Case No: A3/2006/0290

Neutral Citation Number: [2006] EWCA Civ 1689
IN THE SUPREME COURT OF JUDICATURE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE CHANCERY DIVISION
Mann J.
[2006] EWHC 236 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Monday 18th December 2006

Before :

THE MASTER OF THE ROLLS
LORD JUSTICE JONATHAN PARKER
and
LADY JUSTICE ARDEN

- -

Between :

THE SQUARE MILE PARTNERSHIP LIMITED	**Appellant**
- and -	
FITZMAURICE McCALL LIMITED	**Respondent**

- - - - - - - - - - -

(Transcript of the Handed Down Judgment of
WordWave International Ltd
A Merrill Communications Company
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Official Shorthand Writers to the Court)

- -

Anthony Trace QC & Richard Morgan (instructed by Reynolds Porter Chamberlain) for the Appellant
Christopher Nugee QC & Michael Gadd (instructed by **William Blakeney**) for the Respondent

- -

Judgment

Lady Justice Arden:

1. The issues in this appeal arise out of a loosely drawn commercial agreement for the sale of shares in a Lloyd's broker, Robert Bruce Fitzmaurice Ltd ("RBF"). The vendor was Robert Bruce Fitzmaurice (Group) Ltd ("RBF Group"). The purchaser was The Square Mile Partnership Ltd ("S"), the appellant.

2. S has brought proceedings in the Chancery Division against Fitzmaurice McCall Ltd ("F"), which before the share sale was the ultimate holding company of RBF, to recover the sum of £559,297, being the balance of the sum of £583,038 owed by F to RBF and outstanding at the date of completion of the agreement, less an amount of £23,741 already paid on account. S sued as assignee of the benefit of this debt by virtue of an assignment executed by RBF. F counterclaimed for amounts alleged to be due to RBF Group under the provisions of the agreement providing for an adjustment between the parties. RBF Group has assigned those claims to F. Disputes have arisen as to the interpretation of the agreement and this appeal is largely concerned, therefore, with questions of the interpretation of the agreement, although there is a third issue as to the effect of a letter dated 17 February 2004. The process of interpretation of the agreement involves examination of evidence as to certain pre-contractual events, including pre-contractual negotiations, and I will have to consider the admissibility of that evidence for the purposes of interpretation: see paras 50(iv) and 58 to 63 below.

3. By his order dated 18 January 2006, made following trial in this action, Mann J gave judgment in the action for £559,297 against F and entered judgment on F's counterclaim for the lesser sum of £453,732. F was ordered to pay the difference of £105,565 to S. S appeals against the judgment against it, and F for its part cross-appeals on the two subsidiary issues with a view to establishing that the amount owed by it to S was not £559, 297 but £453,732. S also appeals against the judge's costs order but argument on costs has been deferred pending resolution of the substantive issues.

4. The principles applicable to interpretation of written instruments are well established. The court has to find the meaning that a person, having all the background information ("factual matrix") reasonably available to the parties at the time they made their contract, would have attributed to the contractual provision in question. The court has to find the objective meaning of the words used, and evidence as to the subjective intentions of the parties is not admissible. In general the evidence as to what was said in the course of negotiations is also inadmissible. These principles can be found in the speech of Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at 912 to 913.

5. In the case of a commercial contract, the factual matrix includes the commercial context in which the contract was made. Moreover, as Lord Steyn said in *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749 at 771: "in determining the meaning of the language of a commercial contract, and unilateral contractual notices, the law therefore generally favours a commercially sensible approach. The reason for this is that a commercial construction is more likely to give effect to the intention of the parties." The language must of course be capable of bearing that meaning. It also follows from the principles of interpretation that the law in general endeavours to extract the meaning from a contractual provision which it is

clear to the court, from the agreement read as a whole and the factual matrix, it was intended to have, rather than allow that part to fail for ambiguities in the language or defects in the contractual mechanisms. As Hobhouse J said in *The "Zephyr"* [1984] 1 Lloyd's Law Rep 58 at 72 in the context of identifying the reinsured for the purposes of a reinsurance slip: "Where, as in the present case, there is a clear intent to create a legal relationship and the transaction or transactions are of a commercial character, English law is perfectly ready to recognise the contractual relations which the parties so clearly intend and will not frustrate them on account of some difficulty of analysis."

6. This judgment will first set out the factual matrix of the agreement, taken from the judgment of the judge or the documents in the appeal bundles, and then the provisions of the agreement in question. The issues of interpretation cannot be readily stated until that has been done. In paras 22 to 24, I set out the issues on this appeal and I then summarise the judge's judgments. I then turn to discuss the issues that have been argued on this appeal and set out my conclusions.

The factual matrix

7. F is the ultimate holding company of a group of companies run by Mr Hilary Maurice Fitzmaurice McCall. One of its subsidiaries, RBF, was a Lloyd's broker which specialised in the placing of reinsurance in the Lloyd's market, and in that capacity it had received funds paid by its clients and to be accounted for at the appropriate time to underwriters. RBF was the direct subsidiary of RBF Group, which was therefore an intermediate holding company in the F group. Mr McCall had been involved in the business of RBF for some forty years and had decided to retire. He made an agreement with Robert Fleming Insurance Brokers which gave that company the right to place renewal business on behalf of clients. This meant that F ceased to transact any new or renewal business. Mr McCall needed to find someone to take the remaining business of the company. Terminating the business of the company would take many years. There were still premiums to collect and pay to underwriters. Where reinsurance is written in Lloyd's, there may be many syndicates involved and so the process of paying premiums and collecting claims may involve considerable work. This should be income-producing as there would be income from brokerage, the release of monies held in the insurance broking account which could not be returned, interest and settlements. There are companies which specialise in the run-off of insurance or insurance-related businesses, and S is such a specialist. Mr McCall approached (among others) S. F was not insolvent: there simply needed to be an orderly realisation of its business commitments.

8. Insurance brokers are required to maintain an insurance broking account (an "IBA account") into which all monies held for clients have to be paid.

9. Mr Raj Rupal, who features in this narrative, was a director of the parent company and of F. He is also a Chartered Accountant.

10. S made an offer to take over the residual business of RBF for £50,000 although its offer was not for the business but for the share capital of RBF. It appears that the parties did not fully digest that the nature of the transaction was one for the sale and purchase of shares since the parent company agreed to deliver certain shares held by

minority shareholders and it paid for these holdings out of the IBA account. Likewise, the purchase price of £50,000 was initially paid out of RBF's own funds.

11. The draft agreement provided for the extraction of assets from RBF. The circulating draft must have contained a provision in the same terms as clause 14.2 as finally agreed or similar thereto. One of the issues was whether assets could only be removed by a lawful distribution of profits, or whether effect could be given to the transfer of assets in some other way.

12. The agreement did not list or exhaustively identify the assets to be removed and in those circumstances there was in my judgment no doubt that the judge could admit evidence to identify the assets which were in fact removed by agreement in conformity with the provisions of the agreement. There is however an issue, to which I will have to return later, as to the extent to which evidence about the reasons for the transfers of assets that were made could be admitted to determine the meaning of the terms of the agreement. Accordingly I set out the facts as found by the judge without making any comment as to their admissibility on the questions of interpretation on this appeal.

13. The facts found by the judge were as follows. About a day before the date for exchange and completion, Mr Rupal (whose responsibility it was) set about calculating the amount to be taken out by RBF Group. The judge found that his methodology was to distribute by way of dividend. He made a calculation of the profits. He calculated that the appropriate dividend was £2,187,000 and this was declared and paid on 31 May 2002. Mr Rupal's evidence was that Mr Mackay, representing S, was present when the amount of the payment was calculated. Mr Mackay denied this but accepted that the calculation was explained to him afterwards. The judge did not consider it necessary to decide which of those versions was correct. He held that what was important was that Mr Rupal carried out a dividend calculation, that he explained it one way or another to Mr Mackay and that Mr Mackay accepted the explanation. The judge accepted Mr Mackay's evidence that he told Mr Rupal that he was confident that the figure would turn out to be wrong and that there would have to be an adjustment. Mr Rupal could not describe precisely how he made his calculation, but the judge found that it was clear that his approach was to make a distribution by way of dividend and that in order to do that, he probably started from the figure for profit and loss account of £2.2 million from which he deducted sums for losses, redundancy and (according to him) the amount apparently paid out of the IBA account to buy in outstanding minority shareholdings. In his evidence Mr Rupal rejected the suggestion that he was trying to produce a lawful dividend. Mr Rupal said in his evidence that the question of the lawfulness of any dividend did not arise. He was trying to distribute funds in accordance with the arrangements he had made with Mr Mackay.

14. The audited accounts for the period ended 31 May 2002 were produced on some date in 2003. The profit and loss account showed that dividends of £2,187,000 (the amount transferred on about 30 May 2002) had been paid and concluded with a retained loss for the period of £2,325,896. The balance sheet showed as the bottom line the item "Equity shareholders' funds of £453,732". The share capital was £500,000. The notes to the accounts stated that the item of £19,316,228 for debtors included the "net amount due from the former parent and ultimate parent companies

of £528,056 (being £583,038 less £54,982 owed to the former parent company…)" and noted that that amount was disputed by F and its group.

15. We were also shown a letter of 22 May 2006 (wrongly dated 2 May 2006) from Mr Mackay to Mr McCall, setting out the terms of S's offer to acquire the share capital of RBF but as this letter appears to be part of the pre-contractual negotiations between the parties I will not set it out in this judgment.

The terms of the agreement

16. The agreement was executed on 31 May 2002 and the parties are RBF Group as vendor and S as purchaser. The agreement provides for RBF Group to sell the shares of RBF to S for £50,000 on 31st May 2002. I set out the material clauses of the agreement below but first I summarise them in the order in which they appear in the agreement. Clause 4 is particularly relevant to one of the subsidiary issues raised by F in its cross-appeal. Under clause 4.3, RBF agrees (so far as material) to procure that at completion all indebtedness between RBF Group and RBF is repaid or otherwise discharged or waived before completion. Under clause 4.1 of the agreement, this discharge of indebtedness, if not already performed, is apparently performed automatically.

17. The issues raised by S on its appeal arise out of clauses 6 and 14 of the agreement. Clause 14 provides for the transfer of "accumulated net worth". Clause 6.3 deals with financial adjustments between the parties arising out of the removal of assets prior to completion. It provides that the vendor had prior to the agreement removed certain assets from RBF on the basis of the management accounts, and that if the audited accounts when available were to show that any adjustment exceeding £1,000 was required each party remained liable to the other party to pay to that party the sum shown by the audited accounts to be due to that party. The term "audited accounts" was defined to mean the audited financial statements of RBF for the 13 months ended 31 May 2002 to be prepared by RBF's auditors at the vendor's expense. The term "management accounts" was defined as the unaudited accounts prepared by RBF for the same period, although there was in fact no single set of management accounts for this particular period. Clause 14.2 provided (inter alia) that prior to the agreement the vendor had caused RBF to transfer to the vendor the accumulated net worth of RBF (excluding the IBA assets and the IBA fund less the IBA liabilities).

18. The parts of the agreement which it is necessary to set out verbatim are as follows:

> "4. <u>Completion</u>
>
> 4.1 Completion shall take place on the Completion Date when the transactions set out in Sub-Clauses 4.2 to 4.5 shall, to the extent that they have not already been performed, be performed…
>
> 4.3 The vendor shall procure that at completion:-
>
> 4.3.1 All indebtedness owing as:

(a) between the Vendor on the one hand and RBF and the subsidiary on the other hand (or vice versa);

(b) between RBF and the Subsidiary on the one hand and any of the Directors or employees or former employees of RBF and/or the Subsidiary, except as provided in the accounts to the Last Accounts Date;

is repaid or otherwise discharged or waived (whether such indebtedness is due for payment or not)…

6.3 The Vendor has prior to this Agreement removed certain assets from RBF on the basis of the Management Accounts and if the Audited Accounts when available show that any adjustment exceeding one thousand pounds is required each Party remains liable to the other Party to pay to the other Party such sum as shall be shown by the Audited Accounts to be due to the other Party.

14. Proper Law and Construction

14.1 The construction, validity and performance of this Agreement shall be governed by the laws of England.

14.2 This Agreement sets out the entire bargain and understanding between the Parties in connection with the sale and purchase of The Shares and other matters provided for in this Agreement and that prior to this Agreement the Vendor has caused RBF and the Subsidiary to transfer to the Vendor (or elsewhere as directed by the Vendor) the accumulated net worth of RBF and of the Subsidiary (excluding the IBA assets and the IBA Fund less the IBA liabilities) but including (without prejudice to the generality of the foregoing) all reserves, all brokerage paid to RBF prior to the date of this Agreement, all interest earned and all investments (other than the lease of the Property)."

19. The expression "IBA Assets" is defined as "the amount of debts owing to RBF in respect of all insurance broking transactions and the amount credited to all bank accounts of RBF designated 'IBA', in accordance with the requirements of the GISC" , being the General Insurance Standards Council. The expression "IBA Fund" is defined as "the insurance broking accounts maintained by RBF pursuant to the regulations of GISC". The "IBA liabilities" are the liabilities of RBF in respect of all insurance broking transactions of RBF and the amount debited at all bank accounts of RBF designated "IBA", in accordance with the requirements of GISC.

20. By an assignment in writing dated 19 July 2004 RBF assigned to F all the obligations of S under the agreement. That included any obligation of S under clause 6.3 of the agreement. F gave notice of this assignment to S on 20 July 2004. As I have said, on

some date, RBF assigned to S its rights against F in respect of indebtedness due from it and S gave notice of that assignment to F. We are not concerned with the property referred to at the end of clause 14.2.

21. As the judge observed in one of his judgments, clause 6.3 anticipates that adjustments might be required without describing how those adjustments might arise. In my judgment, in the absence of an express reference point for adjustments, the court has to examine the remainder of the agreement to see what provisions could give rise to an adjustment and, if so, on what basis.

Issues on this appeal

22. The first issue ("the 'accumulated net worth' issue") is whether, as contended by S, the judge should have held that the transfers permitted by clause 14.2 were limited to distributions of profits which were lawfully distributable under the Companies Act 1985, as opposed to permitting the transfer of the whole of the net assets of RBF.

23. The second issue is the contractual consequences (if any) of the failure by RBF Group to cause to be discharged an intercompany debt owed by RBF of £54,982, as required by clause 4.3.1. The judge agreed with S that this debt was not discharged and held that no adjustment fell to be made between the parties under clause 6.3. F cross appeals on the ground that the amount of £54,982, which was shown in the audited accounts of RBF for the period ended 31 May 2002 as being owed to RBF Group should have been held to be irrecoverable as it did not represent a true liability of RBF. Accordingly, it contends that an adjustment in that amount fell to be made in favour of S under clause 6.3 of the agreement.

24. The third issue is whether the sum of £58,808 paid by RBF Group under cover of a letter dated 17 February 2004 (set out in para. 30 below) was paid on account of any claims under the agreement, whether against RBF Group or another member of its group. In fact what happened was that S appropriated this amount (other than £8,225) towards sums owed by RBF Group to it otherwise than under the agreement. Although this issue was argued as the second issue, it does not arise under the agreement and is more easily explained in this judgment as the third issue. F accepts that it was liable for the audit fee for auditing the audited accounts (£8,225) and that S was entitled to retain this sum out of the £58,808 and accordingly the sum in issue here is £50,583. If F succeeds on its cross-appeal on this point, the judgment against it would be reduced by the further amount of £50,583.

Judgments of Mann J

25. The judge gave five separate judgments on respectively 22 July 2005 (two judgments), 29 July 2005, 17 January 2006 and 18 January 2006. On 22 July 2005, in the first judgment, the judge dealt with the "accumulated net worth" issue. S's case was that accumulated net worth for the purposes of clause 14 meant in effect distributable reserves. F's case was that the accumulated net worth meant, in effect, net assets.

26. The judge held that the more natural meaning of the words "accumulated net worth" was net assets. This approach was supported by the references to IBA assets, IBA fund and IBA liabilities. He held that the computation for which clause 14.2 provided

was more akin to an asset calculation than the calculation of net profits. Clause 14.2 referred to a transfer which had already been made. On the authority of *The Pacific Colocotronis* [1982] 2 Lloyd's Rep 40, the judge held that evidence as to the transfer was admissible on interpretation. He also took into account that the transfer demonstrated a removal of accumulated net profits, and that there had been an informal agreement between the parties over the calculation to support the transfer. The evidence about the transfer made by Mr Rupal supported the argument by S that the exercise was by way of distribution of profits. Mr Rupal secured the agreement of Mr Mackay to the transfer but the judge held that there was no sufficiently firm or clear agreement to make that transfer the governing benchmark for the purposes of clause 14. The judge held that some support was to be gained from the fact that intra group indebtedness was to be waived, and from the "entire contract" part of clause 14.2, giving primacy to the written agreement. The judge also considered that, on S's approach, a company with a real net worth of £500,000 was being sold for £50,000. The judge held that there was no motivation for leaving £500,000 of assets behind in RBF. Accordingly, in the judge's view, the words "accumulated net worth" meant net asset value.

27. The judge took into account S's argument that F's interpretation of the agreement involved illegality. It would be unlawful to make a distribution of accumulated net assets which did not represent accumulated profits. The judge rejected this argument because the agreement provided that, if accumulated net worth was not transferred, there had to be an adjustment of the sale price when the audited accounts were produced. So the agreement did not require the commission of an unlawful act. The judge also rejected S's argument that the effect of the clause, if F was right, was to reduce RBF to insolvency. The judge held that the effect of the agreement was that there should be a balance of assets and liabilities not a deficit. The judge held that he was unable to consider the actual calculation in the absence of further submissions.

28. I now turn to the judge's second judgment of 22 July 2005. This was concerned with the calculation consequent on his earlier judgement. This raised the question as to the status of a debt of £54,982, which was owed to F by RBF and which ought to have been discharged before completion. The audited accounts of RBF showed this sum as a liability of RBF. S submitted that an adjustment was inappropriate because it was so shown.

29. The judge held that the audited accounts showed a liability for this amount which it was common ground could not be recovered. He held that the clause 6.3 calculation required that there should be an adjustment to show the net assets as increased by a corresponding amount. As appears from his judgment of 29 July 2005, the judge later recalled this ruling as it was not common ground that the sum of £54,982 was not recoverable as he had thought to be the case.

30. The judge then turned to a further matter. It arose out of a letter dated 17 February 2004 from William Blakeney, solicitor for RBF Group, to Addleshaw Goddard, solicitors for S. The letter stated as follows:

> "Dear Mr Blackburne
>
> <u>Robert Bruce Fitzmaurice (Group) Ltd & The Square Mile Partnership Ltd</u>

I enclose my cheque in favour of your firm for £58,808 on behalf of my client, Robert Bruce Fitzmaurice (Group) Ltd. This is the amount which it owes to your client, The Square Mile Partnership Ltd, pursuant to the agreement for the sale of all the shares in Robert Bruce Fitzmaurice Ltd ("RBF"), following the audit of RBF for the 13 months to 31 May 2002.

RBF's shareholders' funds as shown in the balance sheet	£453,732
Add IBA deficit	128,591
	582,323
Less net inter-company debt	528,056
Due to my client once it has settled the IBA deficiency, so far as it is liable	£54,267

Square Mile has accepted that £50,000 of the IBA shortfall is not due from my client. The enclosed cheque is therefore calculated as follows:-

My client's share of IBA shortfall	78,591
Less due to my client, as above	54,267
	24,324
Add tax adjustment for prior years	5,462
Add final auditor's bill	8,225
Add book value of tangible assets	22,797
	60,808
Less due for motor car, as agreed at completion meeting	2,000
	£58,808

The book value of the tangible assets, primarily furniture, fittings and computer equipment is included, as the intention was that each side should be able to remove whatever of them it wanted. It would therefore be unfair to expect your client to pay for those assets in full.

The motor car is different: all cars were to be removed, but at completion it was found that your client still needed a car for one of the two employees remaining with RBF. Although it

> was agreed at the completion of the meeting that a cheque for £2,000 for that car would follow, it never arrived.
>
> The tax adjustment in respect of prior years shown in the audited accounts is included in the enclosed payment. There should, however, eventually be a repayment of tax to RBF and this should be passed on to my client under clause 6.6. Has any tax refund been received? If so, when, how much and with what repayment supplement?
>
> Yours sincerely
>
> William Blakeney"

31. This letter purported to be a settlement of all sums owing pursuant to the agreement, and it enclosed a cheque for £58,808 payable to Addleshaw Goddard. In fact, the calculations were incorrect, though that is not the important point in this narrative. Addleshaw Goddard considered that far larger sums were due and replied on 1 March 2004 that:

> "As you are aware my client [S] claims a substantially greater sum than the sum set out in your letter. In the circumstances, I have been instructed to accept the sum of £58,808 on account of my client's claims against your client. This sum is not being accepted in full and final settlement of my client's claims, and I shall be writing to you separately in relation to those claims and also commenting upon the calculations made in your letter."

32. F argued that, although the letter was written on behalf of RBF Group, this amount fell to be treated as a part payment of the debt owed by it to S and could not be used by S as generally on account of any claim it might have against RBF Group or any member of its group. The judge disagreed. He held that this sum was paid by RBF Group on the basis that it was a sum due to S under the terms of the agreement. It was not tendered as part of the debt due from F to RBF:

> "While in terms an attempt to bring about an overall financial reckoning between the two sets of parties, it was explicitly and in terms an attempt to work out the sums due under the agreement; it was not tendered as a payment by [F]. I cannot see a basis for treating it as such a payment."(judgment, para. 19)

33. The judge held that it might be recoverable on the grounds of mistake, but there was no claim for that in the present proceedings. Accordingly, the judge held that there was no basis on the facts for characterising the payment as anything other than that which it purported to have been in the letter of the 17 February 2004. Accordingly, this amount did not fall to be deducted from the claim of S in the action. F cross appeals upon this point, contending that the judge should have ordered that this sum fell to be treated as a payment on account of S's claim.

34. The judge concluded that S was entitled to judgment for the agreed balance on the inter-company debt for £582,038, reduced by the amount of the agreed part payment (£23,741). This sum has to be set against the amount for which F counterclaimed under clause 6.3, namely the £453,732 (net assets in the audited accounts) plus £54,982. The judge calculated that this left £50,573. However, the judge later reversed his ruling about the sum of £54,982.

35. I next turn to the judge's judgment of 29 July 2005. The judge recorded that he was in error in his earlier judgement in stating that it was common ground that the result of clause 4.3.1 of the agreement was that the debt owing from RBF to RBF Group was not recoverable. This was not the position. The judge therefore agreed to hear further argument on how the sum of money in question fell to be treated in the calculation.

36. I now turn to the judge's judgment of 17 January 2006. This dealt with the point which the judge had recalled. The judge observed that Mr Michael Gadd for F submitted that the debt had been waived by virtue of RBF Group's failure to secure the release of the intercompany debt. Alternatively, F had been entitled to require that the debt be released. In the further alternative, he argued that if RBF Group had brought proceedings against RBF after judgment for recovering the debt, the claimant would have been entitled to have those proceedings stayed or struck out as an abuse of process: *Snelling v Snelling* [1973] QB 87.

37. The judge rejected this reasoning. He held that *Snelling* was not a case which decided that the debt was not due. What Ormerod J held was that he should dismiss the claim once the right parties were before him in order to give effect to the rights of all the parties before him. Accordingly, the question of the correct treatment of the debt before that time did not arise in the *Snelling* case.

38. The judge held that S could not have "restrained an action [by] an injunction or [by obtaining an order for] specific performance". The judge held that RBF Group was not entitled to say that its failure to deal with the matter before completion meant that the debt had to be treated as discharged and the net assets to be adjusted accordingly for the purpose of calculating the consideration. If it had sued RBF, S might not have intervened to prevent it from doing so. The judge held that the audited accounts were the chosen yardstick and that RBF Group had had an opportunity to complain about the status of the debt. The judge observed that RBF was not a party to the proceedings. In conclusion, the judge found for S on this issue. The fifth judgment dealt with costs. It is not necessary for me to summarise it in this judgment.

Discussion and conclusions

(1) The "accumulated net worth" issue

39. I will start by setting out the main arguments on this issue. My conclusions and a summary of my reasons appear in para. 50 below.

40. The appellant's case on the "accumulated net worth" issue is multi-faceted but has, as I see it, three basic elements: these can be summarised as clause 14.2, clause 6.3 and the pre-contractual events. The thrust of the appellant's argument is that no adjustment at all falls to be made under the agreement following completion.

41. First, as to clause 14.2, Mr Anthony Trace QC, for the appellant, submits that the only transfer of assets contemplated by clause 14.2 is the payment of a lawful dividend. The audited accounts as defined showed that there was no distributable profit remaining undistributed and therefore the judge should have made no order against S on F's counterclaim. To give clause 14.2 a wider meaning would result in the agreement being unlawful and the court should lean against that interpretation.

42. The second basic element in the appellant's argument is clause 6.3. Mr Trace contends that it was plainly not the intent of clause 6.3 to recognize and sanction a gratuitous transfer of assets from RBF to RBF Group. He also submits that clause 6.3 is not effective on its face to impose an obligation on S to pay an amount to RBF Group in the event that RBF Group failed to extract assets for no consideration. He submits that the accounts could show the disposal for value or a distribution by way of dividend but could not show a gift, which would not be lawful. The appellant argues that the limit on the transfer of assets within clause 6.3 was that it could not be by way of gift or by way of unlawful distribution. The appellant submits that a liability to make a payment can only be established by reference to what is stated in the audited accounts and further that there is no way in which the audited accounts can be challenged.

43. On Mr Trace's argument, there could be no transfer of assets or adjustment for the failure to make a transfer of assets if the transfer of assets would have reduced assets representing share capital to below the aggregate of share capital. This is because, if clause 14.2 is limited to lawful dividends, share capital could not be distributed. Indeed, section 263(3) of the Companies Act 1985 goes further and limits distributable profits in this case to accumulated net realised profits. The nominal amount of the paid up share capital of RBF was £500,000. On this basis, I observe that S could have gained net assets of that amount for the outlay of a mere £50,000.

44. Mr Trace further submits that clause 6.3 is simply not effective on its face to impose any obligation on S to pay an amount to RBF Group in the event that RBF Group failed to extract any assets from RBF for no consideration. The audited accounts would have to "show", by which he means "show in terms", that there was a liability on RBF to make a payment to RBF Group. Clause 6.3 was intended to have a limited operation. It would apply for instance, if the audited accounts showed a debt remained outstanding from RBF to one of the parties. The judge was wrong to say in his first judgment that intercompany debts outstanding at completion were waived. In that event this clause would give a right to repayment. It is accepted that RBF is not a party to the agreement, but Mr Trace nonetheless submits that the word "party" when used in clause 6.3 of the agreement is in fact a general expression which would include companies in the groups of the purchaser and vendor respectively. This part of the argument is particularly ambitious as the word "party" is capitalised in clause 6.3 of the agreement and must therefore, in my judgment, have been a reference to RBF Group or S. RBF was not a party to the agreement and therefore could not come under an obligation as a result of it. In any event most intragroup debts were to be eliminated under clause 4.2.3.

45. The third element in the appellant's case relates to the pre-contractual events, that is the distribution by Mr Rupal on about 30 May 2002. Mr Trace relies upon the fact that Mr Rupal arranged for the payment of a dividend prior to completion. This shows, on Mr Trace's submission, the true nature of the transfers contemplated by

clause 14.2. The judge ought to have used the evidence as to these pre-contractual events to limit the effect of clause 14.2 to payments of lawful dividends.

46. On Mr Trace's submission, the judge wrongly interpreted the principle in the *Pacific Colocotronis*. That principle was limited to the case where certain events have occurred prior to a contract. He accepts that the court cannot admit evidence of the pre-contractual negotiations between the parties but he contends that the court may have regard to those events in order to determine the meaning of the words used in the contract itself. The effect of the judge's reasoning was that clause 14.2 did not accurately set out what had happened.

47. The judge's conclusion on "accumulated net worth" was therefore inconsistent with his later holding that the audited accounts were the parties' chosen yardstick. If the parties had meant "accumulated net worth" to mean "net assets", they would have used that expression. Furthermore while the appellant does not contend that the business of RBF was loss making, it would need assets representing its share capital to carry on its business. The effect of the judge's construction was that S paid £50,000 for a worthless company.

48. Mr Christopher Nugee QC, for the respondent, seeks to uphold the judge's judgment on "accumulated net worth". If the parties had meant that phrase to mean "accumulated distributable profits", the agreement would have said so. The word "accumulated" simply means total. It was moreover unreal to think that RBF Group would in that event have sold the company for £50,000. The judge was right to hold that clause 14.2 set out the benchmark against which the calculation in 6.3 should be performed. As to the word "show" in clause 6.3, it was enough that the audited accounts showed that an adjustment is required.

49. As to the pre-contractual events, Mr Nugee submits that the judge should not have admitted the evidence of Mr Rupal's calculation. The court is not entitled to rely on what the parties said or did before or after the making of a contract as an aid to construction. The ratio of the *Pacific Colocotronis* case did not apply. By admitting evidence of what the parties said or did before the contract, the court is likely to have a partial and unbalanced picture of the pre-contractual events. In any event, the evidence as to Mr Rupal's calculation did not show how the parties intended the agreement to operate. Accordingly, the judge was right to give the terms of a contract, objectively construed, primacy over what the parties appear to have thought in a rough and ready exercise carried out fairly hurriedly and with no real preparation or forethought. The judge was right to say that the question of legality did not arise. The evidence did not establish whether the net effect of extracting assets would be to render RBF worthless. S had in fact sold RBF on after all the assets and liabilities had been transferred to S but would not reveal the price paid for RBF's name.

50. I now turn to my conclusions. In summary, I reach the conclusion that on the true interpretation of the agreement the expression "accumulated net worth" means "net assets". I reach that conclusion by the following steps:

i) *General effect of the agreement* - I examine the general effect of the relevant provisions of the agreement.

ii) *Clause 6.3* - I examine the provisions of clause 6.3. This refers to transfers of assets and provides for adjustments between the parties in either direction. I conclude that the adjustments can be for the purpose of giving effect to the transfer of net assets, even if this could not be achieved by a transfer of assets by RBF before completion.

iii) *Clause 14.2* – I examine the provisions of clause 14.2. I agree that this contemplates a transfer of accumulated net worth by the vendor prior to completion. However, in the context accumulated net worth must mean net assets. The transfer can be achieved by use of the adjustment mechanism in clause 6.3.

iv) *Evidence as to pre-contractual events* – I conclude that evidence about the assets transferred before completion and in addition evidence as to the calculation made by Mr Rupal to effect that transfer was admissible to identify the assets transferred and the form of the transaction, and the judge was entitled to consider whether the parties had reached any agreement about this which would amount to a collateral agreement as to the form in which transfers were to take place under the agreement. However, the evidence as to the communications between the parties in connection with the transfer was not admissible on the interpretation of the agreement.

v) *Purposes for which the parties agreed to use the audited accounts* - the audited accounts were the contractually agreed reference point for the purpose of determining if an adjustment was required and for the purpose of determining the amount of the liability which arose as a result of an adjustment.

(i) General effect of the agreement

51. The agreement was probably custom-made for the transaction for the sale of the shares in RBF to S. The terms of the agreement make it clear that there were financial implications: assets needed to be moved out of RBF and so on. The terms of the agreement also make it clear that the financial reckoning between the parties was to be by reference to the figures shown in RBF's audited accounts for the period ending on the same date as completion. I say "by reference to" the figures shown in the audited accounts without deciding at this stage whether the accounts were, as the judge held, the "yardstick" and conclusive evidence as to the need to make and in addition, the extent of, any adjustment. For obvious reasons, those accounts were not available. Accordingly, contrary to one of Mr Trace's submissions, it was necessary to provide an adjustment mechanism. That is to be found in clause 6.3.

52. Unusually, the operative parts of the agreement provide for indebtedness to be discharged and transfers made before completion: see clauses 4.3, 6.3 and 14.2.

Normally an agreement contains steps to be taken under the agreement and not in preparation for it. Steps taken in preparation for an agreement are usually referred to in the recitals to an agreement if they are referred to at all. Recitals of this kind can be useful for interpreting the agreement. There are no recitals to the agreement in this case, and that is not uncommon in a commercial agreement.

(ii) Clause 6.3

53. I take as my starting point clause 6.3. It is noteworthy that clause 6.3 starts by referring to the removal of assets. Of course, this could have been a reference back to clause 4 dealing with the elimination of debts, but that is not a natural reading of the words. Commercial people do not usually talk of transferring assets when they are referring to the elimination of intragroup debts. On the other hand, it is not usual for commercial people to refer to the transfer of assets if what they mean is paying a dividend in cash. Accordingly, if Mr Trace's basic submission as to the meaning of clause 14.2 is correct, the lack of a reference to the distribution of profits here is curious and indeed conspicuous by its absence.

54. Clause 6.3 goes on to provide for any "adjustment" which is "required". The expressions "any adjustment" and "required" are unqualified. It is not stated in clause 6.3 how the adjustments might arise or what the requirement is for. The adjustment mechanism appears in a clause dealing with transfers of assets. In my judgment, the words "adjustment" and "required" are be interpreted in conjunction with clause 14.2. That records "the bargain and understanding" of the parties that prior to the agreement the vendor has caused RBF to transfer to it the accumulated net worth of RBF. In my judgment, if that transfer was not completed prior to completion, it was required to be completed thereafter. This is apparent from clause 6.3, which provides for a payment by either party if there is an adjustment.

(iii) Clause 14.2

55. There is an apparent internal conflict in clause 14.2. The judge recognized that. Clause 14.2 starts by providing for a transfer of "accumulated net worth". Without a reduction of capital confirmed by the court, this could only take place by a distribution of distributable profits, i.e. by a distribution not exceeding net realised profits. Mr Trace says that it would be unlawful to agree to more than the distribution of a lawful dividend and thus the court should give the agreement his preferred interpretation. I do not accept his basic submission on this. If the agreement could lawfully be performed only by the company making a gift out of its assets, the agreement would be unenforceable. But RBF was not a party to the agreement. Illegality does not apply in this case because of the provision for adjustment in clause 6.3 which imposes the liability to compensate F for any shortfall in a transfer by RBF. In my judgment, this is wide enough to include any transfer of accumulated net worth not capable of being achieved by lawful dividend.

56. The relevant part of clause 14.2 refers to a transfer that had taken place before the date of the agreement. The judge found that the pre-agreement transfer had been by way of a removal of profits although it may well have exceeded the lawfully distributable amount. He came to these findings after hearing evidence from Mr Rupal as to how (so far as he could recall) he had made the calculation for the transfer. I agree with the judge that this does not mean that the evidence as to the

form of the transfer before the agreement must take precedence over the wording of clause 14.2. It is the written agreement, after all, which represents the concluded agreement between the parties, and indeed the agreement expressly states that it sets out the entire bargain and understanding between the parties: see the opening words of clause 14.2. This clause did not mean that the parties could not agree that their written agreement should not have primacy for any particular purpose, as they must be taken to have agreed when they made reference in their agreement to the transfers of assets that had already been made.

57. When the balance of clause 14.2 is examined, it contains clear and unmistakable reference to the assets of RBF, namely the IBA assets and the IBA fund, reserves, brokerage, interest and investments and the Property. There would be no need to refer to these matters if "accumulated net worth" meant the distributable profits of RBF. S points out that on this interpretation the purchaser had the ability to extract almost all the assets of RBF. But the result is not absurd. S was only paying £50,000 for the total share capital of RBF. The net assets after the transfer made before the agreement were some £453,732, and there would be no logic in RBF Group leaving this sum in RBF, after the share sale, if it was only getting £50,000 for the shares. S is concerned about paying the running costs of the run-off business. But the answer to that is that it will have the income generated by that business, including brokerage. There may be cash flow difficulties, but S is a specialist in run-off. It may be able to provide premises and staff at a lower cost. At all events, I do not think that S has shown that the result of the judge's interpretation is to produce a result which is uncommercial and against which the court should lean. On the contrary, it seems to me that the result is commercial, and it is one open to the court on the wording which the parties have used. In conclusion, in my judgment, there is on analysis nothing of substance to support Mr Trace's argument that clause of 14.2 was limited to the distribution of lawful dividend, save possibly the use of the word "accumulated" as qualifying "net worth". The expression "accumulated" is usually used in relation to profits rather than assets, when the word "aggregate" would normally be used. However, this cannot be determinative of the issues before the court as to the meaning of the word "accumulated net worth".

(iv) *Evidence as to pre-contractual events*

58. There is an issue to the extent to which the judge could properly take into account the evidence as to the transfer which took place on about 30 May 2002. In *Investors Compensation Scheme v West Bromwich Building Society*, Lord Hoffmann held as his third proposition:-

> "(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not an occasion on which to explore them."

59. It is clear from Lord Hoffmann's speech that in general pre-contractual negotiations cannot be admitted as evidence when questions of interpretation of an agreement

arise. There are exceptions to this course. Thus for example the court can admit evidence as to pre-contractual communications made orally where the subsequent written agreement refers to those oral discussions: see *The Pacific Colocotronis* [1981] 2 Lloyd's Rep 40. There are other limited circumstances in which pre-contractual negotiations can be used: see generally *Proforce Recruit Ltd v The Rugby Group Ltd* [2005] EWCA Civ 698 at [30] to [36], [53] to [55] and [61].

60. Lord Hoffmann recognises that the boundaries of this exception of pre-contractual negotiations from the factual matrix are not clear. It may be very difficult to distinguish whether something that was stated in the course of pre-contractual negotiations is or is not admissible: it may for instance be evidence of a fact which forms part of the matrix which is admissible on interpretation or alternatively may amount to an agreement as to the way in which a particular provision under the agreement is to be interpreted.

61. As I explained in *Proforce Recruit Ltd v The Rugby Group Ltd* at [57], evidence as to pre-contractual negotiations may be admissible in other circumstances, but that question raises some difficult issues :

> "Evidence as to negotiations between the parties to a contract leading up to the making of that contract may be admissible for the purposes of interpretation in wider circumstances than I have indicated above, but it is unnecessary for me to go further than those circumstances for the purpose of this appeal. Lord Hoffmann recognises in the *ICS* case that the boundaries of the rule excluding evidence of pre-contractual negotiations on questions of interpretation is unclear. Moreover, Lord Nicholls has argued in the passage cited by Mummery LJ in para. 34 of his judgment and elsewhere, that the rule should be relaxed. The exclusion of pre-contractual negotiations is not on the face of it consistent with the general principle that a contract should be interpreted in the light of its context. Nor, on the face of it, is the application of a meaning which is not that which the parties themselves gave to a term consistent with the general approach of contract law, which is to respect party autonomy. The results may be anomalous. If the judge's ruling in this case expresses the general position in law, the result would be that the parties' meaning would be adopted if they defined the term in their written contract but not if they only did so only in the course of pre-contractual negotiations. Moreover, in that latter event, the meaning given to the term by the court would prevail, and (if the court's meaning is one which is different from that on which both parties in fact proceeded) a party would be able to avoid its contractual obligations deriving from the parties' meaning. That may be the law but, if it is, it is not, on the face of it, an attractive result. There are considerations that may go the other way. Lord Hoffmann's holding is that the exclusionary rule is based on reasons of practical policy (see para. (3) of the passage cited above from the *ICS* case). That policy would have to be carefully considered if evidence of pre-

> contractual negotiations is to be admitted in evidence in interpretation questions in the future on any wider basis than the law presently permits. In that sense there may be parallels to be drawn with the use of legislative history in the interpretation of statutes. In addition, careful consideration may have to be given to the aims to be achieved by contractual interpretation and the precise extent to which the law requires an objective interpretation, as set out in para. (1) of the passage cited above from the *ICS* case. It may be appropriate to consider a number of international instruments applying to contracts. It is sufficient to take two examples. The UNIDROIT Principles of International Commercial Contracts give primacy to the common intention of the parties and on questions of interpretation requires regard to be had to all the circumstances, including the pre-contractual negotiations of the parties (article 4.3). The UN Convention on Contracts for the International Sale of Goods (1980) provides that a party's intention is in certain circumstances relevant, and in determining that intention regard is to be had to all relevant circumstances, including preliminary negotiations. Consideration may also have to be given to the question whether some matters outside the text of a contract should be given less weight where (for example) the contract is one to which different persons adhere at different points in time, such as a company's constitution, than in the case of "one-off" contracts between two persons, as in this case."

62. The *Proforce* case has been the subject of academic discussion: see in particular A. Berg, *Thrashing through the Undergrowth* [2006] 122 LQR 354 and M.J. Bonell, *The UNIDROIT Principles and CISG - Sources of Inspiration for English Courts?* [2006] 11 Uniform Law Review 305. (The CISG is the UN Convention referred to in the quotation in the last paragraph). Mr Berg makes the important point that the meaning of commercial contracts needs to be clear, and that the admission of evidence as to pre-contractual negotiations (or post-contractual conduct) "will often make it more difficult and time-consuming for a party to a commercial contract to ascertain his legal position". Professor Bonell expresses the view that the approach in the UNIDROIT principles and the CISG reflect the trend at international level. Professor Bonell also refers to the decision of Gloster J in *Svenska Petroleum v Government of Lithuania* (2006) 1 Lloyd's Rep 181. Her decision was affirmed by this court ([2006] EWCA Civ 1529, Sir Anthony Clarke MR, and Scott Baker and Moore-Bick LJJ).

63. We have not had extended argument in this court about the extent to which the evidence as to the communications passing between Mr Rupal and Mr Mackay about the transfer on 30 May 2002 was properly admissible on questions of interpretation. Mr Nugee expressed concerns that the judge took a partial view of the pre-contractual negotiations and therefore may have obtained an unbalanced view as to the aims of the parties in entering into the agreement. In my judgment, the evidence that a distribution was made and the form in which it was made on 30 May 2002 was admissible evidence because the judge was entitled to look at the evidence to see what

transfers of assets were referred to in clause 6.3 and clause 14.2. The judge found that there was no agreement between the parties that transfers had to be by way of a dividend. However, in my judgment, the evidence that the transfer was made by way of a dividend was not admissible on the interpretation of the expression "accumulated net worth". The same would apply to clause 6.2. There was evidence from Mr Mackay that everyone knew that there would have to be an adjustment. It may be said that this lends support to the argument that the intention of the parties was that clause 6.2 could be used if the transfer of net assets could not be achieved. In my judgment, this would be the admission of evidence of pre-contractual negotiations for the purpose of interpretation. That would not be permitted under the law as it stands.

(*v) The audited accounts*

64. The parties agreed to use the audited accounts for adjustments. The audited accounts would be the appropriate vehicle because all the provisions for contingent liabilities and so on would be made in those accounts, and they would have been drawn up on the basis of generally accepted accounting principles. Under the management accounts, provision was made for depreciation, though it is not clear to me whether this was done on the same basis as was required for the audited accounts. But there were no provisions for contingent liabilities, and the management accounts may not have been drawn up in accordance with all the applicable accounting principles.

65. Clause 6.3 uses the audited accounts for two purposes: first, the purpose of showing that an adjustment is "required" and this I take to mean required for the purpose of the transfer of accumulated net worth under clause 14.2, and secondly for the purpose of quantifying the sum which was to be paid by one party to the other to make the adjustment. I do not consider that the clause can work if the word "show" is given the restricted meaning for which Mr Trace contends. It must in my judgment include an adjustment which is disclosed when the accounts are analysed. For instance, the audited accounts do not disclose an item for "accumulated net worth" or even accumulated net realised profit (or loss). The accumulated net worth, in the sense that I have given it of "net assets" can be found by looking at the accounts and the accounts delimit the amount of this net worth. If therefore an asset which had been recorded in the accounting records of RBF at book cost had appreciated in value, but had not been distributed in specie before completion, then provisionally it seems to me that RBF Group would simply be entitled to a cash adjustment for its book cost.

66. Mr Trace made much of the point that F could have had "input" into the preparation of the audited accounts. The judge made a similar point in his judgment of 17 January 2006 when he said that that RBF Group "had a chance to have an input into the drawing up of the audited accounts, and it availed itself of that opportunity in various respects without complaining that [the debt of £54,982] should not have appeared there". I do not take the same view about the legal position of RBF Group in relation to the audited accounts. By the time they came to be prepared, RBF was a member of S's group. No doubt S appointed its own directors, and it was they who would have the responsibility for drawing up the accounts that would then be audited by the auditors. It has not been argued in this case whether in the circumstance that the parties had agreed to use the audited accounts as the basis for adjustments, the parties would be bound by clause 6.3 without more if the directors of RBF drew up

the accounts in a manner which restricted or increased the liability of one party to another in a manner which could not have been anticipated by the parties when they made their agreement. As I say, this point has not been argued, and I would hesitate before concluding that there would be no contractual remedy in this sort of situation.

67. I can deal with the remaining issues more shortly.

(2) *the effect under the agreement of the failure by RBF Group to cause the intercompany debt owed by RBF to F of £54,982 to be discharged*

68. On the true interpretation of the agreement, I consider for the reasons given below that the accumulated net worth of RBF had to be calculated on the basis that it did not include the intercompany debt of £54,982 because it was a liability which by virtue of the agreement would no longer be enforceable and that accordingly an adjustment falls to be made for the sum of £54,982 which was shown as a liability of RBF in the audited accounts.

69. The problem arises in this way. Clause 4.3 of the agreement required the vendor to repay, discharge or waive the debts owed by RBF to it. (This clause did not extend to monies owed by RBF to F). Clause 4.1 provides that, if this did not happen by the date of completion, the discharge of indebtedness should "be performed". I agree with Mr Nugee that after completion an intragroup debt which ought to have been eliminated has no reality as between the parties and in practice, if the vendor had tried to sue on the debt after the date of the agreement, it would have been met by a defence put forward by S that it (the vendor) had agreed not to enforce the debt.

70. This does not however mean that the debt could not have been shown in RBF's accounts, including the audited accounts as at 31 May 2002. RBF was not a party to the agreement and its directors, who were responsible for those accounts, might properly have taken the view that they could not act on the basis that it was discharged until that was confirmed to them by F.

71. In those circumstances, what is the effect of the agreement? In my judgment, it is necessary to recall the nature of the transaction. The way the relevant provisions of the agreement worked in simple terms was that S got the company (including its valuable trading name), the IBA assets and the other assets specified in clause 14.2 for £50,000; and the other assets less liabilities were to belong to the vendor and to be removed from the company. The effect of the deemed waiver or discharge, as between the parties, on completion of an intragroup debt which ought to have been discharged would be to increase accumulated net worth since liabilities would be taken to be larger than they were. The agreement must be interpreted on the basis that the parties will comply with its terms, and that in this case that RBF Group would not permit to be enforced a debt which it agreed should be eliminated as at completion. The agreement must also be interpreted as a consistent whole.

72. To give the agreement a consistent interpretation, that liability is in my judgment to be eliminated for the purpose of calculating the accumulated net worth of RBF for the purpose of clause 14.2. As between the parties, it is not to be treated as properly included in the item for creditors in the audited balance sheet of RBF as at 31 May 2002. The agreement does not require the parties to accept the audited accounts for the purpose of establishing, as opposed to quantifying, the accumulated net worth. It

would be absurd for S to have the benefit of that item, which results in a comparable deduction from the net assets. In those circumstances, in my judgment, the adjustment mechanism in clause 6.3 must apply. Put another way, the adjustment is required for the purpose of giving effect to what the parties agreed, which was that the debt should be eliminated. This also gives the term "accumulated net worth" a commercial construction for the purposes of the agreement.

73. The judge was concerned that the parties had chosen the yardstick of the audited accounts. He held that adjustments could only be made on the basis of those accounts. It followed in his judgment that if a debt was included in creditors, which as between the parties to the agreement was irrecoverable, no adjustment could be made under clause 6.3. That provides for adjustments to be made if the audited accounts "show" that any adjustment is required. In my judgment, the word "show" is being used in the sense of "disclosed" and the word "adjustment" is sufficiently general to include an adjustment which arises between the parties and does not involve the participation of the company preparing the audited accounts. Applying the foregoing, the accounts disclosed that RBF had a liability for £54,982. An adjustment was required as between the parties to the agreement to eliminate that debt, because if it was not eliminated the purchaser of the shares could retain assets equivalent to the amount of that debt even though it was no longer a liability of the company being bought. That would be an absurd result which the parties could not have intended. Accordingly, I would allow the cross appeal on this issue.

74. The judge's analysis was to ask who could sue on the debt post completion. He was concerned that RBF had not been joined to the proceedings. The argument of Mr Nugee also invited us to analyse the problem in similar terms. But as I see it, a commercial interpretation does not require the court to think in terms of that sort of solution but rather in terms of what is involved in writing off the debt after completion and to reflect that position in financial terms between the parties to the agreement.

(3) *whether the sum of £50,583, being the balance of the sum of £58,808 paid by RBF Group under cover of the letter dated 17 February 2004, can be appropriated to the amounts due from F to S in this action*

75. This is a short point. In my judgment, it is necessary to read the letter of 17 February 2004 (set out in full above) in a commercial way. It was clear from the calculations contained in the letter that RBF Group was making an offer on behalf of the members of F's group to settle the sums due under the agreement. What S did was to treat that sum as paid on account of indebtedness arising in other ways from RBF Group to itself. In my judgment S was not entitled to do this. F is therefore entitled to require the sum to be appropriated to sums due under the agreement from it either on its own account or as assignee of RBF Group (since it could not have taken the assignment from RBF Group free from equities, that is, free from debts owed by RBF Group to RBF prior to the date of the assignment). There are sums owed by F to S as assignee from RBF. Those are the sums on which S obtained judgment in the action. Accordingly, the judgment obtained by S against F should be reduced in the sum of £50,583 paid under cover of the letter of the 17 February 2004.

Postscript: Procedural issues

76. As I have explained evidence as to pre-contractual negotiations is in general inadmissible on questions of interpretation and a significant part of the trial in this case were taken up with S's application to redact large parts of the witness statements served on behalf of F. They were partially successful in this. I appreciate that it can be difficult sometimes to distinguish what is the factual matrix from what is in truth part of the pre-trial negotiations. However, the fact that many of the witness statements in the appeal bundle are redacted suggests that F should have reviewed its witness statements more carefully before serving them. This is precisely the sort of matter that parties ought to be able to agree between themselves, and if they cannot do so, they should deal with it at a pre-trial conference rather than delay the start of the trial. The chances of disposing of a case by agreement are obviously greater if this kind of issue is dealt with well in advance of trial.

Disposition

77. For the reasons given above I would dismiss the appeal and allow the cross-appeal with respect to the three issues covered by this judgment. The effect is that the judgment of the judge on the claim and the counterclaim must be set aside, together with the order for payment against F. There will instead be substituted judgments for £453,732 on both the claim and the counterclaim. It follows that the judge's order for costs must be set aside.

Lord Justice Jonathan Parker:

78. I agree.

The Master of the Rolls:

79. I also agree.