Respecting the language of the contract

Richard Foss and **Ben Hillman** consider the lessons learned from three significant Supreme Court decisions on contract law in 2015

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A substantial proportion of legal disputes between commercial parties revolve around the interpretation of terms previously agreed between them.

In this jurisdiction, principles underpinning the legal interpretation of disputed clauses often appeal to business people internationally. Our legal system provides a relatively certain outcome of how these principles are applied to the facts of a particular case.

The second half of 2015 saw the Supreme Court make three landmark decisions: *Arnold v Britton and others* [2015] UKSC 36; *Marks and Spencer plc v BNP Paribas Services Trust Co (Jersey) Ltd and another* [2015] UKSC 72, and *Cavendish Square Holdings BV v Makdessi* and *ParkingEye Ltd v Beavis* [2015] UKSC 67. We take a look at them from a litigator's perspective.

All three cases involved the construction of clauses which, on their face, had severe and arguably unfair financial consequences for one of the parties. The president of the Supreme Court, Lord Neuberger, gave leading judgments in all three decisions, setting out several key principles, stressing the need for clarity when drafting, and bolstering the power of express terms when they are sufficiently clear.

There are some overarching themes in all three judgments, of which litigators should take note. The Supreme Court said it should interpret, rather than rewrite, agreements. It will only in exceptional circumstances allow commerciality at the time to override the natural meaning of words; it will not intrude to imply terms; and it has chosen, in effect, to rewrite the rule on contractual penalties. Respect for the natural autonomy of contracting parties is reinforced by respecting the natural meaning of the words originally deployed.

The judgments, or at the very least their principles, should be read carefully when drafting binding contractual terms and should be heeded when arguing interpretation in any contentious dispute.

Literal meaning

The Supreme Court in *Arnold* held that where a contract is clear, the meaning will be upheld and will not save parties (or their lawyers) from bad bargains. In this case the literal meaning of a service charge clause was upheld, despite its being extremely commercially unfavourable to the tenants. Considering commercial common sense retrospectively should not be permitted, said the court – instead, the contract should be assessed at the date of its formation.

In *Marks and Spencer*, the court recognised the intrusiveness of implying terms as distinct from construing express ones within the contract. Implying a term into a contract because it appears fair or because parties would have agreed to it are insufficient reasons to do so.

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In the conjoined appeals of *Cavendish Square Holdings* and *ParkingEye*, the Supreme Court was given the opportunity to abolish the rule regarding contractual penalty clauses but chose not to do so.

The court considered the unambiguous language of the disputed clauses and refused to engage the rule against penalties. A new test was formulated to determine whether a contractual provision is in fact a penalty: it is crucial to determine whether the provision goes beyond the innocent party's 'legitimate interest'.

The court recognised that the innocent party 'can have no proper interest in simply punishing the defaulter', and so only if the relevant clause is a secondary obligation which imposes a detriment on a contract-breaker out of all proportion to any legitimate interest will the rule on penalties be engaged.

Lessons learned

Each of these decisions is, of course, fact sensitive and case specific. As lawyers, we are faced with the knowledge that the buck stops with us. There can be little doubt as to the meaning of Lord Neuberger's comment in *Marks and Spencer* that the lease in question was entered into by 'two substantial and experienced parties and had been negotiated and drafted by expert solicitors'.

When drafting or interpreting a contract, it is advisable to:

- Draft clearly and unambiguously;
- Clearly understand the natural and ordinary meaning and the overall purpose of the clauses and the contract;
- Consider the remedies available to the parties in the event of a breach;
- Agree what the parties' primary obligations are under the contract; and
- Advise clients carefully as to their prospects of success if challenging the terms of a contract which is sufficiently clear. SJ