OUTER HOUSE, COURT OF SESSION

[2021] CSOH 101

CA3/21

OPINION OF LADY WOLFFE

In the Commercial Action

KEIRON DAVID PATERSON

Pursuer

against

ANGELLINE (SCOTLAND) LIMITED

Defender

Pursuer: ECM MacLean; Blackadders LLP
Defender: Dean of Faculty; Morton Fraser LLP

12 October 2021

Introduction

The issue at debate

[1] The parties entered into a share purchase agreement dated 5 July 2019 ("the SPA") under which the pursuer sold, and the defender acquired, the whole pharmacy business conducted by the pursuer from three premises using two corporate vehicles. That SPA provided for payment of the total consideration by four different types of payments (as after defined). A dispute has arisen about the adjustment to the second type of payment, described as "the Initial Deferred Consideration".

The pursuer's position

[2] The pursuer contends that an upward adjustment is required, resulting in a payment due to him in the amount of £341,932 and he concludes for declarator and payment. The pursuer's legal grounds are based first on what he says is the proper interpretation of the SPA, and in the alternative on an implied term. By way of further alternative, in the event that the court is not with him on either of these grounds, he seeks rectification to achieve the same end.

The defender's position

[3] The defender contends for a different, and it says much more straightforward, interpretation. It also contends that the pursuer's legal grounds for an implied term or rectification are irrelevant. On its interpretation of the disputed provision, it submits that a downward adjustment is required, with the effect that the pursuer is obliged to pay the defender the sum of £228,904, and payment of which it seeks in its counterclaim.

The parties' motions

[4] Both parties moved for decree *de plano* in his or its favour. The pursuer seeks one or more declarators (depending on the legal basis on which he might succeed) and payment in the principal action, and dismissal of the defender's counterclaim. The defender resists the principal action (which it contends is irrelevant) and it seeks payment of the sum in the counterclaim said to be due.

The circumstances preceding the conclusion of the SPA

[5] While the pursuer's first legal ground concerns the construction of the SPA, the pursuer relies on the background circumstances as providing relevant context in which the SPA fell to be construed, or as forming part of the factual matrix of which both parties were aware. Accordingly, before setting out the core provisions of the SPA, I first set out the circumstances referred to in the pleadings as constituting the background to, and context of, the SPA. Most of this was not accepted by the defender.

The pursuer's pharmacy business operated by two companies from three premises

[6] As at July 2019 the pursuer was a director of, and 95% shareholder in, Keir Pharmacy Limited ("KPL") and defined in the SPA as "the Company". He was also a director of A D Healthcare Limited ("ADHL"), a wholly-owned subsidiary of KPL, which was defined in the SPA as "the Subsidiary". KPL owned and operated a pharmacy in Denny. Ms Lucie Capaldi, a pharmacist and senior employee in the pursuer's business, owned the remaining 5% of the shares of KPL. ADHL owned and operated two pharmacies, in Larbert and Plean. Collectively, the business was comprised of these two companies ("the companies"), which operated three successful pharmacies from these three premises (collectively "the premises"). In the SPA, the Company and the Subsidiary were defined as "the Group".

Communings preceding the heads of agreement

[7] The pursuer avers that from about February 2019 there were discussions between him and Ms June Friel ("Ms Friel"), the sole director of the defender. These discussions took the form of meetings as well as emails, culminating in the pursuer's acceptance on 5 March

2019 of the defender's informal offer to buy the business for approximately £6.35 million plus a sum for net current assets. The pursuer also avers that in "the market for the sale of such businesses, that was a common means of determining, and paying for, stock and other current assets of a pharmacy".

The heads of terms

[8] The pursuer also avers that on 10 May 2019, the pursuer and the defender signed heads of terms ("the heads"), the principal terms of which recorded their non-binding agreement for the sale to the defender of all KPL's shares and, with them, the whole assets of the two companies and the three pharmacies comprising the business. The heads recorded that the consideration was to be £6.35m "plus net current assets", a valuation which the pursuer avers had been arrived at assuming a sale on a debt-free and cash-free basis ("the valuation assumption"). The pursuer also avers that payment for that was agreed to be structured as follows:-

1) A first payment of £5.2m,

2) Payment of 75% of the estimated net current assets of the companies in cash on completion,

3) A third payment totalling £200k, payable in 60 equal monthly instalments over the succeeding 5 years, and,

4) At the end of that 5-year period the remaining £1 million was to be paid.

Moreover, the second payment (the Initial Deferred Consideration) was to be adjusted following preparation of completion accounts, which were intended to determine the value of *inter alia* the actual net current assets value of the business. The intended sale was subject to the defender undertaking due diligence of both KPL and ADHL and their affairs, and the

common provisos that there were no material adverse changes in the business, assets and financial positions of either. Thereafter, the defender carried out its due diligence of both companies and their affairs. The pursuer's position is that there were no material changes.

[9] In relation to certain current assets, the pursuer avers that on about 29 June 2019, shortly prior to completion, the parties arranged for joint valuations of stock (as this fell within current stock) to be carried out at each of the three pharmacies. The pursuer also averred that neither KPL nor ADHL was denuded of cash (another current asset).

The different drafts of the SPA

Definitions of assets and liabilities that included both companies

[10] The pursuer makes detailed averments about several iterations of the draft SPA, *inter alia* dated 28 June, 29 June, 30 June and 3 July 2019. As I understood it, this was to demonstrate that even though there were changes in defined terms (eg from "Net Current Assets" and "Net Current Liabilities" to "Current Assets" and "Current Liabilities"), these terms always <u>included</u> the assets and liabilities of "each Group Company". The term "Group" was consistently defined as "the Company [ie KPL] and the Subsidiary [ie ADHL]", and "Group Company" meant either one of them.

[11] However, the pursuer focuses on a draft of the SPA of 3 July 2019 (intimated by email timed at 13:02 (and which he defined as "the further revised draft")), containing further revisions (as tracked changes) by which the defined terms "Current Assets" and "Current Liabilities" replaced the definitions of "Net Current Assets" and "Net Current Liabilities", but in which the assets or liabilities (as the case may be) were now restricted to being only those of "the Company" (that is, KPL) ("the Company changes") and therefore <u>omitting</u> the assets and liabilities of ADHL. The pursuer relies on the fact that the tracked

changes effecting the Company changes ceased to be apparent a few hours later, when a further draft was intimated (by email timed at 16:06). Subject to the insertion of "cash at bank" into "Current Assets", those revised definitions were contained in the executed SPA.

The effect of Company changes resulted in the omission of ADHL's NCA from the defined term "Current Assets" and "Current Liabilities"

[12] By reason of the Company changes, namely, the insertion of the two disputed defined terms, of "Current Assets" and "Current Liabilities" (which no longer included the assets or liabilities of ADHL), the adjustment to the Initial Deferred Consideration was no longer by reference to the assets and liabilities of both companies (defined as "the Group" in the SPA), but by reference only to those of KPL. This change is at the heart of the dispute between the parties and the issue debated.

Other conduct prior to conclusion of the SPA founded on as providing relevant context

[13] The pursuer founds on other conduct said to be relevant, and indicative of (it is said) the parties' shared understanding that the net current assets ("NCA") of <u>both</u> companies were to be calculated and factored into the total consideration. The relevant conduct was said to include the following:

1) <u>Calculations of the NCA of both companies</u>: the pursuer refers to an NCA calculation of both companies (based on revised management accounts to 31 March 2019) and produced by the pursuer's accountants to the parties, their agents and the defender's accountants on 2 July 2019 ("the 2 July NCA Calculation"). He avers that the following figures were produced, which were based on these accounts. The

significance for present purposes is that the 2 July NCA Calculation included the NCA of the Subsidiary (ie ADHL):

	KPL	**ADHL**	**Total**
Stock	£41k	£88k	£129k
Debtors	£262k	£264k	£526k
Bank & Cash	£141k	£632k	£773k
Creditors	(£175k)	(£319k)	(£494k)
Net Total	**£269k**	**£665k**	**£934k**

It will be noted that ADHL was the biggest contributor, by far, to the total NCA of the two companies and that the sum it held in cash exceeded the figure of £500,000 stipulated as the Initial Deferred Consideration.

2) No objections by the defender or its accountants to the inclusion of ADHL's assets in the NCA Calculation: The pursuer's position in respect of these figures is that the parties made clear *inter se* that the defender and its accountants had reviewed the NCA Calculation and the management accounts on which the calculation was based; that the defender's accountants had advised the defender about, and provided a written summary of, their observations on the NCA Calculation and, again, in which there was no mention of, and no objection to, the inclusion of ADHL's accounts, current assets and current liabilities in the NCA Calculation;

3) The resultant agreement to pay the Initial Deferred Consideration based on the NCA Calculation: The pursuer also avers that in light of the advice Ms Friel had

received from the defender's accountants following receipt of the NCA Calculation she had proposed that, subject to the defender receiving satisfactory evidence of both companies' bank balances at a specified date, the defender would pay £500k to account of the "NCA value" a week after completion; that the pursuer accepted that proposal and this became the Initial Deferred Consideration (the second tranche of the total consideration was paid); and

4) The pursuer's production of the bank statements, including that relating to the balances held in ADHL's bank accounts: the pursuer thereafter exhibited the bank statements for both companies as at the agreed date, which showed that the cash held by KPL's and ADHL's respective bank accounts was then approximately £90k and £555k, respectively.

The foregoing is a summary of the kinds of conduct or communings on which the pursuer founds. In submissions the pursuer also referred to a number of drafts and communings (by email or WhatsApp) comprising the two lever-arch files of productions lodged for the debate to illustrate these chapters of evidence. It is not necessary to set out the details of those in this opinion.

Completion and payments under the SPA

[14] The pursuer notes that following execution of the SPA, completion took place on 5 July 2019, as a consequence of which:

1) The defender paid the first tranche of £5.2 million to the pursuer;

2) The pursuer implemented his completion obligations, including repayment by the pursuer of his director's loan and transfer to the defender of all the issued

shares in KPL and, thereby, the whole business of the two companies, three pharmacies group, together with both companies' assets, including all current assets.

3) Thereafter, the defender paid the Initial Deferred Consideration (being the £500k to account of NCA), timeously;

4) The "Instalments" became due each month since then (being the 60 monthly payments to be made as the third element of the consideration); and

5) In August and November 2019, the defender paid invoices for current liabilities incurred by ADHL prior to completion.

Conduct post-dating the SPA founded on as providing relevant context

[15] As noted below, the Initial Deferred Consideration, paid a week after completion, was subject to adjustment in due course in accordance with Schedule 8 to the SPA. This adjustment entailed the preparation of draft Completion Accounts and the Completion Account Statements for both KPL and ADHL. The pursuer notes the following timeline of the steps taken to finalise the adjustment in accordance with Schedule 8 to the SPA:

1) The draft Completion Accounts and the Completion Account Statements, produced in December 2019 and February 2020 and intimated to the defender and/or its accountants, at all times included NCA figures for KPL and ADHL;

2) In February 2020, the defender's accountants acknowledged receipt of these documents and requested detailed back up schedules for all balance sheet items, which were subsequently provided;

3) On 25 February 2020, in implement of paragraphs 1.2 to 1.3 of Schedule 8 of the SPA, the defender's accountants notified the pursuer of a number of respects in

which they were not satisfied that the details of the draft Completion Accounts of both KPL and ADHL were correct; and

4) Thereafter, and especially from 10 April 2020, the parties and their respective accountants, in implement of paragraph 3 and Schedule 8 of the SPA, endeavoured to resolve those matters by consistently communicating on the provision and import of information relating to them. In the result, on 13 May 2020, the defender's accountants proposed final minor revisions to the draft Completion Accounts Statement which culminated in their agreement on those matters by 22 May 2020.

The pursuer observes that by this date, all outstanding matters were resolved. None of these ever related to the inclusion of ADHL's current or other assets and liabilities. Moreover, of the comments made from time to time by the defender's accountants in respect of the draft Completion Accounts or the Completion Account Statements, none related, or otherwise objected to the inclusion of ADHL's current or other assets and liabilities in those documents.

The first objection by the defender to the inclusion of ADHL's NCA in the Completion Accounts Statement

[16] The pursuer avers that it was only by letter dated 5 June 2020, from the defender's accountants to the pursuer's solicitors, that they purported to notify him for the first time ("the purported notification") that the defender was not satisfied with the details of the Completion Accounts Statement by reason, *inter alia*, of the inclusion of ADHL's current assets and liabilities. This was shortly after the pursuer had demanded payment, by letter of 29 May 2020, of the balance of the adjusting payment for net current assets due to him in terms of clauses 2.1 to 2.2 of and Schedule 8 to the SPA.

The parties' positions on the relevance of the factual context

The pursuer's analysis of the objective factors informing his three legal grounds

[17] Mr MacLean, advocate, who appeared for the pursuer, identified what he described as objective fundamental aspects of the background which he submitted were, or ought reasonably to have been, known to both parties when they entered into the SPA on 5 July 2019. These were as follows:

1) That the sale, under the SPA, would transfer the whole business comprised of the two companies and three pharmacy premises, together with all their assets, including current assets, to the defender in exchange for the consideration;

2) That, as was common in that market, the element of consideration referable to net current assets was to be separately assessed by subsequent preparation and agreement on, or determination of, completion accounts with a payment to account of them on or about completion;

3) In the end that payment to account of the net current assets of the business was agreed to be £500,000, paid a week after completion;

4) That there was substantial cash, stock, debtors and, overall, net current assets in KPL and in ADHL;

5) That there was, broadly, twice as much in the latter as in the former;

6) That the cash was to remain in the respective companies at completion of the sale, along with the other current assets;

7) That the current assets in each were then likely to be of the order set out in the table above (at para [13(1)]);

8) That it would not have been commercially sensible to omit the net current

assets of ADHL from the assessment and payment of the part of the consideration for such assets;

9) That, from February 2019 until about 3 July 2019, when the defender's solicitors returned the further revised draft (defined at para [11], above), all the parties' discussions, documents and prior drafts had expressly contemplated, stipulated, or provided for, the inclusion therein of ADHL's net current assets and the contrary had never been suggested;

10) That, at no stage, had the parties or their advisors discussed, mentioned or implied that the effect of changes to the further revised draft was, or might have been, to exclude those assets therefrom; and

11) That such exclusion would have been likely to reduce the consideration for net current assets by over £600k and oblige the pursuer to repay over half the £500k to be paid to account just after completion.

In light of the foregoing, Mr MacLean submitted that these objective fundamental aspects of the background strongly reinforced the conclusion that a reasonable person would then have understood that the parties intended that the defender was to pay for the net current assets of ADHL, as well as KPL, all of which were, therefore, to be included in the Completion Accounts Statement.

The defender's position on the factual context

[18] In its pleadings, the defender denies the vast majority of the pursuer's averments. (Under reference to *PIK Facilities Ltd* v *Watson's Ayre Park Ltd* 2005 SLT 1041 at paragraph 25, the pursuer relies on the defender's failure to aver a positive case, as justifying the pursuer's primary motion for decree *de plano*.) In response to questions from the court, the defender's

counsel, the Dean of Faculty, confirmed that in respect of the 11 factors the pursuer identified, the defender accepted items 1, 4, 5 and 7; it did not accept items 2, 3, 6 and 8; and it offered no comment on the remaining items.

The effect of the competing interpretations

The pursuer's position

[19] The pursuer's position is that his interpretation accords with the commercial purpose of the SPA, which was the transfer of the assets of the business carried on by the two companies, and that the consideration included the assets of both of those companies. Otherwise, the defender would have an arbitrary and wholly unexpected windfall, and the pursuer would suffer an equally arbitrary and unexpected loss. For these reasons, the disputed definitions were, in the context of the consideration provisions relating to NCA and in the context of the SPA as a whole, and against those objective aspects of its background, to be construed as applying to both of those companies, which failing a term should be applied or the disputed definitions rectified to achieve that end.

The defender's position

[20] On the defender's analysis of the disputed definitions, they could not be clearer; they should be construed according to their terms; they admitted no alternative interpretation; and therefore the factual context was irrelevant. The disputed definitions excluded the NCA of ADHL. It could not be said that the value of ADHL's assets had not been included in one of the other elements of the consideration. In terms of the commercial purpose of the SPA, this was to transfer the shares in KPL to the defender. There was a utility in including ADHL's NCA in the Completion Accounts, even if not in the Completion Accounts

Statement (as a consequence of the application of the disputed definitions), so that the defender was aware of what it was getting and because some of these assets were subject to warranties.

Discussion

The SPA

[21] The principal provisions relevant to the parties' dispute include the following:

1) many of the defined terms (in clause 1.1),

2) the provision for consideration setting out the four types of payments to be made (in clause 3.1),

3) the mechanism for adjusting the consideration (in clause 3.3) and which was to be done in accordance with the provisions of Schedule 8, and

4) the "Entire Agreement" clause in clause 13.1, on which the defender relies.

In submissions, reference was made to many other provisions in the SPA, particularly by the pursuer, essentially to demonstrate that throughout the SPA it contained references to the Group – that is both KPL and ADHL – not just the former, and that the Company changes resulting in the definitions of Current Assets and Current Liabilities being anomalous by reason of the exclusion of ADHL from its terms. I quote these provisions below, so far as it is necessary to do so. Unless otherwise stated, all of the defined terms come from clause 1.1 of the SPA.

The four payments comprising the consideration

[22] While the parties' submissions focused on the definitions of the "Current Assets" and "Current Liabilities" ("the disputed definitions"), it is how those terms operate in the

provisions governing the calculation of any adjustment to the second tranche (the Initial Deferred Consideration) of the total consideration that the differences between the parties' positions is evident. I therefore start with the structured consideration, provided for in clause 3.1. I shall bring in the defined terms as appropriate.

[23] Clause 3.1 of the SPA provided for the consideration and was the aggregate of four tranches of payments, as follows:

1) the "Completion Payment" (defined as the sum of "£5,200,000") was payable on completion (which was 5 July 2020) (clause 3.1.1);

2) the "Initial Deferred Consideration" (of £500,000), which was defined as " **a payment to account** of **any adjustment** to the Consideration in accordance with clauses 2.1 and 2.2 of Schedule 8" (emphasis added) (the words quoted are repeated in clause 3.1), payable on the day following 7 days from completion (clause 3.1.2);

3) the third tranche of the consideration comprised the "Instalments" (being 59 monthly payments of £3,333.53 and a final payment of £3,333.53 (resulting in a total of £1,000,000 paid as Instalments), payable in accordance with clause 3.1.1; and

4) the Final Deferred Consideration (defined as £1,000,000 payable in terms of clause 3.1.4) was due on the fifth anniversary of the Completion (subject to certain "Trigger Events" in clause 3.5 not here relevant).

It should be noted that the structured payment of the consideration in the SPA, by four different types of payments, reflects that in the heads of agreement, although the figures in the third element (providing for instalment payments over 5 years) differ and there is now a figure specified for the Initial Deferred Consideration of £500,000 in place of 75% of the estimated net current assets of the companies. The pursuer avers that in early July 2019, shortly before the SPA was entered into, the pursuer had explained to Ms Friel that he had

around £1 million in cash sitting in the business; that Ms Friel suggested he could save significant sums in tax if the cash were left in the companies at the time of the purchase and then paid out thereafter in instalments; and that it was accordingly agreed that this would be done. For that reason, the purchase was no longer expressed as being on a cash-free basis. By structuring the payment in this way the pursuer would effectively reduce the tax rate of 46% (assessed on income) to 10% (assessed as capital gains) on that sum. The third element of the consideration was increased (to £1,000,000) but still payable over the same number of months as in the heads of agreement (see para [8], above). It should be noted that the only element of the consideration which was subject to any adjustment was the Initial Deferred Consideration. I therefore turn to consider the provisions of the SPA governing that matter.

The provisions governing the adjustment to the Initial Deferred Consideration

[24] The element at the heart of this dispute, the Initial Deferred Consideration, was defined (in clause 1.1) as a payment of:

> "£500,000 as **payment to account** of any adjustment to the Consideration in accordance with clauses 2.1 and 2.2 of Schedule 8)". (Emphasis added.)

The operative provisions relating to the Initial Deferred Consideration are found in two places: clause 3 of the SPA (defining the four elements comprising the consideration and the dates on which they are to be paid), and Schedule 8 to the SPA and of which paragraph 2 is most germane to the parties' dispute. (While parties referred to provisions in both the principal SPA and in its schedules as "clauses", in order better to distinguish these, I shall use "clause" for the principal SPA and "paragraph" when referring to a provision within a schedule to it.) In terms of paragraph 2, if the Completion Accounts Statement produced Actual Net Current Liabilities there would be a downward adjustment and repayment of the

Initial Deferred Consideration; if it produced a figure which was less than the Initial Deferred Consideration (of £500,000), there would be a reduction in the overall consideration. If the Completion Accounts Statement produced a positive figure, there would be an upward adjustment in the consideration in the amount equal to the Actual Net Current Assets. The disputed definitions are given effect to in paragraph 2 of Schedule 8, because the defined terms of "Actual Net Current Assets" and "Actual Net Current Liabilities" incorporate the disputed definitions ("Current Assets" and "Current Liabilities").

The Completion Accounts

[25] The starting point is to note the accounts on which any calculation to the Initial Deferred Consideration was based. Clause 3.3 (headed "Completion Accounts") provided:

> "The Completion Accounts shall be prepared and the Consideration shall be adjusted as set out in Schedule 8 and payments made in accordance with clause 2.2 of the said schedule."

Before turning to paragraph 2 of Schedule 8 to the SPA, it is helpful first to note what was covered by the term "Completion Accounts". The term "Completion Accounts" was defined as

> "the balance sheet and profit and loss account of **each Group Company** for the period from the Last Accounts Date [defined as 30 April 2018] down to 23:59 on 30 June 2019 prepared in accordance with the provisions of Schedule 8". (Emphasis added.)

The "Accounts" were defined as the unaudited financial statements of each Group Company comprising the balance sheet, profit and loss account and cash flow of each. Further provision governing the Completion Accounts is found in paragraph 3.1 of Schedule 8, which stipulated that the Completion Accounts were to be prepared in

accordance with certain policies or usages, of which the first three (in the order of priority were:

(i) "Specified Policies" (as defined in Schedule 8),

(ii) the usage in the preparation of the Accounts, and

(iii) Standard accounting method.

It suffices to note for present purposes that, to the extent matters were not covered by the "Specified Policies" (in paragraph 3.1.1), the same accounting "standards, principles, policies and practices…" as were used in the preparation of "the Accounts" were to be adopted in the preparation of the Completion Accounts: clause 3.1.2. Accordingly, the inclusion of the NCA of ADHL is consistent with both the Specified Policies and the usage in the preparation of the Accounts. So far as relevant, the Specified Policies (in paragraph 4 of Schedule 8 to the SPA) – being the first in priority of the matters governing the preparation of the Completion Accounts – included "full provision" for salaries (paragraph 4.1) "full provision" for corporation tax in the period up to completion (paragraph 4.3), and that "stock" was stated at the value certified by the professional stock-taker at completion. In none of these matters (salaries, tax or stock) was any distinction made between KPL and ADHL. The clear implication was, for example, that the "stock" stated was the stock of *both* of the companies, not of just one of them. This would be wholly consistent with how "the Accounts" were prepared, which was the second in order of priority of the principles governing the preparation of the Completion Accounts, and with the fact that they included the financial statements of each Group Company. The inclusion of ADHL's NCA was also entirely consistent with the definition of "Completion Accounts".

[26] It is in my view highly significant that the Completion Accounts included the assets and liabilities of both companies. The inclusion of the assets and liabilities of both of the

companies ("each Group Company") is consistent with the definition of "Accounts" as being (read short) "the unaudited financial statements of each Group Company, including balance sheet, profit and loss account and cash flow statements" of each. As will be seen, it is expressly provided that the "Completion Accounts Statement" (referred to in paragraph 2 of Schedule 8) was derived from the Completion Accounts. There is an obvious disconnect between the omission of ADHL's NCA from the Completion Accounts Statement, and the inclusion of those assets at all other relevant points in the SPA and where its commercial object is to transfer the whole assets of both companies for value calculated by reference to their NCA as a distinct element of the consideration (as the pursuer avers is consistent with the structure of share purchase agreements in this sector).

The process of adjusting the Completion Accounts and the Completion Accounts Statement

[27] The next matter to be considered is the provision governing the procedure for the preparation and agreement of the Completion Accounts and Completion Accounts Statement, in paragraph 1 of Schedule 8 to the SPA. The pursuer (described as the "Warrantor" in paragraph 1.1 of schedule 8) was obliged (by paragraph 1.1 of schedule 8) to prepare "draft Completion Accounts and the Completion Accounts Statement in accordance with paragraph 3 of schedule 8" ("Basis of Preparation"), which I have just noted. It should be noted that only the Completion Accounts were to be prepared as a draft but not the Completion Accounts Statement. This reinforces the understanding that Completion Accounts were the means by which the parties were to arrive at agreed figures and that, once done, the mathematical calculation provided for in paragraph 2 of schedule 8 would be done based on those figures and inserted into the Completion Accounts Statement. The buyer's accountants (being the defender's accountants) then had an opportunity to review

the draft Completion Accounts in order "to satisfy themselves that it [ie the Completion Accounts] has been prepared in accordance with" paragraph 2 of Schedule 8. (The reference to paragraph 2 is probably incorrect – paragraph 2 relates to the Completion Account Statement, not the Completion Accounts; the basis of preparation of the Completion Accounts Statements is governed by paragraph 3 of Schedule 8). The remainder of paragraph 1 of Schedule 8 sets out an alternative dispute mechanism (which has not been operated by the parties).

[28] It will be recalled that the pursuer founds on the parties' communications (see paras [15] to [16], above) falling within paragraph 1.2 of Schedule 8 as part of the factual matrix, and, specifically, the failure of the defender or the defender's accountants throughout that process from December 2019 to early June 2020 to object to the inclusion of the assets and liabilities of ADHL and which, on the defender's reading of the relevant provisions fall to be excluded.

[29] Having regard to the terms of the foregoing process, the Accounts and the Completion Accounts both included the NCA of ADHL. The latter were the means by which the parties arrived at the agreed figures *inter alia* for the NCA of both companies. The terms of clause 3.3 reinforce this understanding, as it provided:

> "The Completion Accounts shall be prepared and the Consideration shall be adjusted as set out in Schedule 8 and any payments made in accordance with clause 2.2 of the said Schedule."

This was a two-step process: the adjustment of the draft Completion Accounts (the pursuer's relative averments of which are summarised above, at para [15]), and then the use of those figures to calculate in accordance with para 2 of Schedule 8 the amount of any balancing payment to be made. Once the first step was completed, and parties had agreed on the figures in the Completion Accounts, then these figures were fed into the Completion

Accounts Statement for the essentially mechanical exercise of determining if any balancing payments were required to the Initial Deferred Calculation as determined by paragraph 2 of Schedule 8. It should be noted that prior to the stage of the preparation of the Completion Accounts Statement, the disputed definitions played no part.

The Completion Accounts Statement

[30] The Completion Accounts Statement was defined as:

> "the statement of Actual Net Current Assets or Actual Net Current Liabilities, as appropriate, prepared by the Warrantor's [ie the pursuer's] Accountants **derived from the Completion Accounts**" (emphasis added.)

As is clear from the words highlighted, the Completion Accounts form the basis for the Completion Accounts Statement. Moreover, the adjective "Actual" is at least suggestive that the "Actual" NCA was the result arrived at following the process of adjustment to, and agreement of, the Completion Accounts between the parties (a process the pursuer relies on and which occurred between late 2019 and mid-2020). However, the first two defined terms embedded within the definition of the Completion Accounts Statement, namely, of "Actual Net Current Assets" or "Actual Net Current Liabilities", are themselves defined, respectively as "the excess of Current Assets over the Current Liabilities" or "the excess of Current Liabilities over Current Assets", in each case as "disclosed by the **Completion Accounts** calculated on a debt free basis". Until one turns to the definitions of "Actual Net Current Assets" and "Actual Net Current Liabilities", the natural expectation would be that these are (like the Accounts and the Completion Accounts) inclusive of the NCA of both companies. However, because the terms "Actual Net Current Assets" and "Actual Net Current Liabilities" incorporated the disputed definitions, the NCA of ADHL fall out of

account, a change which is at the heart of the dispute between the parties. I turn to consider the disputed definitions.

The disputed definitions: "Current Assets" and "Current Liabilities"

[31] The "Current Assets" are defined as:

> "cash at bank, stock, trade debtors, prepayments, accrued income and other debtors in the normal course of trading of **the Company**" (emphasis added),

and "Current Liabilities are defined as:

> "those amounts due to trade creditors, accruals, corporation tax, VAT and PAYE/NI and other creditors in the normal course of trading of **the Company**" (emphasis added).

The effect of the use of the words "the Company" is, *prima facie*, to confine current assets or liabilities, as the case may be, to those of KPL, to the exclusion of ADHL's assets and liabilities. This is the point where the parties join issue.

[32] The pursuer contends that these definitions are to be construed as including the assets and liabilities of both companies. He seeks to achieve this by reading in or implying certain words (using the definition of "Current Assets" to illustrate this), namely:

1) By adding the words "and the Subsidiary" (after the word "Company"), to read:

> "those amounts due to trade creditors, accruals, corporation tax, VAT and PAYE/NI and other creditors in the normal course of trading of the Company and the Subsidiary" , or

2) by changing the word "Company" to the plural, "companies", to read:

> "those amounts due to trade creditors, accruals, corporation tax, VAT and PAYE/NI and other creditors in the normal course of trading of the companies,", or

3) by inserting the words "of each Group" in place of "the" where it appears before "Company", to read:

> "those amounts due to trade creditors, accruals, corporation tax, VAT and PAYE/NI and other creditors in the normal course of trading of each of Group Company".

If this cannot be achieved on the application of a purposive construction or by implication, the pursuer seeks rectification to achieve one of these readings.

[33] The reason the pursuer seeks this is because of the effect of these defined terms, when incorporated into the defined terms of "Actual Net Current Assets" and "Actual Net Current Liabilities", and which are themselves incorporated into the definition of the Completion Accounts Statement. Spelling out each of these defined terms, the definition of "Completion Accounts Statement" would read as follows:

> ""the statement of the excess of Current Assets … **of the Company** over the Current Liabilities… **of the Company** … as disclosed in the Completion Accounts on a debt free basis or the excess of Current Liabilities ….**of the Company** over the Current Assets…**of the Company**… as disclosed in the Completion Accounts on a debt free basis….derived from the Completion Accounts. (Emphasis added).

Considering the disputed definitions within the context of the SPA, there is a dissonance between the use of the words "the Company" (in bold), which confine the assets and liabilities to those of KPL, and the references to "the Completion Accounts" (underlined), which definition included the assets and liabilities of both ADHL as well as those of "the Company" (ie KPL).

[34] There is another tension arising from the numerous references to "the Accounts of both companies (and therefore necessarily *including* ADHL's NCA) and the use of those Accounts to compile the Completion Accounts (again including the NCA of ADHL), on the one hand, and the *omission* of the NCA of ADHL from the Completion Accounts Statement, on the other.

[35] I turn to consider parties' competing submissions on the principles of interpretation to be applied.

The parties' competing positions as to the principles of interpretation which were applicable

[36] The cases the pursuer cited to vouch the principles of interpretation he relied on included classic cases such as *The Moorcock* (1889) 14 PD 64, one of the trilogy of seminal cases of Lord Hoffmann in the late 1990s (*Investor's Compensation Scheme Ltd* v *West Bromwich Building Society* 1998 1 WLR 896 ("*Investors Compensation*"), the first consideration of that case in Scotland by the First Division in *Bank of Scotland* v *Dunedin Property Investment Co Ltd* 1998 SC 657 ("*Dunedin Property*") and as subsequently considered by a differently constituted First Division in *Luminar Lava Ignite* v *Mama Group PLC* [2010] CSIH 1, 2010 SC 310 ("*Luminar Lava*")), as well as the ongoing reformulation of those principles in several Supreme Court cases (*Rainy Sky SA* v *Kookmin Bank* [2011] UKSC 50, [2011] 1 WLR 2900 ("*Rainy Sky*"), *Arnold* v *Britton & Ors* [2015] UKSC 36, [2015] AC 1619 ("*Arnold*") and *Wood* v *Capita Insurance Services Ltd* [2017 UKSC 24, [2017] AC 367 ("*Wood*")).

[37] By reason of the focus of discussion in some cases on a rule of evidence to exclude prior communings (eg *Dunedin Property* at p 665F, or *Luminar Lava* at para 41), the interpretation of contracts might be understood as having a presumption favouring the primacy of the words used to the exclusion of context; or, if it could be said that the meaning of the words was clear, that was conclusive of the interpretative task on which the court was engaged. I understood this to be, essentially, the position adopted by the defender, coupled with its submission that in the absence of ambiguity or an alternative meaning, resort to the background – as the pursuer sought to do – was impermissible.

[38] In this case, the defender seeks to persuade the court that the pursuer's averments of the surrounding circumstances are irrelevant and that the defender is entitled to decree *de plano*. Its position is that the natural meaning of the words is clear; they admit of no alternative reading and the disputed definitions should simply be given effect to. In making that submission the Dean of Faculty, who appeared for the defender, founded strongly on *Global Port Services (Scotland) Limited* v *Global Energy (Holdings) Limited & Ors* [2015] CSIH 42 ("*Global Port Services*") at paragraphs 30 to 32, particularly the court's observation that, in the absence of ambiguity or where the wording under consideration was not open to more than one interpretation,

> "it is not open to the court to construe it in a manner contrary to its natural meaning. It must apply that meaning, even if the result is a commercial outcome which could be considered to be improbable." (at paragraph 30).

The court concluded in that case that there was "no sufficient justification for the bargain to be rewritten" (para 32).

[39] Attractive though the simplicity of the defender's submission is, the principle that in construing a contract the court may permissibly have regard to the surrounding circumstances is long established in Scots law (see *Inglis* v *Buttery & Co* (1878) 5 R (HL) 87 *per* Lord Ormidale (at pp 66 and 67) and *per* Lord Blackburn (at pp 106 and 107), cited with approval in *Dunedin Property*) in order "to ascertain what a reasonable person, having all of the background knowledge which would have been available to the parties, would have understood them to be using the words in the contract to mean" (*per* Lord Hodge in *Luminar Lava* at paragraph 41) or "to establish the parties knowledge of the circumstances with reference to which they used the words in the contract" (*per* Lord President Rodger (as he then was) in *Dunedin Property* at p 665F to G). Consideration of the surrounding circumstances can also elucidate the commercial purpose of the transaction (see Lord Hodge

in *Luminar Lava* at para 42). Where the surrounding circumstances are considered for these purposes, the exclusionary rule has no application. Indeed, for these purposes, the permissible (or admissible) background which a party may invoke can include things said and done during the process of negotiations (*per* Lord Rodger in *Dunedin Property* at p 665G).

[40] The respective approaches of the parties in this case brings into sharp focus the different paradigms of "textualism" and "contextualism" Lord Hodge referred to in *Wood* (at para 13) and "their occupation of the field" – or, in this case, battlefield – "of contractual interpretation". The full passage of Lord Hodge's observations (at paras 9 to 13) repays re-reading, but I quote only the last paragraph, in which he said:

> "Textualism and contextualism are not conflicting paradigms in a battle for the exclusive occupation of the field of contractual interpretation. Rather, the lawyer and the judge, when interpreting any contract, can **use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement.** The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements. Some agreements may be successfully interpreted principally by textual analysis, for example, because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance. But negotiators of complex formal contracts may often not achieve a logical and coherent text because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require parties to compromise in order to reach agreement. There may often therefore be provisions in a detailed professionally drawn contract which **lack clarity** and the lawyer or judge **in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contacts of the same type.** The iterative process, of which Lord Mance JSC spoke in *Sigma Finance Corpn* [2010] 1 All ER 571, para 12, assists the lawyer or judge to ascertain the objective meaning of the disputed provisions." (Emphasis added.)

At times the defender's approach in this case appeared to be that, if the terms to be construed admitted of a clear meaning, that was effectively preclusive of the use of other

tools (as Lord Hodge described them, *ibid*) to assist the court in its essential task of interpreting the contract or the disputed definitions under consideration.

[41] In considering parties' competing submissions I bear in mind that the overarching task of the court is "to ascertain the objective meaning of the language in which parties have chosen to express their agreement" (*per* Lord Hodge in *Wood* at paragraph 13). The court's approach to that fundamental task will naturally be informed by the approach taken by the parties in the case before it. In a case where parties do not pray in aid surrounding circumstances in the presentation of their cases, the court's focus will naturally be on the words used, construed in accordance with the other provisions of the contract. Even on that approach, the court may have regard to matters extrinsic to the deed, namely, the underlying commercial purpose of the transaction (even if that commercial purpose is only a "makeweight", *per* Lord Hope in *Aberdeen* (at para 22)), and which may assist a purposive interpretation or help the court to discern between two competing readings.

[42] In other cases, by contrast, parties may, as the pursuer does here, invoke a substantial amount of the factual background. In such cases the court is likely to have regard to those extrinsic matters in ascertaining the objective meaning of the parties' contract. This is not judicial interventionism or the illegitimate protection of the commercially feckless (see paras 21 to 22 of *Aberdeen City*), so much as the court's responsiveness to the nature of the case and the arguments presented to it. Different cases will naturally call for the use of different tools from the judicial toolkit Lord Hodge described.

[43] As will be apparent from paragraphs [7] to [17], above, the pursuer seeks to prove an extensive body of factual material as forming the relevant context of the SPA. It respectfully seems to me that the defender's submissions, and the cases it cites, do not engage with the

pursuer's primary case on interpretation. In a case where one party invokes the factual matrix, it is no answer to ignore that or to seek to dismiss it under reference to an exclusionary rule (eg about prior communings) which has no application.

[44] Moreover, the case law also discloses examples of cases in which hard questions of interpretation arise, even where the contracts have been drafted by professional advisers, and which may only become apparent when the provisions come to be considered or applied to an unprovided for circumstance. Two of the cases the pursuer cited, *Multi-Link Leisure Developments Ltd* v *North Lanarkshire Council* [2010] UKSC 47, 2011 SC 53 ("*Multi-Link*") and *Aberdeen City Council* v *Stewart Milne Group Ltd* [2011] UKSC 56, [2012] SC 240 ("*Aberdeen City Council*"), illustrate this. In *Multi-Link*, the issue was whether the "full market value" of the land the tenant sought to buy under an option was valued as agricultural land or taking into account its development potential for housing. Lord Hope DPSC (giving the opinion of the Supreme Court) expressly acknowledged that the contractual provisions at issue (the assumptions and disregards in an options clause) could not be reconciled to resolve the dispute between the parties, and the dispute had to be resolved having regard to the objective commercial background (see para 22).

[45] In *Aberdeen City Council* the dispute was whether the basis of calculation of an uplift due to the disposing council by the purchaser developer required to be by reference to an arms-length disposal (as the council contended) or could be on the basis of a lower non-arms -length disposal to a related company of the developer (as the developer contended). The problem was that the parties' contract made no express provision governing that question (see para 18). Lord Hope (DPCS) noted that there were "well-understood limits **to the extent to which the court can depart from the express terms of the agreement** that has been

reduced to writing to solve a problem of this kind" (at para 18, emphasis added). "Would the court", he asked,

> "be transgressing these limits if it were to give effect to the case for the respondent in the face of the appellants' submission **that the contract should be given effect according to its terms**?" (Emphasis added.)

After considering the disputed provisions in light of the known context (at paras 19 to 21), Lord Hope answered the rhetorical question he posed in the negative, and found in favour of the respondents. In other words, the court could not resolve the dispute by giving effect to the contract "according to its terms", but could only be resolved by resort to the context.

> "The context shows that the **intention of the parties** must be taken to have been that the base figure for the calculation of the uplift was to be the open market value of the subjects at the date of the event that triggered the obligation. In other words, **it can be assumed that this is what the parties would have said if they had been asked about it at the time when the missives were entered into….** The only question is whether **effect can be given to this intention without undue violence to the words they actually used in their agreement.** For the reason I have given, I would hold that the words which they used do not prevent it being given effect to in the way I have indicated." (Emphasis added.)

By contrast, Lord Clarke, who delivered the only other judgement, noted that the construction being upheld was one that was "not easy to conclude, as a matter of the language" used by the parties. Nor, indeed, was he persuaded that the parties intended that the language used *could* have that meaning (see para 31 and 32). In short, the limitations to the extent to which a court may "depart from the express terms" as a matter of interpretation *were*, in Lord Clarke's view, breached and, therefore, precluded giving effect to parties' intention by the route of interpretation. Rather, Lord Clarke regarded it as a case in which,

> "**notwithstanding the language used**, the parties must have intended that, in the event of a sale, the appellants would pay the respondents the appropriate share of the proceeds of the sale on the assumption that the on sale was at market price". (Emphasis added).

In his view, the case he was considering therefore raised a different issue than that addressed by cases like *Rainy Sky*, where there were two available constructions of the contractual provisions. While he agreed with the result Lord Hope had reached, Lord Clarke preferred to reach it by a different route, namely by implication of a term:

> "Lord Hope says at para 20 that there would be no difficulty in implying a term to the effect that, in the event of a sale which was not at arm's length in the open market, an open market valuation should be used to arrive at the base figure for the calculation of the profit share, I agree. If the officious bystander had been asked whether such a term should be implied he or she would have said 'of course'. Put another way, such a term is necessary to make the contract work or to give effect to business efficacy, **I would prefer to resolve this appeal by holding that such a term should be implied rather than by a process of interpretation.** The result is of course the same". (Emphasis added.)

The case of *Aberdeen City Council* is also instructive, because it demonstrates that judicial views may differ as to whether the dispute is resolved as one of interpretation (*per* Lord Hope) or by implication (*per* Lord Clarke). Indeed, the fact that the other four justices agreed with *both* Lords Hope and Clarke –notwithstanding the divergence in their approaches– illustrates that more than one tool in the judicial toolkit might be appropriate, and that the use of one does not necessarily preclude another.

The purpose of the SPA and the provisions giving effect to the seller's obligations

[46] In light of the cases discussed, I turn first to consider the overall purpose of the SPA, which was to effect the transfer of the shares in KPL (as the parent company of ADHL) in return for payment of "the Consideration" (defined as "made in accordance with 3.1 and subject to the adjustments in clause 3.3" and summarised at para [23], above). The SPA contained further provisions in order to effect the transfer of the underlying assets of both companies which were used to conduct the pharmacy business carried on by the Group (defined as "the Business" in the SPA). Apart from the definition of "Current Assets", in

every other instance in the SPA, the provisions giving practical effect to completion include both companies. This is clear, for example, from the definitions of "Properties" (which include the three premises used by the companies (set out in part 1 of schedule 3 to the SPA)) and "Property Documents", of "Intellectual Property" read together with "Group Intellectual Property", and of "IT Systems" and "Proprietary Software".

[47] The obligations imposed on the seller, and the associated warranties he granted, also relate to both companies. So, for example, upon completion, the pursuer was obliged to deliver the following:

1) Resignations of all directors from the Group (meaning both companies) (clause 4.2.2),

2) All of the books, records, cheque books and statutory books and minute books of "each Group Company" (clause 4.2.4),

3) The Property Documents (which are for the Properties for both companies) (clause 4.2.6),

4) All books of accounts and records as to customers and/or suppliers and other records and all insurance policies in any way relating to or concerning the Business" (clause 4.2.7),

5) Releases of each Group Company and its officers and employees from any liability which may be owed to the pursuer by any Group Company (clause 4.2.8),

6) Statements confirming the cash balances of "the Company's/Group's bank account(s)" as at the date of the SPA and adjusted to reflect the balances on the day preceding settlement (clause 4.2.10), and

7) Mandates of each Group Company to its bankers (clause 4.2.11).

There was further provision for the release of any guarantee or indemnity granted by either Group Company, coupled with a personal indemnity granted by the pursuer for any failure to secure such releases (clause 4.3). Other provisions provided for protection of the goodwill of both companies (clause 6) and the non-disclosure by the pursuer of Confidential Information (defined as that relating to "the Business [ie that carried on by the Group] or the technology, customers or financial or other affairs of the Group…" (clause 7).

[48] Moreover, the associated warranties (eg governing the Properties, as well as TUPE transfers, pension obligations etc. (see clause 5.1 and schedule 4 and part 2 of schedule 5) and the specific indemnities (see clause 8) relate to both companies, as do the tax covenants (clause 4.7 and part 1 of schedule 5). For the purposes of the latter, for example, the liability of the pursuer to assume responsibility for any latent tax liability (in clause 2 of part 1 of schedule 5) is expressed as liability extending to both Group companies. The extent of that liability is measured against the "Relevant Accounts" (as defined at the beginning of part 1 of schedule 5) and which incorporates the definition of "the Accounts" from clause 1.1 of the SPA, namely:

> "the unaudited financial statements of **each Group Company** comprising the balance sheet, profit and loss account and cash flow statement of the Company, **the Group and the Subsidiary** together with the notes thereon and the directors' report as at and for the financial period ended on the Last Accounts Date". (Emphasis added.)

All of these obligations related to both companies.

Justification for use of the disputed definitions in the Completion Accounts Statement

[49] As noted above, the assets and liabilities of both companies were included in the Accounts and in the Completion Accounts. Given the linguistic overlap between the terms

"Completion Accounts" and "Completion Accounts Statement", the latter being the statement "derived from the Completion Accounts" (*per* the definition), one would have expected a similar overlap of their content. The language used, that the Completion Accounts Statement was the statement of "Actual Net Current Assets" and "Actual Net Current Liabilities", would reinforce that expectation. Giving "actual" its ordinary or natural meaning would betoken the specific figures actually ascertained, as adjusted and agreed between the parties in the Completion Accounts. The result of the exclusion of ADHL's assets from the "actual" net current assets sits uneasily with the adjective "actual". However, the incorporation of the disputed definitions into the definitions of "Actual Net Current Assets" and "Actual Net Current Liabilities" results in the omission of ADHL's net current assets and liabilities. Ostensibly, to the extent that the Completion Accounts included the NCA of both companies, the preparation and adjustment of these is substantially redundant, if the Completion Accounts Statement omits those of ADHL. That omission is given effect to at the final stage, involving the adjustment to the Initial Deferred Consideration (as provided for in paragraph 2 of Schedule 8 ("Adjustment to the Consideration")), noted above (at para [24]), and which is made on the basis of the Completion Accounts Statement.

[50] The defender sought to explain the otherwise redundant references to ADHL's NCA throughout the SPA as enabling the defender to know what it was acquiring or to test the scope of the warranties. I am not persuaded by this submission, given the magntitude of the redundancies and the other features of the SPA that I have noted. In respect of the exclusion of ADHL's NCA from the Completion Accounts Statement made pursuant to paragraphs 2 of Schedule 8, as I understood it, the only explanation the Dean of Faculty could offer for that was to protect the seller from a catastrophic decline of value of ADHL's asset position to

one of balance sheet insolvency (see paragraph 9 of the defender's note of argument). On this scenario, the "benefit" to the seller was the exclusion of ADHL's net current liabilities, thereby excluding the risk of a downward adjustment to the Initial Deferred Consideration. While, in the abstract, that reflects an available reading giving effect to the disputed definitions according to their terms, the Dean of Faculty did not seek to relate that to the shared background knowledge of the parties that, as disclosed in the table of net current assets produced a few days before settlement, ADHL was asset-rich to the tune of £665,000 (see para [13(1)], above) and which, on the pursuer's averments of the structure of acquisitions in this sector, was to be reflected in a specific and identifiable element of the overall consideration.

[51] I return to the effects of the parties' competing interpretations. On the pursuer's analysis, the defender's interpretation would result in the defender acquiring the net current assets of the larger of the two companies for no consideration. The defender resists this, not by advancing an interpretation that belies the pursuer's analysis, but by suggesting that ADHL's net current assets might have been accommodated in one of the other elements of the consideration. The difficulty with that submission is that it invites the court to speculate on a matter for which evidence is required, and it is inconsistent with the relative constancy of the different elements of the consideration prefigured in the heads of agreement and the elements comprising the consideration which have found their way into the SPA.

[52] I am not persuaded that the approach and interpretation urged by the defender is well-founded. Drafting errors in commercial contracts rarely announce themselves as such, but become patent upon a consideration of the operation of the term or terms in question within the context of the contract as a whole (and which, as here, may expose a tension or an anomaly), or as those contractual provisions come to be applied in a particular set of

circumstances. It is in such cases that consideration of the commercial purpose of the contract or its factual matrix may assist the court in its essential task of ascertaining the intention of the parties. As Lord Hope DPCS put it in *Multi-Link* (where he had acknowledged that it was not possible to reconcile the terms in question (the assumptions and disregards): "In this situation the solution must be found by recognising the poor quality of the drafting and trying to give a sensible meaning to the clause as a whole which takes account of the factual background known to both parties at the time when the lease was entered into" (see paragraph 19). In my view, having regard to the tensions and redundancies generated by the disputed definitions I have noted above, to the effect those definitions lead to, and to the inconsistency of that outcome with the commercial purpose of the SPA, I am persuaded that the pursuer has pled a relevant case and that the court is faced with a patent mistake in the drafting – subject, of course to proof of the relevant context. It falls into the category of cases described by Lord Hodge (at the end of para 13 of *Wood*) where, notwithstanding the assistance of professional drafters, the provisions of the SPA governing the adjustment to the Initial Deferred Consideration (in particular, the disputed definitions) are such that "lawyer or judge in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type" (*ibid*). As most of this factual matrix is not admitted or agreed, a proof on the pursuer's averments must follow. Given that the factual matrix is contested, it suffices for the court to consider whether the pursuer has pled a relevant case on any of the three legal grounds of interpretation, implication or rectification on which he relies.

The pursuer's legal grounds of interpretation, which failing implication

[53] I consider the pursuer's cases based on interpretation and implication together. I do so because the pursuer founds on essentially the same factual basis in support of both legal grounds and also because, as the difference already noted between the approaches of Lord Hodge and Lord Clarke in *Woods* illustrates, the boundary between interpretation and implication may be fluid and difficult to define with any certainty. Indeed, in light of the concurrence of the other four justices in *Wood* with both Lord Hodge and Lord Clarke, it may not be necessary in all cases to draw a bright line between interpretation and implication. In any event, in this case it would be unwise to try to do so without the benefit of evidence.

[54] In my view, the pursuer has pled a sufficient and relevant basis to justify inquiry into the factual matrix it seeks to rely on for its first two grounds. First, the pursuer has referred to the practice of how agreements in this sector are structured (one of the factors identified in the case law as relevant), and which was to agree a consideration, but to make separate provision for the valuation of the net current assets of the business to be acquired. The pursuer is entitled to seek to prove that averment. At debate, however, this averment is taken *pro veritate*. A construction of the SPA which is radically inconsistent with that practice – because it results in the exclusion of the major portion of the NCA - is *prima facie* inconsistent with, or even frustrates, the commercial purpose of the SPA. The Dean of Faculty suggested that it might have been the case that the defender's payment for ADHL's NCA were covered in some other element of the consideration. As already observed, that can only be a matter of speculation at this stage and is a further justification for allowing a proof. Other elements of the factual matrix the pursuer identifies may be seen as militating against that: the fact that the overall structure of the consideration (into four tranches, with

the separate calculation of the NCA of the business) remained essentially the same as between the heads of agreement and the SPA; the strong asset position of ADHL and the fact that it was the holder of the majority of the business' net current assets (including very substantial cash balances similar in magnitude to the amount of the Initial Deferred Consideration to be paid); the fact that there was no adjustment to the other elements of the consideration to counterbalance the omission of ADHL's NCA from the Initial Deferred Consideration; or the oddity of stipulating for payment of Initial Deferred Consideration (as a payment to account) in an amount that is nearly double the NCA of KPL and which therefore necessarily entails a *repayment* by the seller (the pursuer) to the purchaser.

[55] In holding that the pursuer has pled a relevant case, I bear in mind the observations in the case law that the court must of course guard against regretful hindsight by a party who may have made a bad bargain, and it must not lose sight of the possibility that a provision may have been altered to reflect a compromise in the negotiations (see *Wood* at paragraph 11). Returning to the Completion Accounts Statement, while the adjustment provision in paragraph 2 of Schedule 8 anticipated all possible theoretical outcomes, on the matters the pursuer avers (including about the usual structure of agreements in this sector) and as to the state of knowledge of the parties, the pursuer has relevantly put in issue the improbability that parties would have agreed that the NCA of the larger of the two companies was to be left wholly out of account. As Lord Hodge framed this issue (in *Luminar Lava* at paragraph 43), if an interpretation of the contract frustrates the commercial purpose, "the court would prefer an alternative interpretation". The pursuer has offered an alternative interpretation, which in my view is an available one. In other words, in my view, the pursuer has averred a relevant case which, if his averments are proved, could entitle the court to draw the conclusion that a literal construction of the SPA did not give effect to the

parties' intention, objectively ascertained in light of the parties' shared knowledge and having regard to the commercial purpose of the SPA; and that the pursuer's alternative interpretation is an available one "without", as Lord Hope put it in *Multi-Link* (at paragraph 21), "doing undue violence to the words …actually used" in the SPA and (if the factual matrix is established) is to be preferred.

[56] For completeness I should note that the pursuer advanced a discrete argument based on the opening words of clause 1.1. That clause contained the common proviso that the defined terms applied "unless the context otherwise requires". The pursuer contended that, here, the context otherwise required the disputed definitions to be interpreted differently. The defender's reply was that that proviso could not be used to displace the defined term in the definition itself (the disputed definitions only appear in the definitions in clause 1.1 and nowhere else in the SPA). In my view, there is no limit to the way that a drafting error may manifest itself in a complex commercial contract. Had it been necessary to determine this issue, I would have regarded the features of the SPA already noted to have been sufficient to enable the pursuer to rely on the proviso, notwithstanding that the effect would be to dis-apply the definition itself.

[57] Putting the issue between the parties in a manner consistent with a case of implication, if the officious bystander had asked the parties whether it was their intention that the NCA of ADHL were to be omitted from the defined terms "Current Assets" and Current Liabilities" and therefore omitted from the Completion Accounts Statement, the pursuer has averred a relevant basis upon which, if his averments are proved, a court may conclude that the parties would have answered that question in the negative.

[58] For these reasons, I find that the pursuer has pled a relevant case for inquiry based on his first two legal grounds.

The pursuer's case of rectification

[59] The pursuer needs only to establish that he has a relevant case for any one of the three legal grounds. In light of my decision on his first two grounds, I can deal with his third legal ground, of rectification, without setting out all of the authorities parties produced (including in the supplementary bundle). In any event, other than to agree the terms of the statutory provisions, the parties were unable to agree the principle or principles derived from the case law informing the court's exercise of the statutory power. Much of the discussion in the cases cited concerned whether the proper approach to be taken to an uncommunicated subjective change of intention by one party, at least in circumstances where reliance was placed on evidence of a "common continuing intention" derived from an earlier non-binding agreement (which is sufficient to ground an action of rectification, for the reasons explained by Lord Hoffmann in *Chartbrook Ltd* at paragraph 60 and applied by Lord Hodge in *Patersons of Greenoakhill Ltd* v *Biffa Waste Services Ltd* 2013 SLT 929 at paragraph 38), rather than an antecedent agreement, was objective or subjective. Lord Tyre favoured the latter (see *Briggs of Burton Plc* v *Doosan Babcock Ltd* [2020] CSOH 100 ("*Briggs*") at paragraph 62), whereas Lord Reed (sitting in the Outer House) provisionally favoured the latter but reserved his opinion (see *Macdonald Estates Plc* v *Regenesis (2005) Dunfermline Ltd* [2007] CSOH 123, 2007 SLT 791 ("*Macdonald*") at paragraph 176). That issue does not arise in the present case. While there was a superficial similarity on the facts of *Briggs* (on which the defender relied), because the change of intention was reflected in a draft which preceded the conclusion of the contract in question, I did not understand the parties (or, more particularly, the defender) to contend that there was such a change of intention on its part in this case. There was no suggestion of this in the two paragraphs of the defender's note of

argument addressing rectification. Nor was this the position adopted in its submissions or its pleadings. Had this been the defender's position, some averment would have been necessary, not least because it would be likely that the court would require to hear evidence on that matter including, potentially, the communicated statements and conduct of the defender's professional advisers (see paragraphs 42 to 43 of *Patersons*). Moreover, where there has been a mistake in the expression of the parties' agreement (eg as identified by Lord Hodge in *Patersons* at paragraph 84, after proof), that necessarily precludes an argument that the agreement correctly expresses the parties' agreement even if embodying an uncommunicated change of position.

[60] Turning therefore to the statutory requirements: A party seeking rectification must satisfy the court that "a document intended to express or give effect to an agreement fails to express accurately the common intention of the parties to the agreement at the date when it was made" and, if so satisfied, the court may order the document to be rectified "in any manner that it may specify in order to give effect to that intention": section 8(1)(a) of the law Reform (Miscellaneous Provisions) (Scotland) Act 1985 ("the 1985 Act").

[61] In the event that I had not been with the pursuer on his first two grounds, I find that he has established a relevant ground for rectification. I have already noted above the factors the pursuer has identified from the factual context preceding the SPA and from the non-binding heads of agreement to the effect that the NCA of both companies was to be included in the Initial Deferred Consideration. Lord Hoffman's observations in *Chartbrook Ltd* v *Persimmon Homes Ltd* ([2009] UKHL 38, [2009] 1 AC 1101 ("*Chartbrook*") (at para 65), that the prior consensus on which the rectification is premised may be based wholly or in part on oral exchanges or conduct, is apposite to this case. The pursuer has detailed averments about the parties' conduct following the SPA, in particular, the 5 or 6 month period during

which the parties and their accountants went back and forth on the detail of the Completion Accounts without any challenge by the defender to the inclusion of ADHL's NCA. As Lord Hodge identified in *Patersons* (at paragraph 43), conduct post-dating the conclusion of the agreement may "cast light on the parties' intention when they entered into the contract". On the background the pursuer sets out, he offers to prove that at no stage, prior to receipt of the purported notification, had the defender or anyone on its behalf ever notified any such dissatisfaction with the Completion Accounts or Completion Accounts Statement, or any drafts thereof by reason of the inclusion of the assets or liabilities of ADHL. At no such stage had the defender or anyone on its behalf ever asserted or even suggested that the current assets and liabilities of ADHL were to be excluded from the assessment of, and payment for, ADHL's NCA under the SPA. I have already noted the pursuer's position that the effect of the disputed definitions is wholly to omit ADHL's actual net current assets (it was not balance sheet insolvent) from the Completion Accounts Statement. That distinguishes this case from those where there was a seller's regret, as it were, in the price achieved: here, if the defender's interpretation were given effect, there was no consideration paid to the pursuer in exchange for the transfer of ADHL's substantial assets to the defender. That is suggestive of the kind of "arbitrary, irrational or commercially nonsensical outcome" identified by Lord Hodge (in *Pattersons* at paragraph 16) as some of the *indicia* of a mistake having been made in the translation of the parties' agreement into the final contract terms, and which is susceptible to rectification.

[62] If, throughout the 6 month period during which the Completion Accounts and the Completion Accounts Statement were under consideration, the defender or its professional advisers had adopted or supported the position which the defender now adopts, it would ostensibly be a surprising dereliction not to have immediately pointed out the (on its

approach) egregious misreading of the SPA on the part of the pursuer in including ADHL's NCA. There is nothing in the material presented to suggest that the defender's professional advisors had proffered such advice and which the defender disregarded. Rather, the long period during which the adjustment of figures in the Completion Accounts and the Completion Accounts Statement appeared to be premised on the basis that the NCA of both companies was encompassed in the Initial Deferred Consideration may, if established, provide compelling evidence as to the parties' true agreement, justifying rectification of the SPA, as the pursuer seeks. The pursuer avers that the parties agreed that if the defender were satisfied with the calculation of the NCA (which then included those of ADHL), the defender would pay the Initial Deferred Consideration (defined as a "payment to account") to the pursuer a few days after the SPA was entered into. That payment was duly made, and in an amount that was nearly double the amount of KPL's own NCA. This may be a significant adminicle of evidence in respect of the parties' conduct, and by inference their common intention, at the time of settlement.

[63] Again, however, whether the pursuer is entitled to rectification can only be determined after proof. In my view, the pursuer has made ample relevant averments of the parties' conduct which, when coupled with the heads of agreement, are sufficient to entitle him to proof of his averments on this legal ground as well. For completeness, I should record that, for reasons explained by Lord Reed in *Macdonald* (at paragraph 178), I accept as patently correct that an entire agreements clause (as founded on by the defender in this case) does not preclude the remedy of rectification.

[64] Finally, I am of the view that, having found that the pursuer has pled a relevant case for all three of the legal grounds founded upon, it is appropriate to allow him a proof on all three grounds. It might be suggested that the remedy of rectification is inconsistent with

interpretation (and implication): so, for example, if the SPA is capable of interpretation, rectification would be unnecessary or, conversely, if a deed requires to rectified, that presumes that the same result cannot be reached as a matter of interpretation. In also allowing the pursuer a proof on this matter, I bear in mind that views may also differ in a particular case as to where the boundary lies between competent and inadmissible evidence. Compare, for example, the approach of Lord President Rodger in *Dunedin Properties* at 665F to G (quoted above) and Lord Kirkwood's comments in the same case (and founded on by the defender in this case), that in Lord Kirkwood's view some of the evidence led by the Bank at proof "went rather beyond what was properly admissible as evidence of surrounding circumstances" (at 671A to B). (On the other hand, Lord Kirkwood acknowledged (at 670A to B) that, had he had to construe the disputed condition in isolation, he would have found it difficult to have supported the construction actually accepted by the court upon a consideration of the surrounding circumstances.) Some of the evidence the pursuer may seek to prove to support its case of interpretation might be held to be inadmissible for such a case; however, that same evidence might nonetheless be relevant for a case of rectification. Having found that the pursuer has averred a relevant case under the three legal grounds he seeks to establish, and having regard to the fact that essentially the same factual basis is pled, it is appropriate that the pursuer's whole case goes to proof.

Decision

[65] It follows that I will allow a proof on all averments in the principal action and will dismiss the counterclaim. I will reserve all question of expenses meantime.