It All Makes Sense Now...

In the recently reported case of Arnold v Britton and Others [2015] UKSC 36 the Supreme Court has confirmed that where words used in a contract are clear, they will not seek to interpret them in a manner that would depart from their normal everyday meaning merely because such an alternative interpretation may make more commercial common sense.

The parties' rights and obligations will therefore be confined to the normal and everyday meaning, even though that may result in a very bad bargain having been entered into by one of the parties.

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Introduction

This concerns a majority (4-1) decision by the Supreme Court regarding the interpretation of a service charge clause in 99-year leases for twenty one chalets.

The wording of the tenants' obligation under clause 3(2) in fourteen of the leases is as set out below; the additional wording in bold was included in the other seven leases.

"To pay to the Lessor without any deduction in addition to the said rent ***as*** *a proportionate part of the expenses and outgoings incurred by the Lessor in the repair maintenance renewal* ***and renewal of the facilities of the Estate*** *and the provision of services hereinafter set out the yearly sum of Ninety Pounds and value added tax (if any) for the first year of the term hereby granted increasing thereafter by Ten Pounds per Hundred for every subsequent year* ***or part*** *thereof".*

Further, four of the twenty one leases also included the word *'for'* before *'the yearly sum of ninety pounds'.*

The landlord (Arnold) and tenants (Britton and others) disagreed on how this should be interpreted. It can be seen that there is a conflict between:

- the first part of the clause, that requires a proportionate part; and
- the second part that requires the payment of a fixed sum that is increased yearly by the defined amount.

The landlord said the tenants had to pay an initial annual service charge of £90, increasing by 10% per annum (compounded) thereafter.

The tenants argued that the covenant was only intended to cover each tenant's proportionate contribution to the maintenance and related costs; and that the "£90 plus 10% per annum" calculation was only intended as a cap.

The Court's Decision

The Supreme Court, in dismissing the tenants' Appeal, found that a reasonable reader of Clause 3(2) would consider:

- the first part as descriptive of its purpose, i.e. to provide for an annual service charge;
- the second part as a quantification of that service charge;
- that the second part provides for a fixed increase in the annual sum as the parties assumed that the cost of providing the services would increase; and
- that during the 1970s and 1980s inflation had been running at over 10% per annum (indeed over 15% for 6 of the years) – and hence both parties were taking a gamble as to the inflation rate.

The leading Judgment was by Lord Neuberger who usefully emphasised seven factors that should be considered when interpreting a contract:

- 'Commercial common sense' and surrounding factors should not be invoked to undervalue the importance of the language used in the provision that requires to be construed:
  "Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract. And, again save perhaps in a very unusual case, the parties must have been specifically focussing on the issue covered by the provision when agreeing the wording of that provision";
- there is no justification for the Court searching for bad drafting as a basis on which to depart from the natural meaning of the words used, a drafting error may have no relevance to the issue of interpretation.
- commercial common sense is not to be invoked retrospectively;
- whilst commercial common sense is a very important factor, a Court should be very slow to reject the natural meaning of a provision as correct simply because it appears to result in a bad bargain for one party;
- any interpretation can only take into account facts or circumstances which existed at the time that the contract was made, and which were known or reasonably available to both parties; it is not right to take into account a fact or circumstance known only to one of the parties;
- where an event subsequently occurs that was not intended or in the contemplation of the parties, if it is clear what they would have intended the Court will give effect to that intention; and
- service charge clauses are not subject to any special rule of interpretation and therefore it is not necessarily to construe them restrictively.

Conclusions:

From this decision it can be seen that:

- Courts will be slow to interpret clauses in a manner that is contrary to (on an objective view) their everyday natural meaning;
- commercial common sense should only be applied where the meaning of the relevant provision is ambiguous;
- Courts will not step in to save a party from a bad bargain; and
- the subjective intention of the parties is not relevant for the purposes of interpreting written contracts – the test is an objective one.

Arnold v Britton is a prime example of the vital importance of both precision in drafting and the need for due diligence and careful review prior to entering into a contract.