Charlie Newington Bridges wins in the Court of Appeal in *Monnow Developments v Morgan* [2016] EWCA Civ 1437

Charlie Newington-Bridge ***St John's Chambers***

Published June 2017

Charlie Newington-Bridges of St. John's Chambers was instructed by Neil Morgan, partner at Darwin Gray Solicitors, to represent the successful Respondent, Monnow Developments Limited.

The straightforward construction issue that arose at first instance and the appeal was whether or not the loan agreement between the parties should be interpreted so that Mr Morgan should pay Monnow interest on the loan Monnow had made to him. There was no dispute at first instance or at the Court of Appeal as to the principles that apply in interpreting a contract. These were summarised by the court as follows:

"In ascertaining what parties to an agreement intended, the Court is concerned with what an objective reasonable observer would believe was the effect of what the parties to the contract communicated to each other by words and actions as assessed in context, see Lord Neuberger in ***VTB Capital Plc v Nutritek International Corp & Ors*** [2013] 2 AC 337 and also in ***Daventry District Council v Daventry & District Housing Ltd*** [2011] EWCA Civ 1153.

Secondly if it appears to an objective observer that one party cannot properly rely on what the documents says on its face in light of the negotiation between the parties intended to communicate the substance of the agreement between them as opposed to mere negotiations, then as a matter of law and construction of the agreement as a whole it is proper for the Court to depart from the terms of the written agreement, see ***Thine Group Ltd v Armstrong & Anor*** [2012] EWCA Civ 1227.

Thirdly, if there is more than one possible construction the Court is entitled to prefer the construction that best accords with commercial common sense even though another construction would not produce an absurd or irrational result. In ***Investors Compensation Scheme v West Bromwich Building Society*** [1998] 1 WLR 896 Lord Hoffman held at 912F: 'interpretation is the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably

have been available to the parties in the situation in which they were at the time of the contract."

The specific question in relation to the construction issue was what was meant by the definition of interest rate, namely that interest is payable "at the interest rate applied under the terms of the loan notes". The judge at first instance was of the view that the reference to the interest rate under the loan notes was only to apply to the rate of interest which the loan notes testify should be paid. It was not intended to make the recovery of interest from Mr Morgan contingent on Mr Morgan in turn recovering interest from Pure Options.

This argument was given force by the fact, as was submitted on behalf of Monnow in both courts, that at no point does the agreement state that interest on the loan would be contingent on interest being paid on the loan notes. Moreover, the straightforward interpretation and the one that accords with common sense was that the relevant clause provides that Mr Morgan would pay interest to Monnow at the interest rate. Further clauses substantiated this position because they provided that the interest rate shall accrue on the loan from the date of drawdown up to the date of repayment and that the interest shall accrue on a daily basis and shall be paid at the same time as the loan is repaid. Finally, it was argued that had it been intended to make payment of interest under the loan agreement conditional upon such payment under the loan notes then it would have been a simple matter to say so in the loan agreement, but there is no such provision either there or in any of the pre-contractual documentation. Those submissions were preferred at first instance to those made on behalf of Mr Morgan.

On appeal the argument that was advanced by Mr Morgan took two essentially forms. Firstly, it was submitted that that the loan terms must be read consistently with the definition of coupon adopted in the heads of agreement. It was suggested that the judge failed to do that. On a proper construction, the case advanced was that no interest was payable to Monnow by Mr Morgan unless and until Mr Morgan has received interest payments from Pure Options. Since he had received no interest himself, none was payable to Monnow.

Secondly, in the submission advanced orally, a narrower position was adopted. It was accepted that in all circumstances except insolvency, there would be an obligation on Mr Morgan to repay interest at 8 per cent. However, where, as here, Pure Options was insolvent, no obligation to repay arose.

The arguments were rejected by Elias LJ giving judgment. He found the arguments untenable for a number of reasons. First, if the parties had intended that the Appellant would pay to Monnow only such interest as he in turn had received from Pure Options, that principle could have been simply expressed. Elias LJ did not accept that the only proper inference to be drawn from the reference to the term "coupon" in the heads of agreement was to the full definition of that term in the draft loan notes. He noted that very early on in the negotiations there was a reference to coupon by Mr Morgan himself in a letter of 15 October 2009 when he said this as part of one of the proposed arrangements:

"I pay you a coupon on the same terms as Pure Options, i.e. 8 per cent per annum with interest rolled up."

Elias LJ was at pains to point out though that he referred to that not as part of the background negotiations, but insofar as this was a term which was being used by the parties in a specific way, that indicated a perfectly natural way in which it would be employed.

He continued that that the construction urged on the court for Mr Morgan involved a fundamental rewriting of the contract which changes its very nature. He held that it is simply not permissible to argue that the parties were not in fact intending to refer to a rate of interest at all, even though that is the very language which they agreed.

Elias LJ found that on the Appellant's construction, there is no rate of interest as such under the agreement at all. It is a meaningless concept. On that analysis, there would be no purpose in having great swathes of this contract.

Finally, a vital element in the Appellant's construction argument was that this was not a typical commercial arrangement – rather there was a relationship of trust between the parties. This was rejected. Both the circumstances in which the agreement came into effect as well as its terms pointed inevitably to it having been a contract in which the parties were looking after their own interests. Mr Poole (for Monnow) involved a lawyer and a financial adviser who were plainly concerned to protect his interests in the arrangement. Mr Morgan was separately advised once it became recognised that there was a potential conflict of interest. The agreement was carefully drafted to ensure the security of the loan and the duty to repay in certain defined circumstances.

The second argument was premised on the assumption that on a tight construction of the heads the loan agreement, it should be inferred that Monnow was willing to agree that not even the loan would be repaid in the event of the insolvency. That, it was held, was what the heads of agreement say if one takes them literally. It was not simply the interest that would not be paid in the event of an insolvency, but there was an absence of any obligation specifically in the heads of agreement which would require the repayment of the loan itself. It was held that this cannot conceivably have been what the parties intended. If the intention was to require just the interest to be waived in those circumstances, I would have expected this to be said so expressly. It is certainly not possible to read the heads of agreement as allowing Monnow to recover the loan but not the interest.

Rectification

The issue of rectification was also straightforward in that the question was whether or not the contract should be rectified to reflect the common intention of the parties so that issue was only payable subject to interest being paid on the loan notes.

The relevant legal principles were not in dispute. The circumstances in which a contract may be rectified were summarised by Peter Gibson LJ in the case of ***Swainland Builders v Freehold Properties*** [2002] EWCA Civ 560 where he said at page 74:

"The party seeking rectification must show that:

(1) the parties had a common continuing intention, whether or not amounting to an agreement, in respect of a particular matter in the instrument to be rectified;

(2) there was an outward expression of accord;

(3) the intention continued at the time of the execution of the instrument sought to be rectified;

(4) by mistake the instrument did not reflect that common intention."

Elias LJ held that on the facts that the conditions for rectification were not satisfied, essentially for the reasons given by considering the issue of construction. He found that there was neither evidence of a common intention nor of outward accord. The heads of agreement did not establish that Monnow would only be entitled to interest if the Appellant had received interest from Pure Options.

Elias LJ reasoned that the language is at best ambiguous. He also stated that there was no evidence that was what the parties jointly intended. The case for rectification in effect meant that Mr Poole (on behalf of Monnow) intended to relieve the Appellant from the financial risk that Pure Options might fail and no interest would be paid to the Appellant.

Elias LJ continued that the circumstances in which the agreement was negotiated and the terms of the agreement itself were wholly at odds with Mr Poole exhibiting that intention. Moreover and decisively, the judge heard evidence on the point and specifically accepted the testimony of Mr Poole that at no point in the negotiations had there been any suggestion that the payment of interest to Monnow would be contingent upon the payment of interest by Pure Options to Mr Morgan. Mr Pemberton and Miss Bashir gave supporting evidence to similar effect.

Finally, it was observed that if the contract departed so fundamentally from the alleged common intention, one would have expected Mr Morgan to have immediately alerted the parties to this when he was shown the agreement. It was so at odds with either of the interpretations it was a point of surprise that he did not note this at the relevant time.

Charlie Newington-Bridges
St John's Chambers

June 2017