



Michaelmas Term

[2011] UKSC 56

On appeal from: [2010] CSIH 81; [2010] CSOH 80

JUDGMENT

Aberdeen City Council (Respondent) v Stewart Milne Group Limited (Appellant) (Scotland)

before

Lord Hope, Deputy President

Lady Hale

Lord Mance

Lord Kerr

Lord Clarke

JUDGMENT GIVEN ON

7 December 2011

Heard on 10 November 2011

Appellant

R Craig Connal QC
Jim Cormack
(Instructed by McGrigors
LLP)

Respondent

Craig Sandison QC
David Thomson
(Instructed by Brodies
LLP)

LORD HOPE (WITH WHOM LADY HALE, LORD MANCE AND LORD KERR AGREE)

1. The issue in this appeal raises what the courts below have correctly described as a short point of construction. It relates to a contract which the appellants, Stewart Milne Group Limited, entered into with the respondents, Aberdeen City Council, for the purchase of land with a view to its development to form a business park or for industrial development. The subjects comprised an area of about 11 acres lying to the north of the B9119 public road at Westhill, Aberdeen. The purchase price was £365,000, but it was subject to a possible uplift in the events described in clause 9 of the missives. In general terms this was to be payable if the appellants issued a notice indicating their wish to buy out the respondents' share of the open market value of the land with the benefit of all necessary consents and agreements for its development, or if the appellants wished to dispose of the whole or part of the subjects by sale or by a lease for a term of more than 25 years.

2. The negotiations which were recorded in the missive letters between the parties were conducted over a period of several years. They began with a missive letter by the appellants' solicitors dated 6 November 2001 in which all the terms relevant to the present dispute are set out. By missive letter dated 8 November 2001 the respondents accepted the appellants' offer on the terms and conditions contained in the letter of 6 November 2001 and held the bargain as concluded. But further negotiations then followed, the missives were re-opened and the bargain was not finally concluded until 26 August 2004. The appellants took title to the subjects as heritable proprietors. A development of the kind contemplated by the missives was then carried out.

3. On 4 October 2006 the appellants transferred their title to the subjects to another company within the Stewart Milne Group called Stewart Milne (Westhill) Limited ("Westhill"). On 13 December 2006 their solicitors wrote to the respondents stating that they had disposed of the subjects to Westhill by way of sale. Their contention was that the effect of this transaction was to trigger the obligation to pay the uplift to the purchase price that the missives provided for. They contended also that the gross sale proceeds for the purposes of the calculation of the uplift that the missives provided for must be taken to be that part of the total consideration paid by Westhill for the whole of the development land that was attributable to the subjects, which was £483,020. As this was less than the allowable costs which were to be deducted from the sale price in terms of the missives, the result was that no uplift was payable to the respondents. The respondents refused to accept that the transaction had this effect, as they

maintained that the open market value of the subjects was greatly in excess of the consideration paid by Westhill.

4. The parties were unable to agree on this matter, so the respondents raised an action in the Court of Session in which they concluded for declarator that any further sum due to them in terms of the missives falls to be calculated by reference to the open market value of the subjects referred to in the contract as at the date of their sale by the appellants to Westhill, less the allowable costs as defined in the schedule to the missive letter of 6 November 2001. The appellants' defence to this action was that the contract between the parties, on its true construction, did not provide that any additional payment under clause 9 of the missives should, in the case of a sale of the subjects, be calculated on the basis of their open market value.

5. It was agreed that the matter was capable of being resolved by debate. The debate took place before the Lord Ordinary, Lord Glennie, in May 2009. On 3 June 2009 he found in favour of the respondents and granted decree of declarator in terms of the conclusion of the summons. The appellants reclaimed and the reclaiming motion was heard by an Extra Division (Lord Clarke, Lord Hardie and Lord Drummond Young) on 6 July 2010. On 14 October 2010 the Extra Division refused the reclaiming motion and adhered to the Lord Ordinary's interlocutor. The appellants have now appealed to this court. Their solicitor advocate, Mr Craig Connal QC, invited us to recall the Extra Division's interlocutor and to dismiss the action.

The contractual provisions

6. The appellants were referred to in the missive letter of 6 November 2001 as "the Purchasers". The respondents were referred to as "the Sellers". In clause 2 it was stated that the purchase price of £365,000 payable for the subjects on the date of entry was subject to any uplift payable in terms of clause 9. Clause 4 contained a list of conditions which were described as conditions suspensive of the missives. They provided for a site and soil survey report and an environmental audit on the subjects, the obtaining of outline planning permission and sewage connection consent and water authority consent for the construction and subsequent operation of the development on the subjects. The opening paragraph of clause 9, which was headed "Uplift", was in these terms:

"In addition to the purchase price detailed in Clause 2 hereof, the Purchasers and the Sellers have agreed that the Sellers shall be entitled to a further payment ('the Profit Share') upon the Purchasers purifying the suspensive conditions contained in Clause 4 hereof and issuing a notice to the Sellers intimating to the Sellers that the

Purchasers wish to purchase the relevant part of the profit-share as defined in the Schedule to which the Sellers are entitled. The Sellers' entitlement to the relevant part of the profit-share will also be triggered by the Purchasers disposing either by selling or by granting a lease of the whole or part of the Subjects."

7. Various expressions used in clause 9 were defined in a Schedule to the missives. They included a definition of "the Allowable Costs". The definition, which does not need to be quoted in full, comprised various costs that were likely to be incurred by the appellants with a view to obtaining planning permission and all other necessary consents in connection with the development and servicing of the subjects. Among the other definitions were the following:

"'Estimated Profit' means the Open Market Valuation under deduction of the Allowable Costs.

'Gross Sale Proceeds' means the aggregate of the sale proceeds of the Subjects received by the Purchasers for the Subjects.

'lease' means a lease for a term of more than 25 years.

'Lease Value' means the open market capital valuation of the Subjects or that part of the Subjects to be leased having regard to the terms of the lease but assuming that the lease is an open market transaction carried out at arms length with no consideration or other incentives being paid by either party other than the rent or, in the case of a lease granted in consideration of a grassum, the grassum...

'Open Market Valuation' means the open market value of the Subjects or relevant part thereof as specified in the notice at the date of the notice served in accordance with clause 9.5, with the benefit of and subject to the necessary consents and all agreements entered into with the local Planning Road [sic], Water or other Authority or service provider relative to the Subjects and making due and proper allowance for the costs of remedying any adverse ground conditions, any off site infrastructure or planning gain contributions to be made in terms of any of the necessary consents or the aftermentioned agreements and the costs of completing any access road within or serving the Subjects to adoptable standard.

‘Profit’ means the Gross Sale Proceeds under deduction of the Development Costs.

‘the Profit Share’ means 40% of 80% of the estimated profit or gross sale proceeds or lease value less the Allowable Costs as herein defined.”

8. By clause 9.1 the appellants were to be obliged to keep accounts in respect of the Allowable Costs, which the respondents were to be entitled to examine at any time. Clause 9.2 provided that the profit share was to be calculated in the first instance by the appellants, and that in the event of the respondents disputing their calculations the matter was to be referred to an independent chartered surveyor for his determination. Clause 9.3 provided for what was to happen if the appellants served notice in respect of a part only of the subjects or if they sold or leased part only of them after servicing. Clause 9.4 was in these terms:

“The relevant part of the profit share due to the Sellers shall be paid by the Purchasers to the Sellers within 14 days of it being calculated in accordance with clause 9.2 hereof or in the event of a sale 14 days after receipt of the gross sale proceeds by the Purchasers.”

Clause 9.5 provided that the appellants were to be entitled to serve a notice to the respondents intimating that they wished to purchase the profit share at any time after purification of the suspensive conditions in clause 4. Clause 9.6 provided that in the event of the respondents disputing the appellants’ Estimated Profit or the Lease Value the matter was to be referred, failing agreement between the parties, to an independent chartered surveyor for his determination. Clause 9.7 was in these terms:

“For the avoidance of doubt in the event of all or part of the Profit Share being paid following upon the grant of a lease of all or part of the Subjects no further Profit Share shall be payable upon the sale of that part of the Subjects in respect of which the Profit Share has already been paid.”

9. It should be noted that, quite apart from the problem that has given rise to the present dispute, the drafting of these provisions is not without its defects. The definitions of the expressions “Estimated Profit” and “the Profit Share” in the Schedule, if they were to be taken literally, would require the Allowable Costs to be deducted twice in arriving at the Profit Share in the event of the amount that it refers to having to be calculated by means of an open market valuation. That

plainly cannot be right. So one of those two directions must be disregarded to make sense of the agreement. The definitions of “Lease Value” and “Open Market Valuation” both direct attention to the capital value of the subjects in the open market. But they differ in their description of the assumptions on which these valuations are to be arrived at. The date as at which the valuation in the open market is to be arrived at is provided for in the definition of “Open Market Valuation”. But a direction on this point is absent in the case of the capital valuation that is to be undertaken in the case of the Lease Value. These infelicities appear to be due more to untidy drafting than to differences in matters of substance.

10. I mention these drafting points because they may make it easier to attribute the problem that we have to deal with to oversight rather than to a deliberate choice when the agreement was being drafted.

The issues

11. The appellants’ primary case is that the effect of their sale of the subjects to Westfield is to trigger clause 9 of the missives, with the result that their obligation is to pay to the respondents 40% of 80% of the gross sale proceeds less the Allowable Costs. They submit that the language of the missives is clear. The definition of the Profit Share, read together with the opening paragraph of clause 9 (see para 6, above), contemplates three different situations in which an uplift may be payable: (1) a buy-out of the respondent’s interest in the development value of the subjects, (2) a disposal by way of sale; and (3) a disposal by way of a lease for more than 25 years. Each of these alternatives provides its own base figure for the calculation of the Profit Share: (1) the estimated profit in the case of buy-out; (2) the gross sale proceeds in the case of a sale; and (3) the lease value in the case of a lease.

12. The respondents’ reply to this argument is that the agreement does not require the sale proceeds to be used as the basis of calculation in all circumstances where the subjects were disposed of by way of sale. The commercial purpose of the agreement was to enable the respondents to participate in a share of the development value of the subjects. This was to be arrived at by assuming an open market transaction carried out at arms length, whatever the event was that gave rise to the respondents’ right to a share of the uplift. Effect should be given to that purpose when construing the words of the agreement.

13. Mr Connal sought leave to present an entirely different argument which he had attempted to raise in the Inner House at a late stage but had been prevented from doing so. This was because on 9 June 2010 he was refused permission to add

this argument to his grounds of appeal, presumably because it was inconsistent with the case that was presented in his pleadings, and was then on 25 June 2010 refused leave to amend his pleadings in respect that, as the interlocutor of that date puts it, his motion to do this came too late. The point which he wished to argue was that any commercial absurdity could be addressed by holding that the transfer of the subjects to Westhill did not fall within the definition of a “sale” for the purposes of the obligation to make payment to the respondents of an uplift. In other words, the word “disposal” in the opening words of clause 9 should be read as referring to market value at arms length to a third party rather than to an associated company for a notional value as had happened in this case.

14. For the respondents Mr Sandison QC submitted that the appellants should not be allowed to present this argument as it had not been heard by the Inner House and it did not form part of the appellants’ written case in this court. But, very properly, he conceded that he had received notice of it and that it did not raise any new matters of fact which would require to be investigated before he was in position to reply to it. An appeal under section 40 of the Court of Session Act 1988 has the effect of submitting all the prior interlocutors in the cause to the review of this court: section 40(4). But I do not think that it is either necessary or appropriate to become involved in the niceties of procedure. The overriding aim should be to do substantial justice as between the parties. This aim is best served by allowing the further argument about how the contract should be construed to be presented. It is, after all, just another way of trying to make sense of the words used in the missives in the light of admitted facts.

Discussion

15. It is helpful, at the outset, to take an overall view of what the agreement appears to have had in mind in the provisions that it sets out for the payment to the respondents of a share of the uplift. Three events are identified as triggers to bring the appellants’ obligation into effect. They are set out in the opening words of clause 9 and are picked up again in the Schedule where the expression “the Profit Share” is defined. The Schedule then sets out three ways in which the base figure for the profit share is to be arrived at. At first sight they appear to be mutually exclusive. In the case of a buy out, the base figure is the estimated profit. This is to be arrived at by means of an open market valuation of the subjects, or the relevant part of it as specified in the notice, as at the date when the notice is served in accordance with clause 9.5: see the definition of “Open Market Valuation”. In the case of a sale it is the gross sale proceeds. In the case of a lease it is to be arrived at by means of a capital valuation of the subjects in the open market.

16. These three approaches appear, as I have said, to be mutually exclusive. But the context tends to indicate that they have one thing in common. This is that the

base figure is to be taken to be the amount which the subjects would fetch in a transaction that was conducted at arms length in the open market. This is expressly provided for in the case of a buy out, in which event a valuation of the subjects must be undertaken. This is also provided for expressly in the case of a lease. No mention is made of a valuation exercise in the case of a sale. But a sale at arms length is usually taken to be the best evidence of the value of the subjects in the open market. On this view there was nothing more to be said about the base figure in the event of a sale, other than that it was to be the gross sale proceeds.

17. As the choice between these three methods lay entirely in the hands of the appellants and clause 9.7 precludes the respondents' entitlement to any further Profit Share in the future, it is a reasonable assumption that these methods were expected to produce the same base figure, albeit by different routes or methods of calculation. Otherwise it would be open to the appellants to avoid the basis for the calculation in the case of a disposal by lease by disposing of the subjects to an associated company at an undervalue and arranging for the lease to be entered into by that company. Basing the calculation on the open market value was, on a fair reading of the agreement, the commercial purpose that these various methods were intended to serve.

18. The problem that the facts of this case give rise to is that it was not expressly stated anywhere in clause 9 or the definitions set out in the schedule that the gross sale proceeds were only to be used in the event of a sale at arms length in the open market. Was this a deliberate choice, or was it simply an oversight? The answer to this question is to be found by examining how the agreement can be given effect on the assumption that this was an oversight. There are, of course, well understood limits to the extent to which a court can depart from the express terms of an agreement that has been reduced to writing in solving a problem of this kind. Would the court be transgressing these limits if it were to give effect to the case for the respondent in the face of the appellant's submission that the contract should simply be given effect according to its terms?

19. The problem can be addressed by taking the definitions in the Schedule in their logical order. First, there is the definition of "the Profit Share". The three methods of arriving at the base figure are presented as alternatives. They are separated by the word "or". It is plain that the method referred to as the lease value would be appropriate only in the case of a disposal by way of lease. But the wording of the definition does not, in terms, confine the method to be used in the case of a sale to the gross sale proceeds. In the case of a sale at arms length in the open market a separate valuation would be a needless formality, as it would almost certainly produce the same figure as was provided for in the contract. But it would serve a very real purpose if the sale was clearly not one undertaken at arms length in the open market, as happened in this case.

20. The question then is whether there is anything in the definition of the expression “Open Market Valuation” which shows that this method cannot be used in the case of a sale. The definition directs attention to the open market value of the subjects “or the relevant part thereof as specified in the notice at the date of the notice served in accordance with clause 9.5”. There is no requirement for a notice in accordance with clause 9.5 in the case of a sale. But the absence of a notice does not make the valuation exercise directed by this definition unworkable. In the case of a sale the information that a notice would provide is to be found in the contract, just as in the case of lease it seems not to have been thought necessary to identify the date as at which the subjects were to be valued in order to arrive at the Lease Value. It seems to me therefore that there would be no difficulty in implying a term to the effect that, in the event of a sale which was not at arms 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 see this as the product of the way I would interpret this contract.

21. This was, in essence, the approach which the Extra Division took to the problem. In para 12 of his opinion Lord Drummond Young said that any other approach would defeat the parties’ clear objectives. Martin Hogg, a much respected senior lecturer in law at the University of Edinburgh, has criticised this decision: *Fundamental issues for reform of the law of contractual interpretation* (2011) 15 Edin LR 406, 420. Why, he asks, where a party has been feckless in allowing a clause susceptible of a commercially disadvantageous sense to form part of a contract, should it be protected by the court giving the contract a commercially sensible interpretation rather than allowing the party simply to suffer the results of its commercial fecklessness? Why should commercial good sense be attributed to a party which has not shown it in the drafting of the contract? At pp 421-422 he recommends a departure from what he refers to as a naïve focus on subjective intention in favour of an objective approach to the interpretation of contracts. That would minimise the temptation which some courts have shown to improve upon the bargain reached by parties in the name of commercial good sense.

22. I would not, for my part, view the present case in that way. It seems to me that the position here is quite straightforward. 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 fact that this makes good commercial sense is simply a makeweight. The words of the contract itself tell us that this must be taken to have been what they had in mind when they entered into it. The only question is whether effect can be given to this unspoken intention without undue violence to the words they actually used in their agreement. For the reasons I have

given, I would hold that the words which they used do not prevent its being given effect in the way I have indicated.

23. Mr Connal said that the appellants would never have agreed to having to pay the uplift before the profit that was expected to result from the development had been realised. At any rate the likelihood of their agreeing to this was very slight. So it would be wrong to read the words of the contract in a way that produced that result in this case. But the answer to that submission is to be found in the fact that the sellers' entitlement to the relevant part of the profit share is triggered by the grant of a lease of the whole or part of the subjects for more than 25 years, and in the definition of "the Profit Share" which requires that the capital sum produced by the calculation of "the Lease Value" be paid when the lease is entered. As Mr Sandison pointed out, the obligation to pay this sum could anticipate the date when the profit had been realised. So I do not accept that the contract must be approached on the basis that it was an essential element of the bargain that the profit had actually been realised before the obligation to pay the Profit Share was triggered by any of the transactions referred to. It should be noted too that the timing of the transactions that would give rise to that obligation was entirely in the hands of the appellants.

24. I turn then to Mr Connal's alternative argument. It seems to me that it creates more problems than it solves. It also tends to support the need to approach the agreement in the way the respondents contend for. There is obvious force in his starting point. This is the assumption that when clause 9 refers to a disposal by way of sale it contemplates a sale at arms length in the open market. But it is also clear that the sale, and the only sale, that it contemplates is a sale by the appellants. This is made clear by the definition of the expression "Gross Sale Proceeds", which refers to the sale proceeds received by "the Purchasers" for the subjects. The opening paragraph of the missive letter of 6 November 2001 states that the appellants are referred to in it as the "Purchasers". The appellants, it must be emphasised, are the only parties with whom this contract was being entered into.

25. Mr Connal suggested that the sale to Westhill should be disregarded and the obligation to pay the uplift triggered instead by a sale of the subjects in the open market by Westhill. But that solution cannot fit with the words used in the contract, to which Westhill are not a party. It would not be enough merely to substitute for the word "Purchasers" in the definition words that would include an associate company. It would also be necessary to write in clauses to protect the respondents against the obvious risks that such an arrangement would give rise to. As the contract stands, there would be nothing to prevent the appellants from disposing of the subjects to a wholly owned subsidiary and then disposing of that company to a third party over which it had no control. It would require the insertion of a number of carefully worded provisions to restrict the appellants' opportunity for avoiding the obligation to account to the respondents for the uplift

when it was realised. This would involve re-writing the bargain for the parties, which the court cannot do.

Conclusion

26. I am not persuaded that the Extra Division was wrong to uphold the decision of the Lord Ordinary. I would dismiss the appeal and affirm the Extra Division's interlocutor.

LORD CLARKE (WITH WHOM LORD HOPE, LADY HALE, LORD MANCE AND LORD KERR AGREE)

27. I gratefully adopt Lord Hope's account of the facts and the missives. I agree that the appeal should be dismissed.

28. In the course of argument some reference was made to the recent decision of the Supreme Court in *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50; [2011] 1 WLR 2900. That appeal was concerned with the role of commercial good sense in the construction of a term in a contract which was open to alternative interpretations. It was held that in such a case the court should adopt the more, rather than the less, commercial construction. The court applied the principle that the ultimate aim in construing a contract is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant; the relevant reasonable person being one who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

29. This appeal is concerned with a somewhat different problem from that which arose in *Rainy Sky*. Under the missives the respondent sellers were entitled to "the Profit Share" arising out of the on sale of the subjects by the appellant buyers. The expression "Profit Share" was defined as "the Gross Sale Proceeds", which were in turn defined as "the aggregate of the sale proceeds of the Subjects received by the Purchasers for the Subjects".

30. Lord Hope has drawn attention in para 9 to certain infelicities of drafting. However, the critical language in clause 9.4 is the promise on the part of the appellants to pay 40% of 80% of the gross sale proceeds "within 14 days after receipt of the gross sale proceeds". On the face of it the reference to the gross sale proceeds is a reference to the "actual sale proceeds" received by the appellants.

31. It is not easy to conclude, as a matter of language, that the parties meant, not the actual sale proceeds, but the amount the appellants would have received if the on sale had been an arm's length sale at the market value of the property. Nor is it easy to conclude that the parties must have intended the language to have that meaning. As Baroness Hale observed in the course of the argument, unlike *Rainy Sky*, this is not a case in where there are two alternative available constructions of the language used. It is rather a case in which, notwithstanding the language used, the parties must have intended that, in the event of an on sale, the appellants would pay the respondents the appropriate share of the proceeds of sale on the assumption that the on sale was at a market price.

32. In this regard I entirely agree with Lord Hope's conclusions at para 22 above. As he puts it, the context shows that the parties must be taken to have intended 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 parties expressly agreed that in the case of a buy out or lease the profit would be arrived at by reference to market value. Rather like counsel for the respondent bank in *Rainy Sky*, Mr Craig Connal QC was not able to advance any commercially sensible argument as to why the parties would have agreed a different approach in the event of an on sale. I have no doubt that he would have done so if he had been able to think of one. As Lord Hope says at para 17, on the appellants' approach, it would be open to them to avoid the provisions relating to the open market value of a lease by selling the subjects to an associate company at an undervalue and arranging for the lease to be entered into by that company. The parties could not sensibly have intended such a result.

33. 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 it 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.