural and ordinary meaning of the words. All the judges agreed that the payment premium could not fall within condition 11.3(a) because the natural and ordinary meaning of "accrue" meant a vested right (whether it was ascertained or ascertainable by reference to past events).[48] However, this turned out to be the only common ground in the judgments.

For the Additional Payment Issue, the key difference in the judgments was the extent to which rival meanings were checked against other provisions of the document. Popplewell J's focus in the High Court was what the Conditions *did say*, and much reliance was placed on what inferences could be drawn focusing on a textual analysis of the conditions. This persuaded his Lordship that the

Conditions differed in their substantive content: condition 11.3(a) addressed something which had accrued *at an identified point in time* (i.e. the settlement date), while condition 11.9(a) addressed something which accrued *by reference to a period of time*.[49]

When this analysis is framed within the iterative process, it becomes apparent that Popplewell J could have further examined the Conditions "against the other provisions of the document", including what the Conditions *did not say*. To put this in a different way, the Court of Appeal and Supreme Court were more faithful to a systematic approach of comparing rival interpretations against the other contractual clauses. This was precisely how the Court of Appeal to some extent, and the Supreme Court to a greater extent, differed from the High Court's approach.

In the Court of Appeal, Longmore LJ, while acknowledging the force of Popplewell J's reasoning, turned his attention to what the Conditions *did not say*. Longmore LJ, when contrasting condition 11.9(a) against the other conditions in the LMA Terms, discovered three oddities which proved decisive. First, there was a curious absence of the word "pay" (which several other conditions used).[50] Secondly, there was no contractual mechanism to cater to such payment.[51] Thirdly, ***J.B.L. 403*** it was strange that condition 11.9(a) would use the formulation "for the account of" when it could easily have used the word "pay".[52]

More importantly, and bearing in mind that the iterative process is a competitive exercise benchmarked against which interpretation is the "best fit", which reflects how the "principles" of contractual interpretation are really a collection of general truths, Longmore LJ managed to reconcile these oddities without straining the natural and ordinary meaning of the phrase "for the account of". In his Lordship's view, that phrase was entirely apt to describe how sums already decided to be payable should be dealt with in any accounting exercise undertaken by the parties when such obligations are already imposed by other conditions.[53] This was an elegant interpretation which, we respectfully submit, was a better fit than the High Court's findings.

The Supreme Court proceeded along similar lines and reached the same conclusion, albeit after further buttressing the reasoning. Lord Reed SCJ first acknowledged the force of the reasoning in the courts below, and then pointed to how condition 11.9(a) did not address the possibility of default by the borrower.[54] This was odd given that this risk was expressly contemplated and addressed in two other conditions in the LMA Terms, and was another reason to support the conclusion of the Court of Appeal. Again, framed within an iterative process analysis, this must be the correct interpretation.

We suggest that the difference in the judgments does not simply amount to judicial disagreement where a different judge on a different day might have agreed with Popplewell J. Rather, we respectfully submit that Popplewell J did not sufficiently take into account the content of and interrelationship with the other contractual clauses. We respectfully argue that a more faithful application of the iterative process might have provided his Lordship closer guidance to the correct answer.[55]

Analysis of the judgments—the commercial context

It has already been discussed above how the iterative process provides guidance for the commercial context to inform—but not predominate—the analysis.[56] It was therefore no surprise that all the judgments explicitly recognised and were heavily influenced by the commercial context in *Tael One Partners*. In the High Court, Popplewell J addressed the commercial architecture of the LMA Terms, and discussed whether his findings would lead to commercial impracticalities.[57] Similarly, Longmore LJ in the Court of Appeal addressed the commercial context at length in his discussion of the court implying terms into the assignor-assignee contract, and subsequent sub-assignor-sub-assignee contracts. And again, in the Supreme Court, Lord Reed SCJ made particular reference to Longmore LJ's comments on the commercial context,[58] and further discussed how the LMA Terms ***J.B.L. 404*** were intended for use in a market in which loans were traded, often between many different parties over a number of years.[59]

However, when the High Court judgment is analysed in the light of the iterative process, it becomes apparent that Popplewell J did not sufficiently take into account the wider market practice and industry expectations of the lending industry.[60] Again, we respectfully argue that a more faithful application of the iterative process might have provided his Lordship with closer guidance towards the correct answer.

In the High Court, close attention was paid to the commercial context. Popplewell J carefully

considered Morgan Stanley's submission of the "commercial logic of a clean break for both the old and new lender" and that "a final accounting between final intermediate and original lenders which had to await the repayment would … be uncommercial and impractical".[61]

However, his Lordship nevertheless felt able to conclude that Tael's arguments did not "cut across the commercial architecture of the LMA Terms as a whole",[62] and was also

"not persuaded that there are any commercial impracticalities in there having to be an accounting between lenders of record and original lenders and intermediate lenders at the conclusion of the loan".[63]

There is considerable force to his Lordship's view. When viewed within the four corners of the LMA Terms (and on the facts, including the Morgan Stanley-Spinnaker contract), it was a defensible view that Tael's arguments accorded with the commercial architecture, and that a "settling up" approach (as compared to a "clean break" approach) was practicable. There were no real practical commercial difficulties in contacting the three interested parties, and this analysis could be extrapolated within reasonable bounds to additional parties trading the same (or a sub-set of the same) debt. Within these parameters, the commercial architecture of the LMA Terms also seemed capable of accommodating this reasoning. However, we suggest that upon framing this analysis within the iterative process, his Lordship's reasoning starts to run into difficulties.

It has previously been explained how the iterative process underscores the expansive objective approach to contractual interpretation, and focuses the mind on the proper understanding and role of the commercial context. We respectfully submit that the central difficulty in his Lordship's reasoning is the implicit assumption that the combined number of final, intermediate and original lenders could be restricted to reasonable bounds. But that is to be distracted by the particular facts of the case, to misunderstand the expansive objective approach to contractual interpretation, and to be mistaken as to the commercial context.

The economic reality was that the market expectations of the lending industry ran contrary to this implicit assumption.[64] This was made clear by the Supreme Court's perceptive description of how ***J.B.L. 405***

"the LMA terms are intended for use in a market in which loans are traded. A loan may be traded many times, between many different parties, over a number of years. One would not readily infer that a contract for the sale of a loan in a market of that nature was intended to create continuing rights and obligations between the parties to that contract, in respect of payment, which might exist over a substantial period of time".[65]

The implicit assumption runs into considerable difficulties when the commercial context (i.e. the function and norms of the lending industry) is properly understood. As discussed above, the lending industry derives much of its efficiency by minimising transaction costs (a good example being the widespread use of LMA model legal documents) and this was an area where the decision of the courts would have a direct impact. The consequence of the High Court judgment was to significantly encumber the alienability of debt participation by creating an additional administrative burden (with cost and confidentiality implications) between all subsequent parties to monitor historic trades. This was commercially surprising, and a strong indication that Tael's argument was incorrect.

In addition, we suggest that the application of the iterative process would have assisted Popplewell J by revealing an additional ground to *support* his view. This additional ground is that the "clean break" approach had the potential to introduce additional uncertainty into the lending industry because the crystallisation of the payment premium was temporally unknown, and this unavailable data would be difficult and inaccurate for market participants to price. This reason provided support for the position that it was more efficient for a "settling up" approach.

However, while this additional ground has some force, it is ultimately unpersuasive both for the reasons which led the Supreme Court to its conclusion, and because commercial men are repeat players in the business and are experienced in quantifying and pricing risk. Nevertheless, the important point here is that this additional ground was not raised or canvassed at all before the High Court. This was a missed opportunity to contribute to the High Court analysis.

We argue that the proper application of the iterative process—with its systematic requirement to place rival interpretations within their commercial setting and investigate their commercial consequences—might have better flagged this additional ground to his Lordship (or to counsel). Even

though we consider that this should not have radically changed the ultimate analysis, its inclusion would have contributed to the fullness of the reasoning.

As with the previous theme, we suggest that the differences in the judgments do not simply amount to judicial disagreement where a different judge on a different day might have agreed with Popplewell J. Rather, it is respectfully submitted that a more faithful application of the iterative process might have provided Popplewell J with closer guidance towards the correct answer.

Indeed, it is telling that the Court of Appeal and the Supreme Court were heavily influenced by how Tael's submissions necessarily entailed additional terms being implied into subsequent sub-assignor to sub-assignee contracts, but that this was ***J.B.L. 406*** wholly unaddressed by the High Court.[66] We argue that a proper application of the iterative process, or "placing the rival interpretations within their commercial setting and investigating … their commercial consequences", might have provided the High Court with closer guidance in considering the broader market expectations of the lending industry.

Analysis of the judgments—the argument against redundancy

The argument against redundancy in *Tael One Partners* is of interest because it engages all four reasons which underpin the importance of the iterative process as an invaluable analytical tool. This argument was persuasive before the High Court, considered but dismissed as unpersuasive before the Court of Appeal, and not required before the Supreme Court.

The argument against redundancy, taken on its own, is not particularly compelling.[67] In the Court of Appeal, Longmore LJ acknowledged that his reasoning rendered condition 11.9(a) redundant, but held that this outcome was not altogether surprising in a 20-page complex document.

The recognition that this argument is weak is simply a reflection of human nature. Bearing in mind how "principles" of contractual interpretation are really a collection of general truths, a reasonable contracting party is nevertheless susceptible to infelicitous drafting which produces redundancy, particularly when the contract is lengthy or complex. However, the relative weakness of the argument against redundancy (or to put the same point differently, the relative ease to displace the general truth that reasonable contracting parties intend and actually do draft every word in a contract to be relevant and not superfluous) is only part of the analysis. When the iterative process is properly applied, it—by examining the words used and the admissible factual background—focuses the mind on the expansive objective approach towards contractual interpretation, and to properly characterise the commercial context. It is within this backdrop that a systematic comparison of rival interpretations against the various contractual clauses is undertaken. Insofar that it is still unclear which of the rival interpretations is the correct answer, it is then a matter of judgment as to which is the "best fit", and it is often the hallmark of a correct interpretation that it is an elegant solution which neatly removes the redundancy. Indeed, this is precisely what the Supreme Court found in *Tael One Partners*.[68]

Caution must be stressed here. This is not at all an easy point because, while elegance and coherence are pointers towards the correct construction, on certain facts the correct answer is sometimes a recognition that a more awkward ***J.B.L. 407*** construction was what the parties truly objectively intended. So much of the contractual interpretation exercise is contextual.

On the facts of *Tael One Partners*, as with the previous theme, we (with rather more diffidence here) submit that on the argument against redundancy, the more elegant solution of the Supreme Court is to be preferred to the Court of Appeal's solution. We suggest that the iterative process would have at least presented a persuasive account of the more elegant solution to the Court of Appeal, and the court might have found it helpful to canvass this possibility in more detail.

The limits of the iterative process

Two criticisms of the iterative process have already been discussed above. While we strongly suggest that the iterative process is an invaluable tool to guide practitioners to the correct answer, we acknowledge that there can sometimes truly be seams of grey where there is legitimate judicial difference in opinion.[69]

This can be seen in *Tael One Partners* in the context of the Descriptive Issue. The Supreme Court, *solely* by scrutinising the text of the Conditions alone, unanimously held that it was "clear" that the

payment premium did not fall within condition 11.9(a). This was a surprising result.[70] In the High Court and the Court of Appeal below, the judges had unanimously found that Tael's argument succeeded. It is a reminder that while the iterative process may help guide analysis to the best possible answer, there are always limits to its accuracy.

However, while this illustrates the limits to which commercial law grapples with the inherent uncertainty and dynamism in any contractual interpretation exercise, for the reasons fully explained above, it takes nothing away from the power of the iterative process to assist in the understanding of the legal principles and jurisprudence, and as an invaluable tool in drafting, testing, and reviewing contractual interpretation analysis.

The impact of the Supreme Court decision on the lending industry

We suggest that *Tael One Partners* is significant in the specific context of the lending industry in three ways.

First, and most obviously, the payment premium issue is now definitively resolved in favour of the "clean break" approach, wherein the absence of express wording to the contrary, market participants are expected to have factored the value of the payment premium into the consideration payable at the point of transfer. The decision has also prompted the LMA Secondary Documentation Committee ***J.B.L. 408*** (which continually reviews and updates the market standard documentation for par and distressed debt transactions and other issues affecting the lending industry) to consider amendments to the LMA Terms to include provisions for the payment premium.[71]

Secondly, as set out in our analysis above where we evaluated the judgments within the framework of the iterative process, we have highlighted the common errors encountered in contractual interpretation, and emphasised the arguments and contractual markers which are attractive when the iterative process is applied. What does or does not have traction before the courts is now clear. While this analysis is specific to the facts of *Tael One Partners*, it is persuasive in analogous situations. The same considerations are therefore likely to apply to future disputes which also involve LMA model legal documents because the commercial context (including the contractual architecture and industry expectations) and wording are likely to be similar.

Thirdly, *Tael One Partners* is significant for its display of acute judicial sensitivity to the expectations of market participants in the lending industry. In particular, the Supreme Court was sensitive to the alienability of debt participation, and not to encumber trades with post-transaction obligations which may carry very significant cost and confidentiality implications. In this regard, we suggest that arguments from economic efficiency and alienability will carry considerable weight in informing the admissible commercial context for the court. While it is beyond the scope of this article to examine the suitability and admissibility of expert evidence here, we tentatively suggest that strong evidence of market expectations may be influential before the courts.[72]

Conclusion

Contractual interpretation disputes will always remain a fertile ground for commercial litigation. This is inevitable given the constantly evolving nature of language, the impossibility of foreseeing all the vicissitudes of commercial fortune, and the realities of business bargains often struck under great pressure of events and time. The resultant voluminous body of case law regarding contractual interpretation can also make it difficult to reconcile the different legal principles.

We have sought to explain how the iterative process assists the understanding of the legal principles and jurisprudence relating to contractual interpretation, and is an invaluable tool in drafting, testing and reviewing contractual interpretation analysis. In the context of *Tael One Partners*, it allows us to see *how* and *why* the Supreme Court disagreed with the reasoning of the courts below. But its value is not limited to the present case; it is an invaluable tool of general application.

The influence of the iterative process is attested to by its endorsement at all levels of the judiciary, and has been extolled by Lord Justice Lewison and Lord Grabiner. Its traction before the courts is undoubted. It should be rightly recognised ***J.B.L. 409*** as imperative to maintain clarity of thought, and as the hallmark of rigorous analysis. There is much to commend keeping it at the forefront of the contractual interpretation exercise.

On June 10, 2015, at the proof stage of this article, the Supreme Court gave judgment in *Arnold v*

Britton which concerned the interpretation of certain provisions in leases.[73] Lord Neuberger, giving the leading judgment, endorsed Lord Clarke's formulation of the unitary process of construction in *Rainy Sky*, and after quoting Lord Mance in *Re Sigma Finance*, confirmed that "[t]his unitary exercise involves [the] iterative process… But there must be a basis in the words used and the factual matrix for identifying a rival meaning. The role of the construct, the reasonable person, is to ascertain objectively, and with the benefit of the relevant background knowledge, the meaning of the words which the parties used."[74]

We believe that these judicial endorsements confirm the considerable and growing influence of the iterative process at all levels of the judiciary, and buttress the four reasons set out in this article which explain why the iterative process is an invaluable tool in drafting, testing, and reviewing contractual interpretation analysis.

Konrad Rodgers

Cleary Gottlieb Steen and Hamilton LLP

Joe-han Ho

Cleary Gottlieb Steen and Hamilton LLP

J.B.L. 2015, 5, 393-409

---

*. Konrad Rodgers, barrister, holds undergraduate and postgraduate law degrees from Oxford University. He is a former tutor in law at Oxford University, and a former clerk in the Court of Appeal of England and Wales. His practice focuses on commercial litigation and international and investor-state arbitration. Joe-han Ho holds law degrees from Durham University, Oxford University, and Harvard Law School. He is a former visiting lecturer at King's College London. His practice focuses on commercial litigation and international arbitration. The views expressed in this article are personal to the authors, and all errors, omissions and opinions are their own.

1. The lending industry refers, more accurately, to the European, Middle Eastern and African primary and secondary syndicated loan markets. These LMA model legal documents are adaptable to all governing laws, but are considered to be better adapted for English law. See P. Durand-Barthez, "The 'Governing Law' Clause: Legal and Economic Consequences of the Choice of Law in International Contracts' [2012] I.B.L.J. 505, 513.

2. The High Court citation is *Tael One Partners Ltd v Morgan Stanley & Co International Plc [2012] EWHC 1858 (Comm)*. The Court of Appeal citation is *Tael One Partners Ltd v Morgan Stanley & Co International Plc [2013] EWCA Civ 473; [2013] 1 C.L.C. 879*. The Supreme Court citation is *Tael One Partners Ltd v Morgan Stanley & Co International Plc [2015] UKSC 12; [2015] Bus L.R. 278*. The dispute in *Tael One Partners* was over an LMA model legal document known as the standard terms and conditions for par trade transactions (the LMA Terms).

3. Philipp Schafer has observed how LMA model legal documents have contributed to a standardisation of the market, such that numerous loan agreements have similar conditions and wording. See P. Schafer, "Facility agreements in view of the German General Terms and Conditions Law" (2011) 26 J.I.B.L.R. 484, 485.

4. Lord Justice Lewison is the author of the leading practitioner textbook in the interpretation of contracts, and his comments thus carry very significant weight. See *K. Lewison, The Interpretation of Contracts, 5th edn (London: Sweet & Maxwell, 2011)*.

5. *Rainy Sky SA v Kookmin Bank [2011] UKSC 50; [2011] 1 W.L.R. 2900*.

6. Where the context so requires in this article, when the term "judges" is used, it refers to the judges who handed down substantive judgments in this litigation, namely Popplewell J in the High Court, Longmore LJ in the Court of Appeal, and Lord Reed SCJ in the Supreme Court. Similarly, the term "judgments" refers to their judgments.

7. The lending industry is largely unregulated but privately ordered by the standard forms and procedures of the LMA. See V. Waye and V. Morabito, "The dawning of the age of the litigation entrepreneur" (2009) 28 C.J.Q. 389, 429.

8. See the LMA's website at http://www.lma.eu.com/default.aspx [Accessed May 29, 2015].

9. These model legal documents were originally drafted in conjunction with the British Bankers' Association and the Association of Corporate Treasurers in response to a demand from the industry to standardise loan agreements. See C. Gayle, "Acquisition finance: syndication best practice" [2002] I.C.C.L.R. 300, 305.

10. Given the broad harmonisation of contractual terms in the industry, most litigation involving issues of contractual interpretation has an industry-wide effect, and so functions as test cases. This encourages affected market participants to share the costs of litigation, the high stakes encourage the use of specialist legal counsel to conduct deep and rigorous analysis, and the quality of legal submissions in turn informs the robustness of the judgments.

11. The term "participation" or "participation share" is not a legal term of art. In this context, it refers to a lender under a loan agreement sub-contracting part of its risk (of the borrower's default) to another party.

12. *Tael One Partners [2012] EWHC 1858 (Comm)* at [12].

13. *Tael One Partners [2012] EWHC 1858 (Comm)* at [28].

14. Tael also needed to prove a third point, namely that the payment premium could be properly characterised as a "fee". This was because the parties executed a purchase price letter on the settlement date of January 14, 2010, which appended a schedule that exhaustively set out the interest payable in the transaction. As that schedule did not provide for any portion of the payment premium, Tael was forced to argue that the payment premium was a fee (in contradistinction to interest). However, as the Court of Appeal and the Supreme Court dismissed the claim without needing to decide this third point, we do not address it further.

15. *Tael One Partners [2015] UKSC 12; [2015] Bus L.R. 278* at [41].

16. *Tael One Partners [2015] UKSC 12* at [42].

17. *Tael One Partners [2015] UKSC 12* at [44] (which refers to [37], which in turn refers to *Tael One Partners [2013] EWCA Civ 473; [2013] 1 C.L.C. 879* at [30]).

18. *Tael One Partners [2013] EWCA Civ 473; [2013] 1 C.L.C. 879* at [30] (per Longmore LJ): "It would be necessary to imply into the sale and purchase agreement a term that the buyer would inform the seller when the loan was repaid … [and further terms into any subsequent sub-assignor and sub-assignee contracts]."

19. *Tael One Partners [2015] UKSC 12* at [44]. Lord Reed SCJ discussed how LMA Terms were intended for use in a market in which loans were traded. A loan may be traded many times, between many different parties, over many years.

20. *Tael One Partners [2015] UKSC 12* at [44].

21. *Tael One Partners [2015] UKSC 12* at [45]–[49].

22. *Tael One Partners [2015] UKSC 12* at [45]–[49].

23. *Tael One Partners [2015] UKSC 12* at [45]–[49].

24. *Tael One Partners [2015] UKSC 12* at [45]–[49].

25. *Tael One Partners [2015] UKSC 12* at [50].

26. *Tael One Partners [2015] UKSC 12* at [50].

27. *Tael One Partners [2015] UKSC 12* at [50].

28. *Tael One Partners [2015] UKSC 12* at [50].

29. *Re Sigma Finance Corp (In Administration) [2008] EWCA Civ 1303; [2009] B.C.C. 393*.

30. *Re Sigma Finance [2008] EWCA Civ 1303; [2009] B.C.C. 393* at [98].

31. *Rainy Sky [2011] UKSC 50; [2011] 1 W.L.R. 2900* at [28] (per Lord Clarke SCJ).

32. *Napier Park European Credit Opportunities Fund Ltd v Harbourmaster Pro-Rata Clo 2 BV [2014] EWCA Civ 984* at [31] (Lewison LJ).

33. *Bank of New York Mellon (London Branch) v Truvo NV [2013] EWHC 136 (Comm)* at [43] and [78].

34. *Napier Park [2014] EWCA Civ 984* at [32]–[33] (Lewison LJ).

35. Lord Grabiner, "The iterative process of contractual interpretation" (2012) 128 L.Q.R. 41, 46.

36. See Lord Hoffmann's classic statement in *Investors Compensation Scheme Ltd v West Bromwich Building Society (ICS) [1998] 1 W.L.R. 896 HL* at 912.

37. This is an uncontroversial proposition. The principles of contractual interpretation, whether applied as "rules" or "presumptions" of construction, are only of probative value in guiding the judge to decide what a reasonable person in the position of the parties would have understood the words to mean. William Swadling's discussion of what a "presumption" really means in the context of the law is insightful here. See W. Swadling, "Explaining Resulting Trusts" (2008) 124 L.Q.R. 72, 74–78.

38. A commentator, in a slightly different context, warns of the "peril that the commercially sensible construction may evolve into something which overshadows the other interpretative tools". See D. Cabrelli, "Interpretation of contracts,

objectivity and the elision of the significance of consent achieved through concession and compromise" [2011] Jur. Rev. 121, 141.

39. *ICS [1998] 1 W.L.R. 896*.

40. *ICS [1998] 1 W.L.R. 896* at 912–913.

41. *ICS [1998] 1 W.L.R. 896* at 913.

42. *Napier Park [2014] EWCA Civ 984* at [33] (per Lewison LJ).

43. Lord Grabiner, "The Iterative Process of Contractual Interpretation" (2012) 128 L.Q.R. 41, 49.

44. Although, as part of the expansive objective approach, the commercial context is integral insofar that it is the background knowledge which the contracting parties would reasonably have known at the time of the contracting.

45. See Lord Hoffmann, "The Intolerable Wrestle with Words and Meanings" (1997) 114 S. African L.J. 656.

46. As Lord Steyn elegantly expressed it:

"Disputes about the meaning of contracts is one of the largest sources of contractual litigation, notably in respect of international contracts. The reason is, in the words of Oliver Wendell Holmes, that a word is not a transparent crystal. Clarity is the aim but absolute clarity is unattainable. And it is impossible for contracting parties to foresee all the vicissitudes of commercial fortune to which their contract will be exposed. Moreover, and quite understandably, business bargains have to be struck under great pressure of events and time."

See J. Steyn, "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" (1997) 113 L.Q.R. 433, 439.

47. Lord Grabiner, "The Iterative Process of Contractual Interpretation" (2012) 128 L.Q.R. 41, 61.

48. Lord Reed SCJ did not use these exact words, but his description amounted to much the same thing. According to his Lordship, "accrue" meant the coming into being of a right or an obligation. See *Tael One Partners [2015] UKSC 12; [2015] Bus L.R. 278* at [42].

49. *Tael One Partners [2012] EWHC 1858 (Comm)* at [33].

50. *Tael One Partners [2013] EWCA Civ 473; [2013] 1 C.L.C. 879* at [29].

51. *Tael One Partners [2013] EWCA Civ 473; [2013] 1 C.L.C. 879* at [30].

52. *Tael One Partners [2013] EWCA Civ 473; [2013] 1 C.L.C. 879* at [29].

53. *Tael One Partners [2013] EWCA Civ 473; [2013] 1 C.L.C. 879* at [29].

54. *Tael One Partners [2015] UKSC 12; [2015] Bus L.R. 278* at [50].

55. It is noted that Popplewell J, in a very recent High Court judgment, cited the iterative process and observed the Supreme Court's endorsement of it. See *AL Challis Ltd v British Gas Trading Ltd [2015] EWHC 141 (Comm)* at [9].

56. It is emphasised that the three themes described in this article are a unity. The commercial context *informs* but does not *supersede* the contractual interpretation exercise.

57. *Tael One Partners [2012] EWHC 1858 (Comm)* at [34].

58. *Tael One Partners [2015] UKSC 12; [2015] Bus L.R. 278* at [44].

59. *Tael One Partners [2015] UKSC 12; [2015] Bus L.R. 278* at [44].

60. This background was admissible because it formed part of the factual matrix which the contracting parties would reasonably have known at the time of contracting.

61. *Tael One Partners [2012] EWHC 1858 (Comm)* at [31].

62. *Tael One Partners [2012] EWHC 1858 (Comm)* at [34].

63. *Tael One Partners [2012] EWHC 1858 (Comm)* at [34].

64. Ironically, this was in a sense self-perpetuating in that if the High Court's decision had been upheld, then the market expectations would change and "settling up" would be the norm. But this merely reflects the inherently conservative nature of the common law, where a novel decision, once time-honoured, becomes orthodox and hence legally certain with the passage of time.

65. *Tael One Partners [2015] UKSC 12; [2015] Bus L.R. 278* at [44].

66. With respect, this was surprising. As Lord Bingham pointed out, the implication of terms is so intrusive that the law imposes strict constraints on the exercise of this extraordinary power. See *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd [1995] E.M.L.R 472 CA (Civ Div)* at 474.

67. *Chitty on Contracts* sums this up concisely:

"It might be thought to be a sensible principle of construction that an interpretation which leaves part of the language of a document useless or creates surplusage is to be avoided. But this presumption has often been said to be of little value in the construction of commercial documents."

See *Chitty on Contracts, 31st edn, edited by H. Beale (London: Sweet & Maxwell, 2012), para.12-077*.

68. This should not detract from how, on a proper application of the iterative process, an elegant answer is not necessarily the correct answer. Elegance (i.e. in this context, an interpretation which does not encounter the argument against redundancy) is but one factor in assessing which interpretation is the "best fit".

69. That some of the litigation involving contractual interpretation may fall within this range of legitimate judicial disagreement, where different judges come to different views with no error of law being made, prompted one commentator to observe:

"If the principles of Investors clearly represent the law and provide for a ‘common sense’ approach, then there is little to be gained, beyond the confines of a particular dispute, by troubling appellate courts with questions of interpretation which essentially turn on the facts of an individual case; there will often be legitimate scope for divergence of views on what constitutes a ‘common sense’ interpretation."

See P.S. Davies, "Interpreting commercial contracts: back to the top" (2011) 127 L.Q.R. 185, 187.

70. It is noteworthy that the Supreme Court had already found against Tael on the Additional Payments Issue, and considered the Descriptive Issue only as a matter of full analysis. The judicial reasoning is therefore fully transparent as there were unlikely to be hidden public policy issues at play. It is also noteworthy that the Supreme Court’s reasoning was precisely the same reasoning deployed (most unsuccessfully) by Morgan Stanley’s Counsel before the High Court.

71. *T. Ebbs and L. Watt, "Premium—in whose Interest?", Cadwalader Clients & Friends Memo (March 31, 2015)*.

72. In this context, public statements from influential industry groups like the LMA may carry significant weight. There has also been some judicial discussion of the role of standard commentaries as a source of ascertaining the expectations of market participants: see *Torre Asset Funding Ltd v Royal Bank of Scotland Plc [2013] EWHC 2670 (Ch); (2013) 157 S.J.L.B. 41* at [30]: "the standard commentaries on the syndicated loan market and the LMA precedents reflect the general understanding in the market about the role of the Agent under a set of financing agreements modelled on the LMA precedents."

73. *[2015] UKSC 36*; [2015] WLR (D) 247. The iterative process to contractual interpretation was also cited and applied in a very recent High Court decision. See *PA(GI) Ltd v GICL 2013 Ltd [2015] EWHC 1556 (Ch)* at [28].

74. *Arnold v Britton [2015] UKSC 36* at [77].