10 June 2015

PRESS SUMMARY

Arnold (Respondent) v Britton and others (Appellants) [2015] UKSC 36

On appeal from [2013] EWCA Civ 902

JUSTICES: Lord Neuberger (President), Lord Sumption, Lord Carnwath, Lord Hughes, Lord Hodge

BACKGROUND TO THE APPEAL

Oxwich Leisure Park contains ninety-one chalets, each of which is let for a period of 99 years from 25 December 1974 on very similar terms. The Appellants are the current tenants under 25 of the leases. 21 of these leases were granted between 1978 and 1991.

Clause 3(2) of each lease contains a covenant to pay a service charge. Each lease also contains covenants by the lessor. One such covenant is to provide services to the Park, such as maintaining roads, paths, fences, a recreation ground and drains, mowing lawns, and removing refuse. The lessor also covenants in clause 4(8) that leases of other chalets "shall contain covenants on the part of the lessees thereof to observe the like obligations as are contained herein or obligations as similar thereto as the circumstances permit".

The Respondent, the current landlord, argues that the service charge provision in clause 3(2) requires the lessee to pay an initial annual service charge of £90, which increases at a compound rate of 10% for the first 70 chalets to be let, every three years, but for the last 21 chalets to be let, every year. The service charge provisions in four of the 70 leases were subsequently varied so that the increases were yearly rather than every three years.

The language of the clause 3(2) differs in small respects between the leases, but a typical example is a covenant to "To pay to the Lessor without any deduction in addition to the said rent a proportionate part of the expenses and outgoings incurred by the Lessor in the repair maintenance renewal and the provision of services hereinafter set out the yearly sum of Ninety Pounds and value added tax (if any) for [the first three years OR the first year] of the term hereby granted increasing thereafter by Ten Pounds per Hundred for every subsequent [three year period OR year] or part thereof".

The issue on this appeal is whether the Respondent's interpretation of clause 3(2) in those 25 leases, where the increase is to be every year, is correct.

JUDGMENT

The Supreme Court holds that the Respondent is correct and therefore dismisses the tenants' appeal by a majority of 4-1 (Lord Carnwath dissenting). Lord Neuberger (with whom Lord Sumption and Lord Hughes agree) gives the lead judgment and Lord Hodge gives a concurring judgment.

REASONS FOR THE JUDGMENT

When interpreting a written contract, the court must identify the intention of the parties by reference to "what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean", focussing on the meaning of relevant words in their documentary, factual and commercial context. However, subjective evidence of any party's intentions must be disregarded **[14-15]**.

In the present case, while reliance must be place on commercial common sense, this should not undervalue the importance of the language of the provision **[17]**. 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 as at the date of the contract. 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; neither is the fact that a certain term appears to be very imprudent. It is not the function of the court interpreting a contract to relieve a party from the consequences of imprudence or poor advice **[19-20]**. Moreover, there exists no special principle of interpretation that service charge clauses are to be construed restrictively **[23]**.

The natural meaning of clause 3(2) is clear; 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. This choice is readily explicable; the parties assumed that the cost of providing the services would increase, and they wished to avoid arguments as to the cost of the service and the apportionment between the tenants. The reasonable reader of the clause would see the first half of the clause as descriptive of the purpose of clause 3(2), namely to provide for an annual service charge, and the second half as a quantification of that service charge **[24-27]**.

In the case of the 21 (now 25) leases which provide for an annual increase in the service, it is true that this has an alarming consequence; if one assumes a lease granted in 1980, the service charge would be over £2,500 this year, 2015, and over £550,000 by 2072. However, despite such consequences, this is not a convincing argument for departing from the natural meaning of clause 3(2) **[30-32]**. Although there are one or two small errors in the drafting, nothing has gone significantly wrong with the wording of the clause in any of the 25 leases **[34]**. Moreover, during the 1970s and much of the 1980s, annual inflation had been running at a higher annual rate than 10% for a number of years; the clause could be viewed as a gamble on inflation for both parties **[35-36]**. In relation to the leases which were varied between 1998 and 2002, it is extraordinary that a lessee under a lease which provided for an increase in a fixed service charge at the rate of 10% over three years should have agreed to vary the lease so that the increase was to be at the rate of 10% per annum, at a time when inflation was running at around 3% per annum. However, this does not justify reaching a different result **[39-40]**.

The purpose of clause 4(8) and the opening words of clause 3 may well have been to create a "letting scheme" such that properties within a given area are intended to be let on identical or similar terms, normally by the same lessor, so that the terms are to be enforceable not only by the lessor against any lessee, but as between the various lessees **[47-49]**. The Appellants' case is that there is an implied term in each of the 21 leases granted between 1977 and 1991 such that the lessor is not asking anything of the lessee which had

not been required of lessees of other chalets, whether their leases were in the past or future. Even assuming that there is such a scheme, this would not be a correct term to imply. A term that the already existing 70 leases have services charges which increase at the compound rate of 10% p.a. as in the existing 21 leases would be inconsistent with an express term of the appellants' leases **[50-56]**. Accordingly, the appeal should be dismissed **[60-65]**.

In his dissenting judgment, Lord Carnwath considers that the commercial purpose of clause 3(2) was to enable the lessor to recover from the lessees the costs of maintaining the estate on their behalf, the payment by each lessee being intended to represent a "proportionate" part of the expenses incurred. He is of the view that the clause contained an inherent ambiguity between the two halves of the clause. **[125-126]**. There are only two realistic possibilities for the meaning of the second part of the clause; either it is a fixed amount which supplants any test of proportionality under the first part or it is no more than an upper limit to the assessment of a proportionate amount **[128]**. Lord Carnwath considers the consequences of the lessor's interpretation to be so commercially improbable that only the clearest words would justify adopting it. For this reason he would have allowed the appeal **[158-159]**.

References in square brackets are to paragraphs in the judgment