How to argue the meaning of a contract

Learning Objectives:

- To understand the principles the courts apply when interpreting contracts
- To identify the tensions in those principles
- To use those principles to develop a strategy to win the argument
- To study the principles in play in Duval v 11-13 Randolph Crescent Ltd

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14 May 2020

Reading list:

Wood v Capita Insurance Services Ltd [2017] UKSC 24

Arnold v Britton [2015] UKSC 36

Rainy Sky SA v Kookmin Bank [2011] UKSC 50

Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38

Ali v Lane [2006] EWCA Civ 1532

Investors Compensation Scheme Ltd v West Bromwich Building Society (No.1) [1998] 1 W.L.R. 896

L Schuler AG v Wickman Machine Tool Sales Ltd [1974] A.C. 235

Prenn v Simmonds [1971] 1 W.L.R. 1381

Reading list [cheat's version]:

TAQA Bratani Ltd v Rockrose UKCS8 LLC [2020] EWHC 58 (Comm) paras 26-27 – HHJ Pelling QC

Lewison, The Interpretation of Contracts 6th Ed

Interpretation of a contract - What are we doing?

"Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract."

Investors Compensation Scheme LTD. v West Bromwich Building Society - Lord Hoffman p912

What can we look at?

- The words the parties have used in the contract
- Commercial common sense
- The “factual matrix”

What are we not to look at?

- Subjective intentions

  Prenn v Simmonds
- Pre-contract negotiations

  Chartbrook v Persimmon
- Post-contract conduct and events

  L Schuler AG v Wickman Machine Tool Sales Ltd (exception for boundaries – Ali v Lane)

Primacy of the words the parties have used

"The exercise of interpreting a provision involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision."

Arnold v Britton – Lord Neuberger (para 17)

How to argue the meaning of a contract

"Where the parties have used unambiguous language, the court must apply it" –Rainy Sky SA v. Kookmin Bank – Lord Clarke para 23

And see example of Co-operative Wholesale Society Ltd v National Westminster Bank plc [1995] 1 EGLR 97

Court respects the language used by the parties because:

- Parties have control over the language they used in the contract
- Parties are must have been specifically focussing on the issue covered by the disputed clause or clauses when agreeing the wording of that provision

Arnold v Britton – para 17

Way to win Number 1.

1. Unambiguous Language

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If not unambiguous then what?

"when it comes to considering the centrally relevant words to be interpreted, I accept that the less clear they are, or, to put it another way, the worse their drafting, the more ready the court can properly be to depart from their natural meaning. That is simply the obverse of the sensible proposition that the clearer the natural meaning the more difficult it is to justify departing from it."

Arnold v Britton – Lord Neuberger - para 18

Or…

"where a term of a contract is open to more than one interpretation, it is generally appropriate to adopt the interpretation which is most consistent with business common sense"

Rainy Sky – Lord Clarke - para 30

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"where a term of a contract is open to more than one interpretation, it is generally appropriate to adopt the interpretation which is most consistent with business common sense"

Rainy Sky – Lord Clarke - para 30

Tension with:

"the clearer the natural meaning the more difficult it is to justify departing from it"

Arnold v Britton – Lord Neuberger - para 18

How to reconcile weight given to contractual words and business common sense?

"the court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning"

Wood v Capita Insurance Ltd – Lord Hodge (with whom both Lord Neuberger and Lord Clarke agreed) - para 10 (see also para 13)

But remember…

"negotiators of complex formal contracts may often not achieve a logical and coherent text because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement. There may often therefore be provisions in a detailed professionally drawn contract which lack clarity"

Wood v Capita Insurance Ltd - Lord Hodge – para 13

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"Unitary exercise"

"This unitary exercise involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated"

Wood v Capita – Lord Hodge - para 12

2. Testing possible meanings against business common sense and the factual matrix

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Business Common Sense – Limits

- Business common sense is not to be judged retrospectively
- A party may have made an imprudent bargain

Arnold v. Britton para 19-20

- A provision may be a negotiated compromise
- Negotiators may not have been able to agree more precise terms.

Wood v. Capita Insurance Services Ltd - para 11

Factual Matrix

"Subject to the requirement that it should have been reasonably available to the parties…it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man"

Investors Compensation Scheme - Lord Hoffman - 912-913

Factual Matrix

"Given that a contract is a bilateral, or synallagmatic, arrangement involving both parties, it cannot be right, when interpreting a contractual provision, to take into account a fact or circumstance known only to one of the parties."

Arnold v Britton – Lord Neuberger - para 21

Factual Matrix and Pleading

Elements of "factual matrix" relied on should be pleaded - CPR 16.4(1), 16.5(2)(b).

Commercial Court Guide – C1.3(h)

"Where proceedings involve issues of construction of a document in relation to which a party wishes to contend that there is a relevant factual matrix that party should specifically set out in its statement of case each feature of the matrix which is alleged to be of relevance."

Drafting Errors

- Court cannot embark on an exercise of searching for, let alone constructing, drafting infelicities in order to facilitate a departure from the natural meaning.
- Specific error in the drafting may have no relevance to the issue of interpretation which the court has to resolve

Arnold v Brittan – para 18

Task of interpreting the agreement includes "correction of mistakes by construction"

Chartbrook v Persimmon Homes – Lord Hoffman paras 22-23

"Correction of mistakes by construction"

Two conditions:

- there must be a clear mistake on the face of the instrument
- it must be clear what correction ought to be made in order to cure the mistake

"In deciding whether there is a clear mistake, the court is not confined to reading the document without regard to its background or context"

Chartbrook – para 21-24

Way to win number 3

3. The clear mistake with a clear answer

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Implied Terms - Not truly “construction” but part of the process of determining the scope and meaning of the contract

“When one is implying a term or a phrase, one is not construing words, as the words to be implied are ex hypothesi not there to be construed; and to speak of construing the contract as a whole, including the implied terms, is not helpful, not least because it begs the question as to what construction actually means in this context.”

Marks & Spencer v BNP Paribas – paras 25-27

A term will be implied into a detailed commercial contract only if that were necessary to give the contract business efficacy or so obvious that it went without saying.

Marks & Spencer v BNP Paribas

4. Term implied as necessary for business efficacy or obviousness

Other potential arguments

Rectification
Estoppel
Sham

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Skills & Knowledge Required by Lawyers

Ability to identify ambiguity/alternative meanings

Commercial awareness of

- The industry
- The transaction
- The negotiation
- The clause in question

Recognition of relevant factual circumstances

Helpful questions to test arguments with:

- What would the draftsman have said if the contract really meant X?
- Do all the provisions in the contract have a purpose if the contract means X?
- If the contract means X could absurd results arise?
- Is it really in the client's interest to argue that the contract means X?

Possible Structure of the Argument

- The issue/Your version
- Factual Matrix (if any)
- Relevant Contractual Terms
- Relevant post-contract events (if any)
- Reasons to support of your version including
    - relevant legal principles
    - Contextual analysis
    - Commercial reasons
    - Factual matrix relied on

Re-cap

Four ways to win:

- The text is unambiguous; it means X
- There is more than one possible meaning but having regard to commercial common sense and the factual matrix it means X
- There is a clear mistake in the text. It is clear it should say X
- It is necessary to imply a term that says X

Next Week's Webinar

'Employer's Liability: Back to Basics'

21 May 2020

from Andrew Spencer and Ben Hicks.

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Duval v 11-13 Randolph Crescent Ltd

Supreme Court:
[2020] UKSC 18 (6 May 2020)

Court of Appeal:
[2018] EWCA Civ 2298 (18 October 2018)

- Interpretation of residential lease
- Effect of landlord's covenant containing conditional obligation to enforce tenants' covenants in leases of neighbouring flats

Facts:

11-13 Randolph Crescent Ltd (appellant) = landlord of block of nine flats in Maida Vale, London – a company owned by all the tenants

Dr Duval (respondent) = tenant of two of the flats

Mrs Winfield = tenant of basement flat

Each of the nine leases (all 125 years), in substantially the same form, contain the following covenants…

Tenant's covenants:

Clause 2.6 ('alterations, improvements and additions'):

"Not without the previous written consent of the Landlord to erect any structure pipe partition wire or post upon the Demised Premises nor make or suffer to be made any alteration or improvement in or addition to the Demised premises"

= qualified covenant (consent not to be unreasonably withheld: LTA 1927, s19(2))

Tenant's covenants:

Clause 2.7 ('waste'):

"Not to commit or permit or suffer any waste spoil or destruction in or upon the Demised Premises nor cut maim or injure or suffer to be cut maimed or injured any roof wall or ceiling within or enclosing the Demised Premises or any sewers drains pipes radiators ventilators wires and cables therein and not to obstruct but leave accessible at all times all casings or covering of Conduits serving the Demised Premises and other parts of the Building

= absolute covenant (no right to obtain landlord's consent)

Landlord's covenant:

Clause 3.19:

"… every lease of a residential unit in the Building hereafter granted by the Landlord at a premium shall contain regulations to be observed by the tenant thereof in similar terms to those contained in the Fifth Schedule hereto and also covenants of a similar nature to those contained in clauses 2 and 3 of this Lease AND at the request of the Tenant and subject to payment by the Tenant of (and provision beforehand of security for) the costs of the Landlord on a complete indemnity basis to enforce any covenants entered into with the Landlord by a tenant of any residential unit in the Building of a similar nature to those contained in clause 2 of this Lease."

So:

- Each tenant covenants:
  - Not to carry out alterations or improvements without the previous written consent of the Landlord
  - Not to commit acts of waste spoil or destruction

- The landlord covenants with each tenant to enforce the equivalent of those covenants in any of the other leases at the behest of that tenant, provided the tenant gives security for payment of landlord's costs and duly pays those costs

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What happens?

- In 2015 Mrs Winfield asks managing agents for licence to carry out works including removal of load-bearing wall at basement level
- Works fall within ambit of clause 3.7
- Landlord considers engineer's & architect's representations & is minded to grant licence (so ensuring Mrs W will not be acting in breach)
- Dr Duval objects & twice asks landlord to secure undertaking from Mrs W not to breach clause
- Dr D says she will indemnify landlord for its costs if legal action becomes necessary
- Landlord refuses to secure undertaking from Mrs W

The proceedings

- May 2016: Dr D issues claim against landlord seeking declaration that it would be in breach of cl 3.19 of her lease if it granted permission to Mrs W to carry out the proposed works
- January 2017: DDJ Chambers finds for Dr D – landlord has no power to waive cl 2.7 or grant licence without prior consent of all other tenants
- July 2017: HHJ Parfitt allows landlord's appeal. Held: (a) landlord has power to license works that would otherwise be a breach of cl 2.7; (b) once licence granted there would be no breach; (c) so works could not be subject of enforcement action under cl 3.19; (d) so there would be no breach of cl 3.19

The proceedings

- October 2018: Court of Appeal (Lewison , Newey LJJ , Sir Stephen Richards) allows Dr D's appeal. Held: whilst landlord has *power* to license the works & thereby waive breach of cl 2.7 in Mrs W's lease, to do so would amount to a breach of cl 3.19 of Dr D's lease: cl 3.19 imposed a conditional obligation (to enforce upon provision of security) & was subject to an implied term that landlord would not put it out of its power to comply with that obligation that if and when the tenant complied with the condition by providing the necessary security
- May 2020: Supreme Court (Lady Hale, Lord Carnwath, Lady Black, Lord Kitchin, Lord Sales) dismisses landlord's further appeal.

How does the Supreme Court reach its decision?

- Step 1: It considers the relevant background / factual matrix (see paras 27-30):
  - Each lease is long and was acquired for a substantial premium
  - Original parties to each lease would have realised (a) it was a readily marketable & extremely valuable asset, but that it would require maintenance to retain or enhance its value; (b) over its lifetime not only would routine works would need to be carried out, but that lessees might wish to modernize or refurbish to reflect changing tastes, or to incorporate technological developments

How does the Supreme Court reach its decision?

- Original parties would have understood that routine improvements & modifications of this kind would be unlikely to impinge on other lessees or adversely affect structure of entire building, so that it would be sensible for the landlord to be able to give permission to lessees to allow such works to take place
- Original parties to each lease would have appreciated (a) desirability of landlord retaining rights in possession of the common parts including outer and load bearing walls, and (b) the important and active role landlord would play in managing the building as a whole

How does the Supreme Court reach its decision?

- Step 2: It compares the relevant tenant obligation clauses of the contract and interprets their meaning (see paras 31-36):
  - Clauses 2.6 and 2.7 were intended to be 'read together in the context of the lease and the leasehold scheme for the building as a whole'.
  - So read, it is clear the two clauses are directed at different kinds of activity: cl 2.6 at the routine improvements etc that all lessees would expect to be able to carry out, subject to the landlord's approval; cl 2.7 at activities in the nature of waste, 'intrinsically such that they may be damaging to or destructive of the building'.

How does the Supreme Court reach its decision?

- It draws support for this interpretation from other aspects of the relationship between the parties: the covenant of quiet enjoyment; the obligation not to derogate from grant; the obligation not to authorise a nuisance; the landlord's own common parts repairing obligations.
- By contrast, the parties (and apparently the CA) had concentrated on the individual words used, seen that some activities could fall within both cl 2.6 & 2.7 (e.g. cutting of pipes), and found it necessary to impose some hierarchy between the two clauses, assuming 2.7 trumped 2.6.

How does the Supreme Court reach its decision?

- Step 3: It interprets the relevant landlord obligation clause (see paras 37-43):
  - Clauses 3.19 has two parts: a promise to ensure that every other lease in the building will contain clause 2-type tenant covenants; and a promise to enforce any such covenants at the request of the tenant, subject to the provision of the required security and the promise to indemnify the landlord for its costs
  - This amounts to a mechanism whereby any tenant can require the landlord to take action to prevent another tenant carrying out a threatened breach. This matters because absent a letting scheme the tenants have no rights of enforcement *inter se*

How does the Supreme Court reach its decision?

- Step 3: It interprets the relevant landlord obligation clause (see paras 37-43):
  - But it acknowledges that, on the crucial question, cl 3.19 does not *expressly* preclude the landlord from giving a tenant permission to carry out structural work falling within cl 2.7 and thereby waiving the breach that would otherwise occur.
  - That being so, it is necessary to consider the tenant's case for an implied term.

How does the Supreme Court reach its decision?

- Step 4: It considers whether cl 3.19 is subject to an implied term (see paras 44-59):
  - It endorses the approach of Lord Neuberger in *Marks and Spencer plc v BNP Paribas* at [14-32] *viz.* (a) express terms must be construed first; (b) the term to be implied must be either necessary to give business efficacy (would the contract lack commercial or practical coherence without it?) or so obvious as to go without saying; (c) the term must be capable of clear expression.
  - On that basis it holds that there must be implied into Dr D's lease a promise by the landlord not to put it out of its power to enforce cl 2.7 in another lease by licensing a prohibited activity.

How to argue the meaning of a contract

- It would not give ‘practical content’ to the obligation in cl 3.19 if the landlord had the right to vary or modify the absolute covenant or to authorize what would otherwise be a breach of it i.e. it is necessary to imply such a term to give the lease business efficacy.
- Moreover it would be ‘uncommercial and incoherent’ to say […] that cl 3.19 can be deprived of practical effect if the landlord manages to give consent before another tenant makes an enforcement request and provides the necessary security. ‘The parties cannot have intended that a valuable right in the objecting lessee’s lease could e defeated depending upon who manages to act first, the landlord or that lessee’.

- The landlord's argument that to imply such a term confers on each of the other tenants the power to veto repairs or improvements, however capricious or unreasonable that tenant's intentions, is flawed because cl 2.7 does not, on its proper interpretation, extend to routine works, but is directed to more fundamental works that might be damaging or destructive of the building. '*These are the kinds of work which it is entirely reasonable to suppose should not be carried out without the consent of all the other lessees.*'

Conclusion

Appeal dismissed.