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## Clear words and certainty of operation: the holy grail of contractual drafting

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A good example of the interpretation of contracts, in practice, arose in *Havila Kystruten AS v Abarca Companhia De Seguros, SA* [2022] EWHC 3196 (Comm), a case that concerned the disputed termination of two shipbuilding contracts.

Lawyers are routinely required to advise their clients on the likely meaning and effect of contractual provisions, in so doing seeking to predict the outcome of a determination by a court or arbitration tribunal. So the opportunity to consider a detailed judgment on the meaning of complex provisions in a shipbuilding contract merits further consideration. This is all the more so given that these types of disputes are generally subject to confidential arbitration proceedings, i.e. the reasoning employed in determining the outcome is normally not publicly available.

The judgment in *Havila*, by Mr Justice Henshaw, is set out in some detail over 159 pages and in fact addresses various legal issues. We will focus however in this article on the approach taken by Henshaw J. on the meaning and effect of certain of the termination provisions under the shipbuilding contracts.

### Background

The dispute arose out of two shipbuilding contracts concluded in April 2018 between Havila Kystruten AS (“**Havila**”), the buyer, and Hijos de J. Barreras SA (“**Hijos**”), the shipyard. Under those contracts, Hijos had agreed to design and construct two coastal passenger vessels for a contract price of EUR 108 million per vessel.

At the time of the dispute, Havila had paid Hijos three pre-delivery instalments in the sum of EUR 18.4 million per Vessel, i.e. EUR 36.8 million in total. Further pre-delivery instalments would become payable by Havila in due course under the contracts. As is customary in shipbuilding projects, Havila had the benefit of refund guarantees from Abarca Companhia de Seguros SA (“**Abarca**”) in relation to the (already paid) pre-delivery instalments. Those guarantees provided security to Havila in the event of termination of the shipbuilding contracts and a claim by Havila to recover those instalments.

The dispute arose in the context of ongoing discussions related to Havila’s financing of the project. In short, Havila’s originally intended lender was unable to provide finance in line with the structure of the project and Havila had to secure an alternative lender. Havila’s financing arrangements were also linked to the provision by Hijos of additional refund guarantees securing the repayment of the further (still to be paid) pre-delivery instalments. Indeed, it appears from the judgment that the provision by Hijos of that security was contingent upon Havila securing financing for the project.

### The disputed provisions

There were lengthy discussions related to Havila’s financing and various addenda to the contracts were concluded between the parties. In one addendum (Addendum 7), there were two important provisions agreed between the parties as follows:-

- (1) That Havila would, within a prescribed deadline, provide a “*written, committed statement*” from its new lender confirming Havila’s alternative pre- and post-delivery financing for the vessels.

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- (2) If Havila missed that deadline, then Hijos could terminate the contracts – but only if both Hijos and Havila came to the conclusion, after a 14-day good faith negotiation period, that there were no other alternative arrangements open to Havila.

These provisions were drafted in circumstances where there was no fault on the part of Havila for having failed to arrange its financing. The reason that Havila's intended financing fell through was associated with the complex tax structure that applied to the projects, i.e. not because of any (financial) shortcomings on the part of Havila. Indeed, as a whole, the provisions appear to be aimed at finding a solution to Havila's financing issues that would permit the project to proceed.

## The dispute

Matters ultimately came to a head because of problems related to Hijos' solvency. Just before it petitioned the Spanish courts for its dissolution, Hijos purported to terminate the contracts relying on the two provisions noted above. It sought to do so on grounds that Havila had failed to provide a "*written, committed statement*" of financing, neither by the initial prescribed deadline or, subsequently, during the 14-day negotiation period.

In response, Havila contended that Hijos was not entitled to terminate under those provisions and its purported termination was therefore a repudiatory breach, which Havila accepted as bringing the contracts to an end. Havila sought recovery from Abarca (under the refund guarantees) of the instalments already paid.

## The principles applied by the court

Before turning to the court's interpretation of the provisions relied upon by Hijos (and Abarca), it is worth saying something about the guiding principles. In this respect, Henshaw J provides a useful summary of the principles relevant to the interpretation of contracts at paragraphs 210 to 218 of his judgment. The key points to keep in mind are that:-

- The court/tribunal has to ascertain the objective meaning of the language used (i.e. what the parties think or thought the contract meant is not the test) and in the context of the whole contract.
- The court/tribunal can have regard to the factual background in determining the meaning of a contractual provision. This can include evidence of what was said or done at the time the contract was concluded, but only to the extent that this establishes a fact that is relevant as background (i.e. evidence of negotiating positions is not admissible). Such facts also need to have been known or reasonably available to both parties at the time the contract was made.
- The aim or commercial purpose of a transaction or provision can also be relevant factual background, but that will always be assessed objectively by reference to what reasonable people would have understood the parties had in mind.
- The process of interpretation is an "iterative" process. This means that rival constructions are checked against the provision of the contract, business common sense, and their commercial consequences. However, the language of the contract itself is also critical, and where (such as in this case) the court/tribunal is dealing with complex agreements concluded with the assistance of skilled professionals, then the contract should be interpreted principally by analysis of the words themselves (a "textual analysis").

## The court's analysis

The central thrust of the arguments on behalf of Hijos/Abarca were that:

- (i) to comply with its obligation to provide a "*written, committed statement*" of financing, Havila had to provide executed loan documents evidencing its new financing arrangements. Whereas what Havila had in fact provided to Hijos was a term sheet from its new lender; and
- (ii) once Havila had failed to provide proper evidence of its financing (by way of executed loan agreements), there was no requirement for the parties to come to any conclusion about other arrangements. Instead, Havila had a further 14-days to provide to provide evidence of its financing arrangements.

### *The written, committed statement*

Part of the basis on which Hijos/Abarca put this argument was that Havila knew that Hijos' bank needed sight of executed loan agreements; and that a non-binding term sheet was insufficient. This was said to be a fact relevant to the interpretation of the provision. However, on the evidence, Henshaw J determined that there was no coherent basis to reach this conclusion, i.e. it could not be said, on the basis of the witness evidence before the court, that Havila knew this was a requirement of Hijos' bank. So this was not a fact known to both parties and so not something that was relevant to the interpretation of the contracts.

As to the words themselves, i.e. a "*written, committed statement*", Hijos/Abarca argued that this had to amount to an obligation to provide executed loan agreements. They relied on wording in the relevant provision that talked about Havila giving "*confirmation*" (in the form of a "*written, committed statement*") of its pre- and post-delivery "*financing*". They drew on the word "*committed*", which they said indicated an unequivocal promise to provide finance, which was something that a bank could only provide if it had signed a binding contract to lend. Additionally, Hijos/Abarca argued that this mechanism in the contracts was included to provide a regime to allow Havila to bring its performance back up to speed and, if Havila could not, to allow Hijos to terminate.

These arguments were rejected by Henshaw J for a number of reasons:-

- His (textual) analysis was that the words were much more apt to refer to a commercial commitment to lend, i.e. an in-principle indication that a bank was prepared to lend on specified terms, but without any binding legal agreement yet in place. That is something that a bank normally provides by way of a term sheet.
- Havila's witnesses had explained that the issue by a bank of a term sheet represents an important degree of commercial commitment to a proposed transaction. Henshaw J accepted that evidence, which was important commercial context and supported his analysis of the meaning of the words.
- Henshaw J also considered that the word "*financing*" did not have any special meaning in this provision – it was used as a means of identifying the underlying problem associated with financing the project. He also considered that the word "*financing*" itself, in its ordinary meaning, was not a term necessarily synonymous with executed legal contracts. The key point was that its meaning had to be taken from the context.

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- Henshaw J also did not agree that Havila was at fault for the current position. So it was not part of the relevant factual background to say, as Hijos/Abarca did, that the provisions were agreed in order to bring Havila's performance back up to speed.
- The key-point, emphasised throughout by Henshaw J, was that if the parties had meant for Havila to provide executed loan agreements, then it would have been easy to say so in the contract.

In the circumstances, the term sheet provided by Havila was a "*written, committed statement*" of the kind required by the contracts.

An additional point of interest to note is that Hijos/Abarca also sought to rely on wording in later addenda to the contracts (i.e. addenda concluded later in time to Addendum 7 containing the requirement on Havila to provide a "*written, committed statement*"). We do not consider the related arguments made by Hijos/Abarca, but what is interesting to note is that, in principle, Henshaw J thought that it was arguable that those later addenda could be relevant to the interpretation of the earlier addenda. This was despite the fact that they are later contracts (and therefore would normally be inadmissible), and because all of the addenda read together can arguably be said to be relevant to the interpretation of the shipbuilding contracts a whole. However, Henshaw J did not reach a final view on that point given that he did not consider that the later addenda assisted.

## *A conclusion about other arrangements?*

One of the ways that Hijos/Abarca put their argument on this issue was that, as a minimum, Havila had to provide evidence of its financing during the 14-day good faith negotiation period. They said that it would be nonsensical for the parties to have agreed (in the first provision noted above) that Havila must provide a "*written, committed statement*" by a set deadline, but that when that deadline was missed (and a right to terminate potentially triggered) allow a further 14-day period for good faith negotiations at the end of which Hijos could only terminate if the parties concluded no other alternative arrangements were open to Havila. Such an interpretation, Hijos/Abarca argued, would mean that the requirement to provide a "*written, committed statement*" was redundant.

Henshaw J took the view that the language and purpose of this provision spoke for itself, and it did not need the kind of "*reinterpretation*" suggested by Hijos/Abarca. The provision did not involve setting any further deadline for Havila to provide evidence of alternative financing arrangements. Rather, it envisaged good faith discussions by the parties over a 14-day period. A right of termination would then only arise if a conclusion was reached by both Hijos and Havila that there was no alternative financial arrangement to be provided by Havila sufficient to avoid termination of the contracts. A right to terminate simply did not arise unless and until such a conclusion was reached by the parties and, on the evidence, no such conclusion had been reached.

## **Clear wording always the answer?**

It feels trite to make this point, but in this case clearer wording was needed if Hijos/Abarca were to succeed with their arguments. The wording that required a "*written, committed statement*" was in the end far too imprecise to impose an obligation to provide executed loan agreements. On their face, and judged objectively, those are not words that connote such an obligation. When considered against the commercial context and the factual background, which also militated against Hijos/Abarca's interpretation, it was therefore always going to be challenging for Hijos/Abarca to persuade the court to accept their arguments. The upshot is, if something is critical, spell it out clearly.

Arguably, that is precisely what the parties did do in relation to the second provision dealing with the 14-day good faith negotiation period. That provision was quite clear in its drafting: there had to be a conclusion reached between the parties. The problem with that provision, however, is that one can see that difficulties could plainly arise in determining when, or if, any conclusion had been reached. In the context of the operation of a termination mechanism, such uncertainty is at best unhelpful and at worst fraught with danger for the party seeking to rely upon it. So the answer is most likely twofold: use clear words, but also ensure that the relevant provision is capable of being operated with certainty.