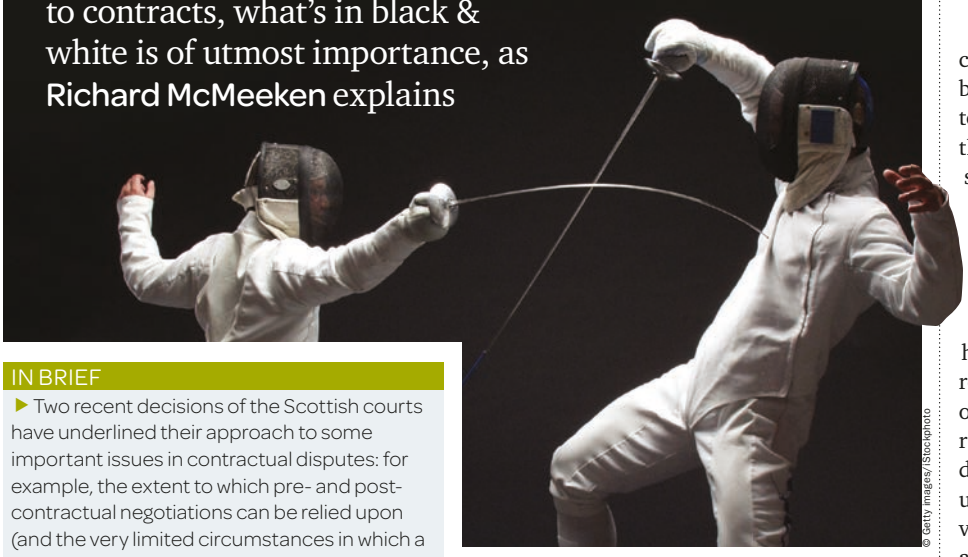
Drawing up the battle lines

No escape from a bad bargain: the courts have made it clear that when it comes to contracts, what's in black & white is of utmost importance, as **Richard McMeeken** explains



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IN BRIEF

- Two recent decisions of the Scottish courts have underlined their approach to some important issues in contractual disputes: for example, the extent to which pre- and post-contractual negotiations can be relied upon (and the very limited circumstances in which a contract can be disregarded or overlooked).
- This is a UK-wide issue and not just limited to Scotland—indeed, the law north and south of the border is now approached on the basis of the same principles.

Negotiating a commercial contract is a careful and often time-consuming process, as any corporate lawyer knows. The process often starts with heads of terms broadly setting out what the parties are seeking to achieve, but not legally binding on them. The contract then goes through multiple iterations, with the lawyers on both sides seeking to best reflect their client's goals and aspirations in the final document. It can be a bit of a battle and often, while the final draft reflects the parties' broad intentions, one or another party has likely had to give up something that they wanted. The complexity of the drafting process in a share purchase agreement means that parties will invariably involve experienced lawyers to negotiate and agree terms for them. Occasionally, however, the contract will not reflect the parties' intentions because a mistake has been made, or one of the parties to it will decide after signing that they've entered into a bad bargain and want out of it.

The *Angelline* case

In order to explore how the law deals with that sort of problem, we can look at the case of *Paterson v Angelline (Scotland) Ltd* ('*Angelline*'). The case in *Angelline* was simple. The defender was buying a pharmacy from the pursuer known as Keir Pharmacy Limited (KPL). The share purchase agreement provided that the defender was buying the entire issued share capital of KPL. As a consequence of that purchase, the defender also acquired KPL's subsidiary, AD Healthcare Limited (ADHL). Both the parent and the subsidiary ran trading businesses. The consideration for KPL included a deferred consideration. That deferred consideration was, according to the signed share purchase agreement, calculated by reference to the net asset position of KPL alone.

However, the pursuer argued that that was a mistake. He argued that the common intention of the parties had been that the deferred consideration was calculated by reference to the net asset position of both KPL and ADHL. That was significant because of the trading position of these companies. If deferred consideration included KPL's position only, then the purchaser was due money back. If it included ADHL as well, then the seller was due additional payment. So, the pursuer sued for the deferred consideration and the defender counterclaimed.

The pursuer's argument rested primarily on a change to the draft contract that had been made during the negotiation process and shortly before completion. While that change was not concealed (indeed it was highlighted and change-tracked in the revised draft agreement), the claim was that it did not reflect the parties' intentions and, in particular, did not follow what had been agreed in non-binding heads of terms between them. The legal argument was that:

a) the contract should be read as including ADHL; or
b) a term should be implied into the contract providing for the inclusion of ADHL in the calculation; or
c) the contract should be rectified so that it properly reflects what the parties were alleged to have intended in the non-binding heads of terms.

The pursuer relied heavily on pre-contractual discussions and negotiations between the parties—both the non-binding terms and various emails between him and the principal of the defender, which he said showed that the final version of the contract was a mistake. He also relied on post-contractual dealings and, in particular, the fact that completion accounts had been prepared for both KPL and ADHL which he claimed would not have happened had KPL's net asset position been the only relevant one. The defender argued that all of this was irrelevant. There was a legal rule against reliance on pre-contractual dealings. All that mattered was the clear and unambiguous wording of the final signed version of the contract. If the pursuer had not agreed with what it said, then he shouldn't have signed it.

What did the courts say?

The commercial judge's decision at first instance was surprising ([2021] CSOH 101, 2021 Scot (D) 16/10). She found that there was no reason why the pursuer could not make this argument. She was not impressed by an approach which focused on the precise words of the contract, but preferred to look at the matter contextually (almost ignoring at times what the words actually said). The commercial judge considered that the pre-contractual discussions were important—indeed, these discussions may reveal that something has gone wrong with the words and that the final agreement didn't reflect what the parties intended. According to the commercial judge, the contract may be capable of rectification if the pursuer could make out his case.

However, in July the civil appeal court in Scotland (the First Division of the Inner House of the Court of Session) reversed the commercial judge's decision ([2022] CSIH 33, 2022 Scot (D) 19/7). It held that the pursuer's argument stood no chance of success and should not be allowed to go any further. It reiterated the well-established rule that where the terms of a contract are clear, the court has to apply them. It isn't for the court to go looking for problems with the contract where none exist. It wasn't possible to read the contract in the way in which the pursuer suggested, and pre-contractual

negotiations (and indeed post-contractual negotiations) were entirely irrelevant to what the contract said. There was no obvious mistake by either party. Indeed, objectively speaking, the pursuer's solicitors had accepted the revised version of the agreement and so, on the face of it, there was no way of arguing that it didn't reflect their common intention.

Unpicking the issues

While the Inner House's judgment was brief, it was brief because the issues involved were clear. Where the court has to decide what a contract means, what is in black and white is of primary importance. That is not saying anything new. It has been the way in which the courts have interpreted contracts for years now and the Supreme Court in London has, over the last 15 years or so, made numerous statements to that effect. That's not to say that context doesn't matter; on the contrary, context can matter a great deal, but how much it matters depends on how clear the words are. If the words are crystal clear, then context doesn't add much. If the words are ambiguous then the court will, at that stage, look more closely at the factual background, the purpose of the contract and will think more carefully about which of the possible meanings makes the most commercial sense. But these considerations have little weight when the words are clear.

The Inner House's judgment is very important for commercial business in Scotland. If commercial contractual relationships are going to work properly in practice, then the contracting parties need to be sure that the court will give effect to what they've agreed—not what they *think* they've agreed, but what they've actually agreed. The problem with the decision of the commercial judge is that it undermined the security of contractual relationships. The whole point of instructing lawyers to review and revise draft contracts is to ensure that you have a final version which reflects what you want. Indeed, the Supreme Court has said before that where experienced lawyers are involved, it will be even less inclined to think that something has gone wrong with the words. Lawyers are expected to get it right for their clients.

Now of course, mistakes do happen. Sometimes a contract will contain an obvious typographical error, which is capable of being rectified, and occasionally it is clear that the final contract does not actually reflect the true intention of the parties. For example, there may be a binding prior agreement which hasn't been followed in a subsequent one. Or one party may have fallen into error as a result of misrepresentations (whether deliberate or not) by the other party. But these examples are exceptions to the general rule that parties will be held to the letter of their contractual commitments. It's not possible to revisit contracts after they are signed and it's not possible to escape the consequences of your contractual commitments just because, with the benefit of hindsight, you think you've got a bad deal or have agreed something which you wish you hadn't agreed. The court will not let parties escape from a bad bargain.

A UK-wide issue

One interesting reflection on the *Angelline* judgment is that it covers an area of law where the law is closely aligned throughout the UK. English courts will often grapple with difficult issues surrounding the interpretation of contracts and implication of terms as well, and a lot has been written over the last ten years about what the proper approach should be. The law north and south of the border is now approached on the basis of the same principles. Commercial parties can, by and large, expect consistent results whichever side of the border they choose to litigate.

The case also deals with two difficult issues which are still more contentious. First: the extent to which pre-contractual negotiations/discussions are relevant in the process. The Inner House has firmly closed the door on their use, subject to very limited exceptions where they have a bearing on the meaning of the words or the purpose of the contract. The court will never allow pre-contractual negotiations to be used by one party to put a gloss on the words of the contract.

Second: when a contract can be rectified by the court to properly reflect the parties' intention. In England, that relies on their being an 'outward expression of intent' by the parties which is capable of being relied upon as a basis for rectification. In Scotland, it has been suggested previously that the English test should be followed. But the Inner House seems to have closed the door on that argument, saying that the Scottish statutory wording of 'common intention' is all that is relevant. It may be that, in most cases, the respective courts would reach the same result regardless of how the test is expressed, but it goes to show that the highest courts in Scotland are careful to protect the consistent development of Scots law even if that diverges from the position in England.

That issue is by no means restricted to rectification of contracts. In other areas of law, Scottish and English law will broadly reflect the other but will not be entirely aligned. The use of extrinsic evidence in the interpretation of wills or testamentary writings is a good example or whether and the way in which insolvency practitioners can disclaim property. These seemingly minor differences are capable of leading to significantly different results depending on the jurisdiction, and so it remains crucial to seek local legal advice on the issues being litigated. NLJ

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