When is the law not the law?

David Cook seeks certainty from the Supreme Court

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It sounds like the beginning of a bad joke, but it is no laughing matter that a recent run of Supreme Court cases serve to demonstrate that conventional wisdom and common practice concerning some of the apparently established legal principles underpinning many commercial disputes may actually miss the mark.

Restatement of the rule against penalties

Anyone practising in commercial contract litigation in recent years will be aware that, in considering whether a provision amounts to a penalty in *Cavendish Square Holding BV v Makdessi; ParkingEye v Beavis* [2015], the Supreme Court pointed out that, over the century since Lord Dunedin identified a number of tests which could prove helpful or conclusive in deciding that question in *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1914], those tests had been applied more rigidly than was ever intended.

Conventional wisdom and common practice over time had effectively distilled Lord Dunedin's *Dunlop* tests into an unhelpful, over-simplified distinction between a genuine pre-estimate of loss which is compensatory, and therefore enforceable; and a deterrent which is penal, and therefore not. The Supreme Court in *Cavendish* stated that it was 'unfortunate' that Lord Dunedin's judgment 'had achieved the status of a quasi-statutory code in subsequent case-law'. It therefore undertook a wholesale review of the guiding principles of the rule against penalties and brought clarity by restating – but not outright altering – the law in this area.

The Supreme Court explained that a penalty is a secondary contractual obligation that imposes a detriment on the party in breach of a primary obligation which is out of all proportion to any legitimate interest of the innocent party in the performance of that primary obligation. Breaking that down, there are three questions which can help to determine whether a provision amounts to an unenforceable penalty:

- **The 'threshold test': is the penalty rule engaged at all?** In English law, the court will not generally interfere with a party's 'primary' contractual obligation to do something, but it can regulate the 'secondary' liability that may be imposed when a party breaches that obligation. The penalty rule is only engaged at all, therefore, if the provision in question imposes a secondary liability for breach of a primary obligation.

- **The 'legitimate interest test': does the clause serve to protect any legitimate interest?** A clause that is potentially penal in nature may nevertheless be allowed if it serves to protect a legitimate interest of the innocent party in the performance of the primary obligation.

- **The 'exorbitance test': if so, is the provision out of proportion to the protection of that interest, by being extravagant or unconscionable?** So long as the provision in question is not exorbitant or unconscionable in amount or effect, by reference to some norm, as against the legitimate interest which it serves to protect, then it may not amount to a penalty.

The Supreme Court has therefore highlighted to contract drafters and commercial litigators of the dangers of complacency when it comes to our

understanding of fundamental legal principles, and it has advocated a more flexible and more modern approach.

Death of *Caparo*: have a care?

Similarly, a high-profile case in the public law arena has challenged received wisdom when it comes to determining a duty of care in tort.

In the 1990 case of *Caparo Industries plc v Dickman*, the House of Lords referred to the three-stage test of foreseeability, proximity and fairness. Since that time, it has become habitual to follow that formula when establishing the existence of a duty. However, in *Robinson v Chief Constable of West Yorkshire Police* [2018] (and also very shortly afterwards in *Steel v NRAM* [2018]) the Supreme Court reminded us that *Caparo* was not decided by the three-stage test. In fact, in *Caparo*, the House of Lords commented that (per Lord Oliver):

> ... to search for any single formula which will serve as a general test of liability is to pursue a will-o'-the wisp... [and] the attempt to state some general principle which will determine liability in an infinite variety of circumstances serves not to clarify the law but merely to bedevil its development...

Yet, perhaps because lawyers like a nice, neat rule, in almost slavishly adopting the three-stage test, that is exactly what many courts and practitioners have done!

In *Robinson*, the Supreme Court explained that the approach actually endorsed in *Caparo*, and the correct approach, was and is:

- that established duty situations should be decided in accordance with previous case law; but
- otherwise, the court should:
  - identify and compare novel factual circumstances with any relevant established precedents to allow the law to develop incrementally and by analogy with authorities; and
  - balance reasons for or against the imposition of a duty of care to determine whether that would be fair and just.

In *Steel* the Supreme Court unanimously agreed that *Caparo* had been wrongly construed for years and it endorsed the interpretation as per *Robinson*. The Supreme Court went on to confirm that *Caparo* also decided that, in negligent misstatement cases, the reasonableness of a representee's reliance on a statement made by a representor is central to the imposition of a duty of care. That is an element that has been missing from the customary three-stage test.

Implying terms: new Supreme Court 'spin'

Finally (and turning again to contract law), prior authority on implying terms (*Marks & Spencer plc v BNP Paribas* [2015]) established that in order for a term to be implied, it must be necessary to give business efficacy to the contract. That is a clear, almost trite test which simply asks whether, without the term, the contract does not work. However, as Gwendoline Davies and Clare Acklam reported in the March/April 2019 edition of *The Commercial Litigation Journal* ('Safe as houses', *CLJ*84, p16), the Supreme Court has, in the recent case of *Wells v Devani* [2019], seemingly added a new 'spin' to the rule.

In *Wells* Lord Kitchen stated that if the contract did not contain the particular term in dispute (emphasis added):

> ... then a term to that effect must be implied to make the contract work and to give it practical and commercial coherence *[and in] carrying out this exercise of implication the court would be reading into the contract that which its nature implicitly requires. Put another way, to leave Mr Wells without any obligation to pay Mr Devani would be completely inconsistent with the nature of their relationship.*

Those comments can potentially be read not as changing the established *M&S v BNP Paribas* rule, but as introducing an additional discretion for the court to imply a term where that is an obvious step which accords with a 'natural understanding' of the relationship and agreement between the parties.

It obviously remains preferable, where possible, for contracts to be in writing and drafted clearly, accurately and comprehensively to expressly contain, in unambiguous language, all necessary terms to reflect the parties' agreement. No doubt it also remains true that where parties have entered into a carefully drafted contract, particularly where they have been legally advised, it will be difficult to imply any term(s). The Supreme Court's decision in *Wells* does, however, seem to suggest a less rigid approach than hitherto and to offer increased flexibility for terms to be implied on the basis of an obvious, natural understanding of the parties and their arrangements.

Key takeaways

These cases illustrate that the Supreme Court is currently very active and progressive, with such recent decisions taking into account the importance of flexibility in modern authority, and demonstrating a move away from rigid and oversimplified step-by-step tests. While that can make it difficult for lawyers to accurately predict the outcome of cases, it does also give increasingly greater scope for courts to reach the 'right' decision on a practical and factual basis. These decisions also emphasise the old adage: never assume anything. Never assume that you know the law – go back to the original authorities and read them thoroughly and without the bias of hindsight; and never assume that the facts and natural justice won't play a potentially significant part. ■

Caparo Industries plc v Dickman [1990] UKHL 2

Cavendish Square Holding BV v El Makdessi; ParkingEye v Beavis [2015] UKSC 67

Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1914] UKHL 1

Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd & anor [2015] UKSC 72

Robinson v Chief Constable of West Yorkshire Police [2018] UKSC 4

Steel & anor v NRAM Ltd [2018] UKSC 13

Wells v Devani [2019] UKSC 4