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The Supreme Court Adopts a Literal Approach to the Construction of a Commercial Contract

Arnold v Britton and others [2015] UKCS 36

"Reliance placed in some cases on commercial common sense and surrounding circumstances should not be invoked to undervalue the importance of the language of the provision which is to be construed". The leading judgement given by Lord Neuberger of the Supreme Court in this case followed the literal rather than the purposive approach. This has provided important clarification of the role of commercial considerations when construing commercial contracts particularly in light of *Rainy Sky SA v Kookmin Bank* [2011] UKCS 50.

This dispute related to the proper meaning of service charge provisions in a number of holiday chalet leases. The significance of their lordships 3-1 majority decision, however, is much wider in scope and extends to the construction of commercial contracts in general.

The Background Facts

The litigation arose out of the interpretation of a service charge provision contained in 25 of the 91 leases entered into between the years 1970 and 1991 regarding chalets in Oxwich Leisure Park. It was argued by the landlord that the service charge provision in clause 3(2) contained in these 25 leases required the tenants to pay an initial service charge of £90, which increased by 10% each year. The remaining leases, however, increased by 10% only every three years. Clause 3(2), although differing in small respects between the 25 leases, essentially provided that:

"To pay to the Lessor without any deductions 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."

The tenants contended that the landlord's construction would result in such an absurdly high annual service charge in the later years of each of the 25 leases that it could not be correct. The tenants argued that clause 3(2) only required them to pay a "*proportionate part*" of the landlord's costs of providing the contractually required services and that the 10% increase was the maximum that could be charged. In other words, the tenants contended that the words "*up to*" should be read into clause 3(2) so that the clause states "*…the provision of services hereinafter set out up to the yearly sum of…*".

If the landlord's construction was correct, each tenant would end up paying, by the end of the lease period, service charge payments totalling over £11 million. Viewing the commercial outcome another way, assuming that a lease was granted in 1980, the service charge payment would have increased from £90 in 1980 to £2500 in 2015. By 2072, the service charge would be £550,000.

Therefore, the key question the court had to decide was what, using the rules governing contractual construction, does clause 3(2) actually mean?

Supreme Court Decision

Lord Neuberger, giving the leading judgement, confirmed that when construing a commercial contract, the court must consider: (i) the natural and ordinary meaning of the clause; (ii) any other relevant provisions of the contract; (iii) the overall purpose of the clause and the contract; (iv) the facts and circumstances known or assumed by the parties at the time the contract was executed; and (v) commercial common sense; but (vi) disregarding subjective evidence of any party's intentions.

However, when interpreting clause 3(2), Lord Neuberger emphasised that:

1. Whilst in some cases reliance must be placed on commercial common sense and surrounding circumstances, such reliance should not be invoked to undervalue the importance of the language of the provision which is to be construed.
2. Commercial common sense cannot be invoked by reference to facts which arose after the contract was made; it is only relevant to ascertaining how matters would or could have been perceived by the parties, or reasonable people in the position of the parties, as at the date that the contract was made. The fact that an arrangement has worked out badly or even disastrously is not a reason for departing from the natural meaning of the language.
3. While commercial common sense is a very important factor to take into account when entering into a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed.
4. When interpreting a contractual provision, one 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.
5. When considering centrally relevant words, the less clear they are, the more ready the court can be to depart from their natural meaning. However, that does not justify the court embarking on an exercise of searching for, let alone, constructing, drafting infelicities in order to facilitate a departure from the natural meaning.

6. In some cases, if an event that subsequently occurs which was plainly not intended or contemplated by the parties in the wording of the contract, the court will give effect to an intention of the parties, if it is clear what the parties would have intended.

Taking the above considerations into account, it was found that the natural meaning of clause 3(2) was clear. That is the, first half of the clause provides that the lessee is to pay an annual charge to reimburse the lessor for the costs of providing the services which he covenants to provide, and the second half of the clause identifies how that service charge is to be calculated, namely as a fixed sum, with a fixed annual increase. It was therefore held that, although there are one or two small errors in the drafting, they are not enough for the court to depart from the literal wording; regardless of whether the commercial outcome is absurd or disastrous.

It should be noted, however, that Lord Carnwath disagreed with the other Lords. In his dissenting judgement, Lord Carnwath referred to a number of authorities promoting interpretation in accordance with business common sense. Two such case referred to were (1) *Antaios Cia Naviera SA v Salen Rederierna AB (The Antaios)* [1985] AC 191, in which Lord Diplock stated: "*If detailed and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense it must yield to business common sense"*; and (2) *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10, in which Lord Hoffmann stated: "*one assumes* the [reasonable person] *will take into account the practical consequences of deciding that it* [the contractual wording] *means one thing or another.*"

In considering such authorities, Lord Carnwath concluded, in disagreement with the other Lords, that the landlord's interpretation was so commercially improbable that only the clearest words would justify the court in adopting it.

Comment

It is clear from this judgement that there are limits to which courts will apply a purposive business common sense approach. The courts clarified that where wording is clear enough so that the literal meaning can be applied, such wording will be given its natural meaning whether or not the end commercial result is disastrous. Ensuring careful attention is given to the language used in expressing the contracting parties' intentions is a sure way to avoid such costly litigation. This is particularly crucial in shipping were the market is unpredictable and can be highly volatile and parties enter into long term agreements such as time charterparties.

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