IMPORTANCE OF COMMERCIAL COMMON SENSE IN CONTRACT INTERPRETATION? – AN ANALYSIS OF RECENT CASES

Since the Supreme Court's decision in *Arnold v Britton & Ors [2015] UKSC 36*, there have been a number of cases generated about the natural meaning of commonly used provisions or phrases in contracts. The first step in interpreting a contract is always to ascertain the natural and ordinary meaning of words. The fact that the ordinary and natural meaning makes little commercial common sense is not a good enough reason to depart from that interpretation. However, the more unclear the natural meaning of the words are, the more scope there is for taking into account the wider context of the provision, including commercial common sense.

In the M&A sphere, a number of recent cases have focused on the interpretation of limitation and notification provisions in Sale and Purchase Agreements (SPAs). By way of example, in *Nobahar-Cookson v The Hut Group Ltd [2016] EWCA Civ 128*, the Court of Appeal considered what level of knowledge about a possible warranty claim triggered the Buyer's notification obligations to the Seller. This was important as the Seller was only liable under the SPA if the Buyer complied with the notification provisions. As the provision limited the Buyer's ability to pursue the Seller for a breach of warranty, the Court of Appeal was willing to resolve the ambiguities in the drafting in a way more favourable to the Buyer and more in accord with what it considered to be commercial common sense. *Nobahar-Cookson* and other cases (such as *Ipsos S.A. v Dentus Aegis Network Limited [2015] EWHC 1171*) also give helpful guidance as to the general purpose of notification provisions in SPAs, which should be taken into account when resolving ambiguities in drafting.

We consider below some other recent cases which involve an analysis of some common provisions found in SPAs and other corporate documents. What is somewhat surprising about some of the cases is the Court's willingness (despite *Arnold v Britton*) to depart from what would appear to be the natural and ordinary meaning of words in order to give effect to the perceived commercial intention of the parties. This underscores the importance of clear and precise drafting if certainty is to be achieved.

RUSH HAIR LTD V GIBSON-FORBES [2016] EWHC 2589 (QB)

The Purchaser bought two salons from the Seller. In the SPA, the Seller gave various restrictive covenants, which the Purchaser argued had been breached.

The restrictive covenant in question read: *"the Seller shall not at any time during the period of two years from Completion canvass, solicit, entice or employ: [various named stylists]"*. Within the two year period, the Seller incorporated a new company and engaged some of the named stylists as consultants to that company.

The Seller argued that the clause only prevented the Seller from undertaking the restricted acts, and not a company of which the Seller was a shareholder or director. It therefore did not prevent the Seller from incorporating a new company, and that new company employing the stylists. Despite the absence of the usual boilerplate language to bolster the restriction (such as, *"whether on their own behalf or with or on behalf of any person, and whether directly or indirectly and in whatever capacity"*), the Court found that the clause should be construed in a way that is commercially sensible. The Court in effect read in language so that the clause was effective in preventing the Seller, either on its own behalf or as agent for another, from canvassing, soliciting, enticing or employing any of the named stylists.

The Court also went on to find that entering into a consultancy agreement amounted to employing the stylists, as it decided that "employ" should be interpreted as *"a contractual relationship between two persons in which one provides work to the other, which the other does for remuneration."*

KAREN DENISE MILLEN V KAREN MILLEN FASHIONS LIMITED AND MOSAIC FASHIONS US LIMITED [2016] EWHC 2104 (CH)

In 2004 Karen Millen disposed of her fashion business to an Icelandic consortium, who later sold it to Karen Millen Fashions Limited (KMFL). Karen Millen wanted to return to the fashion business and launch labels in the USA and China. This was a somewhat unusual case as it involved Karen Millen (as the Seller) seeking various negative declarations as to what she was and was not entitled to do under the SPA before trading in connection with her new business venture.

Of particular interest are the Court's findings in relation to the following restrictive covenants in the SPA:

> *"5.1…[the Sellers] will not and shall procure that none of their Connected Persons shall, whether on their own behalf or with or on behalf of any person, and whether directly or indirectly and in whatever capacity:-*
>
> *… 5.1.4 at any time after the date of this Agreement, use or attempt to use in the course of any business, any KMHL IPR (as defined at Schedule 2);*
>
> *… 5.1.7 at any time after Completion in any connection with any business which is similar to or competes with the business of the KMHL Group (not only in the United Kingdom but anywhere in the world) use the name "Karen Millen" or any other name confusingly similar thereto (including names which use, as a prefix or suffix, "KM" or "K. Millen");*

5.4 [The Sellers] agree that the restrictions and undertakings contained in clause 5.1 are reasonable and necessary for the protection of the Rollover Purchaser's Group's legitimate interests in the goodwill of the KMHL Group."

KMHL IPR was defined as:

"all patents, trade marks, copyright, moral rights, rights to prevent passing off, rights in designs, know how ("Know-How") and all other intellectual or industrial property rights (including in relation to Software), in each case whether registered or unregistered and including applications or rights to apply for them and together with all extensions and renewals of them, and in each and every case all rights or forms of protection having equivalent or similar effect anywhere in the world."

As a preliminary point, the Court decided that the reference to "passing off" in the definition of KMHL IPR, when read in the context of the whole agreement which placed emphasis on the Karen Millen name and brand and in light of the language in clause 5.4 (which expressly referred to goodwill), should be read as including a reference to goodwill.

Karen Millen argued that the restrictions at 5.1.4 and 5.1.7 were frozen in time, so that the reference to KMHL IPR should be construed as the intellectual property rights that existed at the time of the SPA only, and that 5.1.7 had to be assessed against the backdrop of the Karen Millen business in 2004. In 2004, the Karen Millen business was established in the UK but much less so in the US and China. It was common ground, however, that the business would expand into the US and China. Karen Millen also argued that the reference in 5.1.7 to *"the business of the KMHL Group"* required the business to be held within the KMHL Group (KMHL Group was defined as KHML and various named subsidiaries). Since the SPA, KMHL had been dissolved and the business sold to KMFL.

The Court considered that the parties must have contemplated that certain intellectual property, such as goodwill, would change and develop over time, particularly as expansion of the brand was anticipated. This view influenced the Court's interpretation of the provisions because it considered it was impractical, and perhaps artificial, to measure Karen Millen's behaviour strictly against the state of the Karen Millen business in 2004.

Accordingly the Court found that:

- While limited to the categories of rights which existed at the date of the SPA, some of the rights contained in 5.1.4, such as goodwill, the focus of the litigation, were changeable over time. The restrictions therefore applied to the current form of the goodwill, not just the extent of the goodwill that existed in 2004.
- Clause 5.1.7 should be assessed against the state of the Karen Millen business as at the date of the act alleged to be a breach of that provision. By the time of the dispute between the parties, the Karen Millen business was well established in the US and China. The Court also found that the phrase "the business of the KMHL Group" was directed at the business itself, rather than to its corporate ownership. Removing a business from the corporate structure of the KMHL Group, or a change in the corporate ownership of the business, did not mean that the protection provided to the brand by the clause would lapse.

Finally, the SPA also contained a standard provision stating that each party's rights under the SPA extended to their successors in title, permitted assignees and personal representatives. Karen Millen accepted, as did the Court, that KMFL was a "successor in title" to KMHL. KMFL could therefore enforce the terms of the SPA. This is a surprising conclusion as KMFL acquired the business from KMHL by way of an asset sale and not a share sale.

IDEMITSU KOSAN CO LIMITED V SUMITOMO CORPORATION [2016] EWHC 1909

Idemitsu bought a business from Sumitomo. Under the SPA, Sumitomo gave various warranties about the business being purchased, which Idemitsu argued were false. A claim for breach of the warranties was not available to Idemitsu because of the contractual time limitation periods in the SPA. Idemitsu therefore tried to find an alternative way to formulate its claim and argued that the warranties (which were not expressed to also be representations) in the SPA also amounted to representations. It argued that the presentation of the draft SPA by Sumitomo to Idemitsu amounted to a pre-contractual representation that the warranties contained therein were true.

The Court looked at the wording of the SPA to determine whether the warranties could also amount to pre-contractual representations. In contrast to the other cases discussed in this piece, there was no need for the Court to depart from the natural and ordinary meaning of the wordings in order to give effect to the parties' commercial intentions. The Court therefore found that the warranties did not also amount to pre-contractual representations.

The Court considered that:

- There must be something in the language of the SPA which permits a finding that the warranties were also intended to be representations: it is not enough that the subject matter of the warranty is capable (in theory) of amounting to a representation.
- There was nothing in the language of the SPA that supported the contention that the warranties were intended by the parties to also amount to representations. In fact,

the opposite was true. The limits of liability section in the SPA applied to claims for breach of warranty, and not to misrepresentation claims. Had Idemitsu succeeded, Idemitsu could claim significant damages which would not have been capped by the limits on liability section in the SPA. It would be an odd result if Sumitomo was deprived of protection afforded by those sections in relation to a misrepresentation claim.

- The timing issue was not resolved by the language in the SPA. Where the SPA itself is the representation, there is a conceptual timing problem in the argument that the form of the SPA was a pre-contractual representation which induced the entering into of the SPA. This problem may sometimes be resolved by language in the SPA, expressly identifying certain statements as contractual representations. No such language existed in this case.

Idemitsu was therefore not permitted to recover damages for misrepresentation against Sumitomo. Its real claim was for breach of warranty, and that claim had expired. This case follows a number of recent cases dealing with the same point, such as *Sycamore Bidco Ltd v Breslin [2012] EWHC 3443 (Ch).*

LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMIN.) V EXXONMOBIL FINANCIAL SERVICES BV [2016] EWHC 2699 (COMM)

This case involved the service of notices in the context of the administration of Lehman Brothers International (Europe) (LBIE).

In the context of the repurchase of various securities under a repurchase agreement, ExxonMobil Financial Services BV ExxonMobil) was entitled to serve a default valuation notice by "close of business" on the fifth dealing day after the event of default occurred. The event of default occurred when LBIE went into administration on Tuesday 15 September 2008.

ExxonMobil served its default valuation notice on LBIE by fax on Tuesday 22 September 2008. The fax was received in full at LBIE's London office at 6:02 p.m. London time.

The repurchase agreement did not define "close of business". However, it did state that, if a notice was received after close of business, or on a day on which commercial banks are not open for business, it would be regarded as received on the next business day (i.e. on Wednesday 23 September 2008, more than five dealing days after the event of default).

LBIE argued that "close of business" meant 5 p.m., whereas ExxonMobil said that "close of business" meant the typical close of business for commercial banks, which was 7p.m.

The Court agreed with ExxonMobil and found that the notice was received before close of business on 22 September 2008.

The Court noted that the term "close of business" may be used in many different contexts. The relevant context here was an agreement between an international investment bank and a large corporation. Although in another context 5pm might be considered as the end of normal business hours, in this context a reasonable person would not consider that close of business was at 5p.m., especially where the business does not in fact in reality close at 5p.m. In addition, the fact that the agreement did not (as it could have done) impose an express cut-off time and instead used the less precise term "close of business", indicated to the Court that some flexibility was intended by the parties *"and should deter arguments based on the precise time of receipt, which may make little commercial sense".*

CONCLUSION

As can be seen from the above cases, the Court remains willing, in some cases, to depart from what would appear to be the natural and ordinary meaning of words in order to give effect to the perceived commercial intention of the parties. Very clear and unambiguous language is required if certainty is to be achieved. Alternatively, parties may wish to avail themselves of the opportunities vague or ambiguous language could present in the context of a later dispute. However, parties should be cautious about doing so. As indicated by the fact that the above cases were litigated all the way to trial, the scope for argument where the language is vague may make assessing the prospects of success difficult and make it more likely that some parties will wish to take their chances before a judge, rather than engage in settlement discussions at an early stage.

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