Contractual Interpretation: Some latest cases and trends 2008

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INTRODUCTION

Contracts including commercial contracts are of infinite variety. But apart from special rules for special types of contract such as insurance, and special types of rule as for exclusion, limitation and penalty clauses, the approach to the interpretation of an agreement is the same for all contracts of any kind.

This is because the aim of interpretation (aka "construction") is the same in all cases, namely the determination 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"

(*BCCI v. Ali* [2002] 1 A.C. 251, 281 G per Lord Clyde applying Lord Hoffman in *Investors Compensation Scheme Ltd v. West Bromwich Building Society* [1998] 1

W.L.R. 896, 912).

So we're back to the reasonable man again – but not necessarily the one on the Clapham omnibus ! This makes sense as the aim is – and always has been – objective :

"Commercial contracts cannot be arranged by what people think in their innermost minds. Commercial contracts are made according to what people say" (*Muirhead v. Turnbull & Dickson* (1905) 7 F 686, 694 per Lord President Dunedin).

How is the aim achieved ?
The Scottish approach has been set out by the Inner House as recently as December 2008 in *Connell v. Hart* [2008] CSIH 67, (a case on missives between private individuals involving an unsuccessful argument that "would" meant "could") The Extra Division noted § [27] that there was little purpose in attempting to rephrase, refine or put a gloss on the following words of Lord Macfadyen in the Outer House in Glasgow City Council v. Caststop 2002 S.L.T. 47 @ § [33] :

> "On the one hand, the approach adopted by the Lord President [Rodger] in *Bank of Scotland* v *Dunedin Property Investment Co Ltd* involved first inquiring as to the ordinary meaning of the words used, then, having reached a conclusion on that matter, considering the surrounding circumstances in which the contract was entered into to see whether they affected the result of the original inquiry. On the other hand, the approach advocated by Lord Hoffman in *Investors Compensation Scheme Ltd* runs those two stages together, by regarding the task of construction as the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge reasonably available to the parties in the situation in which they were at the time of the contract. Whichever of these approaches is adopted,...the result should be the same. The language of the contract is of paramount importance. As

Lord Mustill said in *Charter Reinsurance Co Ltd* v *Fagan* [[1997] AC 313] at 384B, in a passage quoted with approval by the Lord President in *Bank of Scotland* v *Dunedin Property Investment Co Ltd* at 661G: "the inquiry will start, and usually finish, by asking what is the ordinary meaning of the words used".

Part B – BACKGROUND CIRCUMSTANCES

Distribution of goods agreement; Whether conduct subsequent to contract can be taken into account; Whether term can be implied by construction Wincanton Group Ltd v. Reid Furniture Ltd : Court of Session : Outer House : Lord Glennie : 01 August 2008

Furniture retailers had a contract with hauliers who transported their furniture to their shops from their warehouses. That contract was superseded by heads of agreement which were to set out the framework for a new detailed contract. That detailed contract was never entered into – hence this litigation.

The heads of agreement provided for the hauliers to provide distribution services which included not just the transport but also the storage of the furniture in the retailers' own warehouses. In return for this expanded service the retailers agreed to pay "a fixed management fee and service charges in amounts to be agreed", the management fee to be payable on the 15th working day of the month together with 75% of the "projected core service charges" for which there would be a reconciliation in the following month. It was also agreed that,

"any variations to the agreed management fees or service charges will be agreed between the parties prior to being incurred.

At the time of the heads of agreement the retailers were paying a fixed rate per vehicle and labour per day with overtime paid for for the labour separately. On

occasion the demand for furniture was such – hard to believe in these credit crunch days – that the hauliers had to employ additional vehicles to meet this demand and employ agency labour. They charged the retailers for these additional costs which the retailers paid. The relationship between haulier and retailer began to deteriorate. The retailers refused to pay the additional costs claiming that these were variations that they had not agreed to beforehand and so were not due under the heads of agreement.

The hauliers argued :

That the fixed management fee and service charges in the heads of agreement were rates per vehicle/labour and that the retailers' prior agreement was not required for the hauliers to be remunerated for additional vehicles ; and that this intention was evidenced by –

- the retailers paying for the additional vehicles used without their prior agreement after the heads of agreement had been entered into (which was evidence that the variations clause did not require prior agreement to the additional vehicles); and

- the wording of the contract itself as seen in the light of the circumstances at the time that the heads were entered into, which were that that the vehicle rates had been applied to the additional vehicles under the previous contract without any need for prior consent to the additional vehicles.

Lord Glennie was given a full review of the case law and decided -

(1) that the law was not as set out in the 19th century and early 20th century Inner House cases but in English House of Lords cases James Miller v. Whitworth Street Estates [1970] A.C. and Schuler A.G. v. Wickman [1974] A.C. as approved in the Outer House, namely that actings of the parties subsequent to the contract cannot be used to construe it, given that a contract must be capable of construction the moment it is entered into

(2) that having regard to the wording of the payment provisions against the background of the fixed fee regime at the time of the contract, the requirement to obtain prior agreement applied to the variation of the fixed rate per vehicle and not to the amount of vehicles charged for – the practical difficulty for the hauliers to obtain that agreement every time an additional vehicle was needed further supporting this interpretation, and the hauliers were entitled to payment

The interpretation issues didn't end there ! The hauliers' expanded services provided for them to take care of the goods in the retailers' warehouses and to insure them while they were there. An issue arose as to who bore the risk for the damage of the goods whilst they were in the warehouses. The matter was not covered by the heads of agreement. Title remained with the retailers throughout.

Lord Glennie decided (3) that because the contract provided for the insurance of the goods by the hauliers they bore the risk of any damage to the goods in the warehouses.

In some European countries actings subsequent to a contract are used to interpret a contract, this is admissible in certain European countries. MacBryde thinks that it would not be a bad rule as it would accord with parties' expectations. That was the rationale in the old Inner House cases. The matter does not appear to have been reconsidered by the Inner House since and the Outer House has followed the English cases. So it's still up for decision. Whilst the rationale for the English Whitworth Street view is the clear pure view, this isn't an area where purity necessarily triumphs.

Lord Glennie did say that the subsequent actings could be used to establish the facts at the time of the contract but that is something different from their use to interpret the contract.

The background was critical as it made it clear that the parties understood the fixed fees and service charge to be a rate per vehicle and did not include a fixed

number of vehicles.

The practical consequences of requiring consent before every additional vehicle were also significant.

The decision on risk seem difficult to understand given that there was no term and no implied term was founded on !

Partnership; Dissolution; Interest on capital shares; Whether due from dissolution
Purewal v. Purewal
Court of Session; Outer House; Lord Drummond Young : 21st October 2008 [CSOH] 147

A written partnership agreement governed a restaurant. There were 4 partners. Following the death of one of them, two of the remaining three served a notice of dissolution of partnership on the defender. The defender went on carrying on business. The partnership was dissolved. The partnership's accountant prepared draft dissolution accounts including a balance sheet as at the date of dissolution in terms of the notice. The defender objected to the accounts and an arbiter was appointed to resolve the dispute. The arbiter rejected the objections and held that the draft dissolution accounts were correct and final.

The dissolvers raised an action to enforce the arbitral award with interest from the date of dissolution. The defender said that interest was due from 6 months after the date of the arbiter's award.

The partnership agreement provided that "In the event of the determination or dissolution of the partnership . . . a balance sheet shall be made up . . . as at the date of dissolution . . . the sum at credit of the outgoing partner shall be ascertained from such balance sheet and paid by the surviving or continuing partner to the outgoing partner . . . by six equal half yearly installments

commencing six months after the date of determination with interest . . . also payable half yearly on the same date . .”

The defender argued that “date of determination” meant the arbiter’s determination and that if the parties had intended that the interest begin from the date of dissolution they would have said “after the date of determination or dissolution with interest”.

The pursuers argued that the interest was due from the date of dissolution as the clause had to be interpreted in the light of the general law in sections 42 and 43 of the Partnership Act which provided for the payment of interest on the outstanding capital shares from the date of dissolution at common law.

Lord Drummond Young decided that –

(1) the clause had to be given its commercially sensible meaning
(2) the words “after the date of determination” could refer to both the dissolution and the arbiter’s award
(3) the use of “dissolution or determination” at the outset of the clause indicated that parties used these words in the clause in question as synonyms
(4) it was commercially sensible for the interest to be due from the date of dissolution as from that point the defender who was continuing the business was taking advantage of the pursuers’ capital without the pursuers consent, this being a substitute provision for the general situation under sections 42 and 43 of the Partnership Act 1890 which recognized that outgoing partners’ capital accounts become debts as at the date of dissolution with a right to interest thereon from the date of dissolution or a share of the profits thereafter;
(5) that there was nothing especially unusual about a debt being due while its precise quantum was identified;
(6) “after the date of determination” meant after the date of dissolution.

This seems a correct result, although one cannot help but feel sorry for the defender's counsel who was relying on the wording of a deed drafted by professional advisers who would be expected to be careful in their use of language. On a first reading most would probably think that "determination" means the award of the arbiter.

The commercially sensible result, though, is the one that was reached. The moral for those drafting partnership deeds is that if the provisions of sections 42 and 43 are to be ousted, very clear wording is necessary.

PART C – WORDING

Asset Sale and Service Agreements; Machinery for determining consideration; whether waiver possible; whether retention possible

Inveresk p.l.c. v. Tullis Russell Papermakers Ltd : Court of Session : Outer House : Lord Glennie : 29 August 2008 : [2008] CSOH 124

This was a sale of various business assets including intellectual property rights relating to papers manufacture. The parties entered into two separate agreements at the same time, a sale agreement and a services agreement. Under the services agreement the sellers agreed to provide certain handover services for a period of a few months after completion for a fee.

Under the sale agreement the price for the assets included an "Additional Consideration" of up to £ 2m. The Additional Consideration was effectively a share of the turnover in the sales of various paper products during the year after the sellers ceased to have any involvement. It was calculated by reference to a formula linked to the tonnage (as defined) of the sales.

In the sale agreement the parties had a detailed mechanism for working out the sales tonnage. Basically the process was that at the end of the year the purchasers would give the sellers a draft account of tonnage. The sellers then had a chance to intimate proposed adjustments to the draft account. If they didn't the draft account would bind them. If they did and there was no agreement

between the parties the matter had to be referred to a expert draft accountant for a decision to confirm or verify the tonnage.

The purchasers intimated a draft account. The sellers intimated adjustments. The matter was due to be remitted to the draft accountant when the sellers withdrew their adjustments and sued for payment. The purchasers refused to pay arguing that in terms of the contract the action had to be sisted and the matter had to be referred to the expert who was not bound by either draft account or adjustment. The sellers argued that in terms of the scheme the purchasers' draft was the keystone of the assessment process and could not be deviated from by the purchasers, whereas the sellers did not have to challenge the purchasers' draft and that similarly they did not have to insist on their adjustments. The expert was restricted to considering the draft and the adjustments.

The purchasers also argued that they were entitled to refrain from making payment given that any duty to pay the Additional Consideration had arisen after the sellers had breached their handover duties under the related services agreement. The sellers argued that (i) the two duties were not contemporaneous; and (ii) they were not reciprocal and for either of these two reasons the purchasers were not entitled to retain payment.

Lord Glennie decided –

(1) that looking to the wording of the dispute resolution scheme and the role of the expert which was to confirm or verify the draft accounts, the purchasers were stuck with their draft accounts and therefore the sellers were entitled to withdraw their adjustments and seek payment without any need for expert determination.

(2) as a matter of timing the handover duties did (assuming it was proved) pre-date the duty to pay the additional consideration so that they were contemporaneous;

(3) whilst the two contracts could be considered together, the two duties were not reciprocal, given that they were not expressly or by implication conditional

on each other : the handover duties were conditional on payment of a handover fee; the additional consideration duty was conditional on the transfer of the assets and the creation of the tonnage.

A feature which immediately stands out is the lack of relevance of the background circumstances. Both sides accepted that they weren't relevant. The case was decided in both its aspects on the wording in the contracts construed as a whole.

Limited Liability Partnership ; leaving condition; construction; wording; Greck v. Henderson Asia Pacific Equity Partners (FP) LP : Court of Session : Outer House: Lord Glennie : 8 January 2008 [2008] CSOH 2

A limited partnership was set up to manage the distribution of bonuses to managers of private equity funds managed byH. G was a member of the partnership. The limited partnership agreement provided for members leaving the partnership being classified as "Good Leaver" , "Bad Leaver" or "Intermediate Leaver". Good Leavers retained the bulk of their bonuses. Intermediate Leavers part of them and Bad Leavers lost the lot. A person was a "Bad Leaver" if within 6 months he joined a "competitor". A person was a "Good Leaver" if he left for certain limited reasons. If a person was neither he was an "Intermediate Leaver". There was a provision deeming any business which made, dealt in, managed or advised on unquoted equity investments e.t.c. as being in competition with H or any associate.

There was also a provision that the general partner of the partnership "may in its sole discretion determine in respect of a Bad Leaver" that he shall not lose everything but will receive the Good Leaver's entitlement with reductions to be determined in the general partner's sole discretion.

G left H and the partnership. He was initially classified as an Intermediate Leaver. He then joined a company dealing in e.t.c. unquoted equity investments

albeit in different parts of the world from Hor its associates. He was classified as a Bad Leaver and forfeited all of his bonuses.

G sued the partnership arguing that (i) the deeming provision did not detract from the need for the company which he joined from being a “competitor” which it was not; (ii) by reason of his initial categorisation G was an Intermediate Leaver and could not lose this status once gained (iii) in any event the general partner had not exercised his discretion at all and had not considered whether to make him into a Good Leaver which would have naturally followed as a matter of fairness if that discretion had been exercised.

Lord Glennie decided -

(1) that looking to the wording the provision deeming a business to be in competition was a provision which defined “competitor” so if it was satisfied there was no need for the new employer to be actually in competition with H e.t.c. – so G had joined a “competitor” in terms of the agreement. In any event the construction preferred by G was impractical as it required every leaver to carry out a difficult check to see whether his new company was in competition.

(2) that if a person joined a competitor within 6 months he automatically became a Bad Leaver regardless of how he was on departure : the suggestion that a classification could not be changed would mean that only those joining competitors immediately on departure could be Bad Leavers which could not have been intended for a provision vesting rights to the bonuses.

(3) that again on the basis of the wording the provision allowing the general manager a discretion with regard to the making a Bad Leaver a Good Leaver was a permissive one, evidenced by the word “may” – and given G had not applied for the exercise of the discretion no duty to exercise had arisen.

(4) even if there had been a duty to exercise the discretion G had failed to show that by not applying the discretion in his favour the general manager would have acted capriciously, arbitrarily or perversely which was the test that required to be applied by virtue of Ludgate Insurance Company Ltd v. Citibank

N.A. [1998] Lloyds Rep. 221, 230, 239 (which is founded on the Scots trust case of Board of Management of Dundee General Hospitals v. Bell's Trustees [put in citation]

Again the wording is paramount, although it's interesting that it is backed up by a practicality issue.

The case is also useful for a re-statement of the law relating to the exercise of a contractual discretion.

Evidence was given by video link from Australia in part for the defenders whilst the pursuer did so from the witness box in person whilst still suffering from fatigue from a long flight from Australia both without loss of clarity or cogency. Fewer commissions to sunny places ? (or even less sunny places)

PART D – CONCLUSION

And finally ! A blast from the past,

A 1913 style charter party provided that fuel used by the vessel while off hire, "also for cooking, condensing water, or for grates and stoves to be agreed as to quantity, ,and the cost of replacing same to be allowed by owners". The style was used in a 1979 charter where the vessel in question used only diesel which supplied all the power for the domestic consumption of the crew. The owners refused to pay for any of the diesel apart from cooking claiming that it was not covered by the clause. Gatehouse J. at first instance agreed with the owners but allowed heating as well on the basis of the "grates" and "stoves" wording. For the other domestic uses held that the charterers were trying to re-write the contract.

The matter went before the Court of Appeal where the court were clear that the clause was intended to cover domestic use of fuel generally and not just for heating and cooking whether it be lighting, heating cooking or crew indulgences – there was reference to pin-ball in the judgment – with Lloyd LJ commenting, *Summit Investment Inc. v. BSC* [1987] 1 Lloyds Rep 230, 235

"If ever a case was designed to separate the purposive sheep from the literalist goats this is it" (counting himself among the purposive sheep)

With the comforting thought that regardless of a lawyer's best efforts in this area he or she may end up being classified as a sheep or goat, I bring these comments to a close.