CONTRACTUAL CONSTRUCTION IN A COVID CONTEXT

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The recent case of Westminster City Council v Sports and Leisure Management Limited[1], from the English Technology and Construction Court, is a useful illustration of the approach adopted by English courts in interpreting the contractual allocation of risk for losses arising from Covid-19 restrictions. While the case concerned a leisure services contract awarded by a local authority, and turned on the specific wording of that contract, the decision will be of interest to all commercial parties whose businesses have been impacted by government measures in response to the pandemic.

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LEISURE SERVICES CONTRACT

In 2016, Sports and Leisure Management Ltd ("the Contractor") entered into a contract with Westminster City Council ("the Council") which granted the Contractor the right to operate and manage a number of leisure facilities in exchange for the payment of a management fee to the Council ("the Contract"). In return, the Contractor was entitled to retain a third of the revenue generated from the leisure centres' customers. In the early years of the Contract this arrangement was profitable to the Contractor.

This changed dramatically with the onset of the coronavirus pandemic. Nationwide lockdowns and varying levels of local and national restrictions ("the Restrictions") either forced the Contractor to close the facilities altogether or open them subject to significant constraints.

It was common ground between the parties that the Restrictions amounted to a "Change in Law" as defined in the Contract. While the Contract specified which party was to bear the cost of certain kinds of Changes in Law, the precise allocation of risk that applied to the Restrictions themselves was open to interpretation. The parties were unable to reach agreement on this and so the Council commenced proceedings seeking a court declaration on the proper interpretation and application of the Contract.

WERE COVID RESTRICTIONS GENERAL OR SPECIFIC CHANGES IN THE LAW?

The Contract drew a distinction between changes in the law which were *"General"* and those that were *"Specific"*, being changes that specifically impacted the kind of services which the Contractor was engaged in.

The Contractor was to bear the costs of a *"General Change in Law."* This was perfectly natural, in Mr Justice Kerr's view, as the risk of general changes in law impacting commercial parties' profits is simply an *"ordinary vicissitude of business life"*. The allocation of risk for "*Specific Changes in Law*" was more ambiguous.

At trial, it was common ground between the parties that the Restrictions amounted to *"Specific Changes in Law"* under the Contract. Therefore, the intriguing question of whether the all-embracing nature of the Restrictions (limiting the use of leisure premises as well as prospective users' rights to leave their homes) were sufficiently *"Specific"* to the Contractor's business was never tested in court.

MANAGEMENT FEE

In the ordinary course of things, the Contract envisaged that the Contractor would pay the Council a management fee for the right to manage the leisure centres. During the Restrictions, the parties accepted that the management fee needed to be recalculated by reference to complex income and expenditure projections and formulae set out in the Contract. However, they were unable to agree what the contractual effect of clause 39.5.2 was. This said (our emphasis):

"any Specific Changes in Law…shall be put into effect as provided in Clause 37…as if the [Council] had issued a [Council] Notice of Change and any ***changes to the Management Fee*** *(or, if applicable and agreed by the [Council],* ***a capital payment****) shall be reasonably agreed between the Parties."*

(Clause 37 provided that the Council could give notice of a change to the services arising out of, for example, the closure of a facility or opening of a new facility and clause 37.5 provided that *"the Contractor should not be worse off as a result of the implementation of the [Council] Change".*)

The Council reduced the management fee to nil for certain periods in 2020 in light of the Restrictions. However, the Contractor argued that the Contract's formulae needed to be adjusted in a way that produced a *"negative management fee"* (that is, a payment from the Council to the Contractor, rather than the other way around).

The Council argued that this would amount to an obligation from the Council to indemnify the Contractor for losses in excess of the management fee, which the Contract did not oblige it to do. In support of this argument, the Council noted that the Contract made reference only to the management fee being payable *"by the Contractor to the Council",* and never vice versa.

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ALTERNATIVE CAPITAL PAYMENT

The Contractor argued that, if the Court rejected its arguments that the management fee should be adjusted to a *"negative"* fee, the Council should instead pay it a capital payment under clause 39.5.2 such that the Contractor would be put in the same financial position as though the management fee had been so adjusted.

The Contractor relied on the reference in:

- clause 39.5.2 to a Specific Change in Law being dealt with *"as if"* the Council had issued a Council Notice of Change in accordance with clause 37 of the Contract; and
- clause 37.5 that *"the Contractor shall not be worse off as a result of the implementation of the Council Change"*.

The Contractor said that (barring a negative management fee) a capital payment from the Council to the Contractor was the only way that the Contractor could be no worse off as a result of the Restrictions.

"While the Court accepted that the management fee could be reduced to zero, it held that it could not reach negative values, even if the formulae upon which it was calculated did produce such values."

THE DECISION

The Court re-affirmed the general approach to contractual interpretation as set out in pre-Covid cases such as *Wood v Capita Insurance Services Ltd*[1]. It said that it needed to consider both contextual and textual factors.

Contextual factors

In this particular case, it decided that contextual factors were of little assistance. Neither party could have foreseen the Restrictions at the time of the Contract. All that the contextual factors offered was the general proposition that the parties had entered into a sophisticated contract, one of the purposes of which was to *"allocate risk as between the authority and the contractor where the law changes".* In other words, there was no indication from contextual factors as to *how* that risk was to be allocated in respect of the Restrictions.

Textual factors

Turning to textual factors, the Court noted that the drafting did not display "*surgical linguistic precision*". That said, the words used in the Contract would likely be decisive and so required careful examination, *"imperfect as they are".*

The Court considered the management fee issue to be *"absolutely clear"*. It unequivocally agreed with the Council's submission that the wording of the Contract made provision only for a one-way payment of the management fee by the Contractor to the Council. There were references only to payments *"by"* the Contractor *"to"* the Council, and never the other way around. While the Court accepted that the management fee could be reduced to zero, it held that it could not reach negative values, even if the formulae upon which it was calculated did produce such values.

The Court's critique of the perfunctory drafting of the Contract included the reference in clause 39.5.2 to the clause 37 process. The Court held that the reference to Specific Changes in Law being dealt with *"as provided in clause 37"* was intended to mean only that the *process* was to be broadly the same under both scenarios. It did not require that the financial outcome should necessarily be the same. The Contract, in this respect, took a *"neutral stance"*. Crucially, the Court decided that the phrase in clause 37 providing that the Contractor should be *"no worse off"* as the result of a Council Change did not apply to a Specific Change in Law. This phrase only occurred in a sub-clause concerning issues specific to the implementation of Council Changes and was not intended to operate as a general principle that applied to Changes in Law as well. Essentially, the Court seemed to find the Contractor's argument on this issue somewhat contrived.

The Court noted that the Contract was *"quite nuanced in allocating risk"* despite some poor drafting. The position was not as simple as placing all General Changes in Law at the Contractor's risk and all Specific Changes in Law at the Council's risk. While a Council Change was a matter that the Council had control over, external circumstances such as the Restrictions were not. Therefore, the wording of clause 39.5.2 did not support a clear intention between the parties that the Council was required to ensure that the Contractor was *"no worse off"* from the Restrictions by making a capital payment. That said, the management fee was still to be adjusted due to the clause 37 process applying (at least to that extent) to the Restrictions.

Contra Proferentum doctrine

The Court also emphasised that the *contra proferentum* doctrine (that any ambiguities in the wording of a term should be construed against the party that proposed the wording) should only be referred to as a matter of *"last resort"*.

COMMENT

The contract in question was broadly based on terms often used in contracts for the supply of leisure services, such as Sport England's standard terms. Therefore, the Court's decision will be of immediate interest to parties providing similar services in the leisure industry. Similar provisions can also be found in concession and other arrangements in the hotel sector and other industries.

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However, the Court's consideration of textual and contextual factors to contractual interpretation are of universal application. The decision reaffirms the primacy of the specific language used in commercial contracts in determining the proper allocation of risk between the parties. It also demonstrates the importance of precision in the drafting of such contracts, as the dispute might have been avoided altogether were it not for the ambiguities in clause 39.5.2. Although the decision may be discouraging for commercial parties considering similar claims to recover losses caused by the pandemic, they may take some comfort in the UK Supreme Court's recent judgment in *Financial Conduct Council v Arch & Ors*[2]. As a result of that decision, the prospects of such parties' business interruption policies responding to losses caused by Covid restrictions very much appear to have improved, though the extent of any coverage will depend on the wording of the particular policies in question.

It is, however, a considerable reassurance to contracting parties that the contractual construction principles in English law can comfortably contend with, and are unchanged by, the pandemic. This consistency of approach maintains a welcome environment of legal certainty for parties (and their lawyers) in times of commercial adversity.

[1] [2017] AC 1177.
[2] [2021] UKSC 1. See our article here for further information.

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