Neutral Citation Number: [2016] EWHC 3012 (Ch)

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Case No HC 2015-005034

Rolls Building, 7 Rolls Building
Fetter Lane, London EC4A 1NL

Date: 1st December 2016

Before:

ANDREW SIMMONDS QC
(Sitting as a Deputy Judge of the High Court)

Between:

HELIX 3D LIMITED

Claimant

and

(1) DUNEDIN INDUSTRIAL PROPERTY NOMINEE LIMITED
(2) DUNEDIN INDUSTRIAL PROPERTY NOMINEE 2 LIMITED

Defendants

Kester Lees (instructed by Grant Saw Solicitors LLP) for the Claimant
Charles Harpum (instructed by Nabarro LLP) for the Defendants

Hearing date: 2 November 2016

APPROVED JUDGMENT

I direct that pursuant to CPR PD 39A para.6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

Andrew Simmonds QC:

Introduction

1. These Part 8 proceedings concern a dispute between the landlord and tenant of commercial premises as to the correct interpretation of an agreement conferring on the tenant an option to purchase the freehold of the premises. The essential question is whether the tenant has validly exercised the option in accordance with its terms.

2. The Claimant is the lessee, and current tenant, under a Lease ("the Lease") dated 20 July 2011 of premises known as 138-140 Nathan Way, London SE28 ("the Property"). The Lease is for a ten-year term commencing on the date of the Lease. The Lease was granted by a predecessor in title of the Defendants, who are the current landlords.

3. On the same date as the Lease was granted, the original lessor granted to the Claimant an option to purchase the freehold of the Property at a defined purchase price. The option was granted in consideration of a payment of £25,000 and was exercisable for a period of five years from the date of the agreement (i.e. until 20 July 2016). The terms of the option agreement dated 20 July 2011 ("the Agreement") are critical and I set them out in more detail below.

4. By letter dated 2 July 2015 to the Defendants' immediate predecessors in title, the Claimant's Solicitors purported to exercise the option at a price of £1.5m and paid a deposit of £90,000 (i.e. 5% of the stated purchase price plus VAT) to the then landlords' Solicitors.

5. The Defendants have consistently disputed the validity of the letter (and deposit payment) as a valid exercise of the option. Hence these proceedings. If the Defendants are correct, it is of course now too late for the Claimant to attempt to exercise the option again because the five-year option period has expired.

The Agreement

6. The option was granted by Clause 2 of the Agreement in the following terms, so far as relevant:

"2.1 In consideration of £25,000 (inclusive of VAT at the standard rate) ("the Option Fee") paid by the Buyer to the Seller (receipt of which is acknowledged) the Seller grants to the Buyer the Option to buy the freehold interest in the Property at the Purchase Price...

2.3 The Option Fee and any interest accrued on it is not refundable to the Buyer in any circumstances but will be deducted from the balance of the Purchase Price due on completion if the Buyer completes the purchase of the Property".

For the purposes of the Agreement, "the Buyer" is the Claimant; "the Seller" is the original lessor (although Clause 13.2 and the Fourth Schedule contain provisions to ensure that the Agreement remains binding on any successor in title of the original lessor and it is common ground that the Agreement is binding on the Defendants); and "the Purchase Price" means "the purchase price stated or ascertained in accordance with the Second Schedule".

7. Exercise of the option is governed by Clause 3:

"3.1 If the Buyer serves on the Seller at any time during the Option Period notice in writing substantially in the form set out in the Third Schedule accompanied by or preceded by payment of the deposit in accordance with clause 4 the Seller shall sell and the Buyer shall buy the Property at the Purchase Price

3.2 If the deposit is (*sic*) not been paid in accordance with clause 3.1 the purported exercise of the Option is ineffective".

As I have mentioned, "the Option Period" is five years from 20 July 2011. The form of notice set out in the Third Schedule is as follows:

"In accordance with the terms of the Option Agreement dated (date) made between [yourself] (1) and [myself] (2) relating to the Property described above I GIVE NOTICE to you that I exercise my option to buy the Property at the price of (purchase price)...

I [enclose the deposit of £... (insert details of cheque draft or as the case may be) (or) have paid the deposit of £... to (seller's solicitors) by (insert method of payment)]...".

8. As is apparent from both Clauses 3.1 and 3.2, payment of the requisite deposit was a critical requirement for effective exercise of the option. That is governed by Clause 4:

"The Buyer shall on or before service of the Option Notice pay a deposit of 5% of the Purchase Price and of the VAT to the Seller's Solicitors as stakeholders by direct credit or a banker's draft drawn on and by a clearing bank".

9. In the event of a valid exercise of the option, completion is governed by Clause 5 which incorporated a definition of "the Completion Date" as "the twentieth working day after the date of service of the Option Notice". This provision gave rise to difficulties which the parties have now sensibly resolved by agreement, as I shall explain.

10. As indicated, the Purchase Price is that "stated or ascertained in accordance with the Second Schedule". This provides, relevantly, as follows:

(1) Paragraph 2 distinguishes between the first two and the last three years of the Option Period as follows:

> "2.1 The Purchase Price for the Property during the first or second year of the Option Period shall be £1,500,000 plus VAT at the standard rate.
>
> 2.2 The Purchase Price for the Property during the remainder of the Option Period shall be ascertained in accordance with this schedule and shall be the greater of the Open Market Value as agreed or determined in accordance with this schedule and £1,500,000 plus VAT at the standard rate".

(2) "Open Market Value" is defined as "the best price at which the sale of the freehold interest in the Property....would have been completed unconditionally for cash consideration as an investment purchase subject to and with the benefit of the Lease by private treaty at the date of the Option Notice" and making various stated assumptions.

(3) The mechanism for agreeing or determining the Open Market Value is set out in paragraph 3. For present purposes, it is sufficient to state that

(a) by paragraph 3.1, "immediately upon service of the Option Notice" the Seller and Buyer shall consult and attempt to agree the Open Market Value in good faith;

(b) if there is no such agreement within 20 working days after service of the Option Notice, either party may refer the matter for determination by an independent valuer who shall act as an expert and not as an arbitrator;

(c) the remainder of paragraph 3 sets out a timetable for determination of the dispute by the independent valuer.

The Dispute

11. The letter dated 2 July 2015, by which the Claimant purported to exercise the option, was in the following terms:

> "In accordance with the terms of the Option Agreement dated 20 July 2011 made between.....relating to the Property described above WE GIVE NOTICE to you that Helix 3D Limited exercise their option to buy the Property at the price of £1,500,000.00
>
> We have paid the deposit of £90,000 to Nabarro LLP by Faster Payment to their client account number 73665305".

12. The Defendants dispute the validity of this notice, essentially on the footing that the Claimant failed (or may have failed) to pay the correct deposit, which is a condition precedent to effective exercise of the option, because in year 4 of the option period the Purchase Price was the Open Market Value (as defined); this value had (when the notice was served) yet to be determined; and so it is impossible to say that £75,000 plus VAT constituted 5% of the Purchase Price (i.e. the Open Market Value) as required by Clause 4.

13. The Claimant's position is that, on its true construction, the Agreement permitted service of an Option Notice in years 3-5 which stated the Buyer's proposed purchase price (although the actual Purchase Price would be determined by agreement or fixed by the independent valuer pursuant to the Second Schedule) and payment of a deposit of 5% of that stated price.

14. By its Part 8 Claim Form, the Claimant asks for declarations as follows:

> "2.1 A Declaration that on a true construction of the express and/or implied terms of the Option Agreement the Option Notice was valid and the Option has been validly exercised
>
> 2.2 A Declaration that the Claimant is now entitled pursuant to the terms of the Second Schedule to the Option Agreement to seek the appointment of an Independent Valuer to determine the Purchase Price payable under the Option Agreement for the Property".

15. When the hearing before me commenced, there was a further dispute as to how (if the Claimant's notice exercising the option was valid) the Completion Date was to be ascertained. However, during the hearing, agreement was reached that, if the primary dispute is resolved in the Claimant's favour, a further declaration should be granted as follows:

> "The Completion Date shall be 20 working days after the Purchase Price is agreed or determined in accordance with the Second Schedule".

Principles of construction

16. The resolution of the primary dispute between the parties depends on the correct construction of the Agreement, and in particular on determining what conditions must be satisfied for a valid exercise of the option in years 3-5 when (as provided by the Second Schedule paragraph 2.2) the Purchase Price is the Open Market Value (subject to a minimum of £1.5m) which falls to be determined only after the service of the Option Notice.

17. The relevant legal principles to be applied in this exercise are well-established and were not seriously in dispute before me. I will nevertheless refer to some of the most pertinent authorities.

18. The overarching principle is that "the question is what a reasonable person having all the background knowledge that would have been available to the parties would have understood them to be using the language in the contract to mean": **Chartbrook Ltd** *v* **Persimmon Homes Ltd** [2009] 1 AC 1101 per Lord Hoffmann at [14].

19. I was taken to a number of passages dealing with the case of documents which contain obvious mistakes or which are otherwise badly drafted. In **Chartbrook**, Lord Hoffmann said (again at [14]):

> "The House [in the **Investors Compensation Scheme** case] emphasised that "we do not easily accept that people have made linguist mistakes, particularly in formal documents"...but said that in some cases the context and background drove a court to the conclusion that "something must have gone wrong with the language". In such a case, the law does not require a court to attribute to the parties an intention which a reasonable person would not have understood them to have had."

He continued at [15]:

> "It clearly requires a strong case to persuade the court that something must have gone wrong with the language...It is fortunately rare because most draftsmen of formal documents think about what they are saying and use language with care. But this appears to be an exceptional case in which the drafting was careless and no-one noticed".

And then at [21]:

> "I do not think that it is necessary to undertake the exercise of comparing this language with that of the definition in order to see how much use of red ink is involved. When the language used in an instrument gives rise to difficulties of construction, the process of interpretation does not require one to formulate some alternative form of words which approximates as closely as possible to that of the parties. It is to decide what a reasonable person would have understood the parties to have meant by using the language which they did. The fact that the court might have to express that meaning in language quite different from that used by the parties...is no reason for not giving effect to what they appear to have meant".

20. I should then quote in its entirety the passage in Lord Hoffmann's judgment dealing with "correction of mistakes by construction":

> "22. In **East** *v* **Pantiles (Plant Hire) Ltd** (1981) 263 EG 61 Brightman LJ stated the conditions for what he called "correction of mistakes by construction".
>
> > "Two conditions must be satisfied: first, there must be a clear mistake on the face of the instrument; secondly, it must be clear what correction ought to be made in order to cure the mistake. If those conditions are satisfied, then the correction is made as a matter of construction".
>
> 23. Subject to two qualifications, both of which are explained by Carnwath LJ in his admirable judgment in **KPMG LLP** *v* **Network Rail Infrastructure Ltd** [2007] Bus LR 1336, I would accept this statement, which is in my opinion no more than an expression of a common sense view that we do not readily accept that people have made mistakes in formal documents. The first qualification is that "correction of mistakes by construction" is not a separate branch of the law, a summary version of an action for rectification. As Carnwath LJ said, at p.1351. para.50:
>
> > "Both in the judgment, and in the arguments before us, there was a tendency to deal separately with correction of mistakes and construing the paragraph "as it stands", as though they were distinct exercises. In my view, they are simply aspects of the single task of interpreting the agreement in its context, in order to get as close as possible to the meaning which the parties intended".
>
> 24. The second qualification concerns the words "on the face of the instrument". I agree with Carnwath LJ, paras.44-50, that in deciding whether there is a clear mistake, the court is not confined to reading the document without regard to its background or context. As the exercise is part of the single task of interpretation, the background and context must always be taken into consideration.

> 25. What is clear from these cases is that there is not, so to speak, a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed. All that is required is that it should be clear that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant".

21. On the subject of business common sense (and its antithesis, commercial absurdity), I was referred to the well-known passage in the judgment of Lord Clarke of Stone-cum-Ebony in **Rainy Sky SA** *v* **Kookmin Bank** [2011] 1 WLR 2900 at [21]:

> "The language used by the parties will often have more than one potential meaning. I would accept the submission made on behalf of the appellants that the exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person 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, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other".

22. However, it should be noted that in **Arnold** *v* **Britton** [2015] AC 1619, the Supreme Court warned of the dangers of placing too great an emphasis on commercial common sense at the expense of a proper consideration of the language used and its natural meaning: see per Lord Neuberger at [17]-[23].

Discussion

23. The Claimant's case is that the Agreement cannot sensibly be construed in a way which requires it, if it is effectively to exercise the option in years 3-5, to (a) specify in the Option Notice a price which cannot then be ascertained, namely the Open Market Value (with a minimum of £1.5m), and (b) pay a deposit of an amount, namely 5% of the Open Market Value (with a minimum of £1.5m) which cannot then be ascertained. The Claimant relies on the fact that it was granted the option for the full Option Period, namely five years, and paid £25,000 for the privilege. The Claimant argues, therefore, that the Agreement must be construed in a manner which enables the option to be exercised in a practical way for the full five-year period and not in a manner which, to all intents and purposes, emasculates the option in years 3-5.

24. The Claimant's primary argument, in terms of how the Agreement should be construed so as to achieve that outcome, is that the definition of "the Purchase Price" should be read as "the purchase price stated in the Option Notice or ascertained in accordance with the Second

Schedule". This enables practical effect to be given to the requirement in Clause 4 for the deposit to be "5% of the Purchase Price".

25. I am unable to accept this argument. First, as Mr Harpum for the Defendants submitted, the natural meaning of the "Purchase Price" definition when read in conjunction with the Second Schedule is "the purchase price stated (in paragraph 2.1 for years 1-2) or ascertained (as referred to in paragraph 2.2 for years 3-5) in accordance with the Second Schedule". Secondly, it is not clear to me how this approach to construction is to be reconciled with the fact that in years 1-2 the purchase price plainly is stated in the Second Schedule. Thirdly, this approach would result in a situation in years 3-5 where there might (perhaps, probably would) be a conflict between the price stated by the Claimant in the Option Notice (x) and the Open Market Value ascertained in accordance with the Second Schedule (y). If, as would be probable, x is less than y, what price is the Claimant bound to pay under the contract resulting from the exercise of the option? The Claimant's construction of the relevant definition does not resolve this problem.

26. As an alternative to this, Mr Lees, for the Claimant, argued simply that Clause 4 should be construed as if it provided in years 3-5 for a deposit of "5% of the purchase price stated in the Option Notice". This is, I consider, a more promising approach. It focuses on the provision in the Agreement which appears to have gone wrong, namely that dealing with the deposit.

27. In this context, I should observe that the Defendants did not contend that the Claimant's Option Notice was invalid for reasons other than those arising from the deposit provisions. They accepted that the form of notice specified in the Third Schedule (especially given that Clause 3.1 merely requires the notice to be "substantially" in that form) permitted a notice which expressed an intention to buy the Property either "at the price of [£1.5m]" (or some other specific amount) or "at the Purchase Price". However, in the former case, I think that the Option Notice would have to specify a price of at least £1.5m in order to be valid: the Agreement does not confer any right to purchase at a price lower than £1.5m and the option must be exercised in accordance with its terms.

28. The Defendants' response was that, on its true construction, the Agreement (and, in particular, Clause 4 in relation to the deposit) enabled the option to be validly exercised in years 3-5 in only two circumstances, namely:

(1) where the Purchase Price had been agreed between the parties before the Option Notice was served; and

(2) where the deposit paid happened to be 5% of the Open Market Value subsequently determined in accordance with the Second Schedule.

29. Since the Open Market Value of the Property has not (yet) been determined, Mr Harpum accepted (as he had to) that the most he could ask me to do is to adjourn the proceedings pending determination of the Open Market Value (which may prove to be £1.5m) which would then dictate whether the Claimant's Option Notice served in July 2015 was or was not valid.

30. It is worth setting out the corollary of the Defendants' argument at this stage. They accept that the Agreement cannot be read entirely literally. This is because the procedure for agreeing or determining the Open Market Value in the Second Schedule is not triggered until an Option Notice has been served (paragraph 3.1 providing: "immediately upon service of the Option Notice..."). *Prima facie* the reference to the Option Notice in this provision must be to a valid Option Notice. This leads to the "Catch 22" situation that the service of an Option Notice the validity of which is not established cannot trigger the mechanism necessary to determine whether it is indeed valid or not. Mr Harpum's solution to this conundrum is that paragraph 3.1 of the Second Schedule must be read as beginning "Immediately upon service of the Option Notice (whether valid or not)...".

31. In relation to Mr Lees' alternative argument, based on the interpretation of Clause 4, Mr Harpum argued that I could not accede to it because, even if I were satisfied that something had gone wrong with its language, I could not be sure what alternative version must have been intended by the parties. By way of illustration, he suggested that, rather than simply 5% of the purchase price stated in the Option Notice, the parties may well (if they had been alerted to the problem) have opted for a two-stage deposit payment, *viz.* 5% of the purchase price stated in

the Option Notice but with a top-up to 5% of the Open Market Value (if higher) when, or shortly after, the Open Market Value is determined.

Conclusion

32. In considering the rival arguments, I note at the outset that this is not a case (as, for example, **Chartbrook** was) where one party is arguing for "correction by construction" and the other is arguing for the literal interpretation of the language used. In the present case, the parties are agreed, first, that the Agreement is badly drafted (Mr Harpum's skeleton argument refers to it as "thoroughly inept") and, secondly, that, in order to make the Agreement work at all in years 3-5, it is necessary to read words in (or alter them) somewhere. The only question is which provision(s) should be corrected.

33. In my judgment, the Claimant's argument in relation to Clause 4 is correct and I reject the Defendants' alternative which focuses on paragraph 3.1 of the Second Schedule. My reasons are as follows:

(1) The Claimant's argument gives practical effect to the Agreement in years 3-5. In my judgment, the parties must have contemplated that the figure on which the 5% deposit was based was an ascertained or ascertainable figure at the time the deposit fell to be paid. The Purchase Price (as defined) was not. The only ascertainable figure at that time was the purchase price stated in the Option Notice.

(2) The Defendants' alternative approach seems to me to be divorced from reality. First, the circumstances in which (according to the Defendants) the option can be validly exercised in years 3-5 are extremely narrow: see paragraph 28 above. In any event, I do not accept that the Agreement contemplates agreement of the Purchase Price before service of the Option Notice. The Agreement deals with agreement of the Purchase Price but only in the context of an Option Notice having been served: see paragraphs 2.2 and 3.1 of the Second Schedule. The second circumstance identified by the Defendants is one where the Buyer has to guess what the Open Market Value will be. A reasonable person would not expect commercial parties to have modelled the Agreement on a lottery.

(3) Nor do I see any greater commercial sense in the Defendants' argument based on paragraph 3.1 of the Second Schedule. Mr Harpum frankly accepted that this argument leaves the validity of the Option Notice "in limbo" pending determination of the Open Market Value. Moreover, it means that the Buyer must commit professional fees (for the independent valuation), and, no doubt, management time to completion of the Second Schedule timetable only to find out at the end of the day that the Option Notice may have been invalid after all. Commercial parties would, in my judgment, expect the validity of the Option Notice to be ascertainable immediately upon service. That approach is consistent with the wording of Clause 3.1 ("If the Buyer serves on the Seller...notice in writing...the Seller shall sell and the Buyer shall buy the Property at the Purchase Price") which contemplates the Seller's contractual obligation to sell arising immediately upon service of the Option Notice and payment of the deposit.

(4) Applying the guidance in **Chartbrook**, I am satisfied that, although the Agreement is a formal document and was professionally drawn, something must have gone wrong with the language of Clause 4. I have already pointed out that the parties agree that the Agreement was poorly drafted, even though they disagree as to which provisions need to be "corrected by construction". With reference to [25] in **Chartbrook**, I have also concluded that it is clear what a reasonable person would understand the parties to have meant in Clause 4, namely that in years 3-5 the requisite deposit is 5% of the purchase price stated in the Option Notice. I do not accept Mr Harpum's submission that there is real cause for doubt here: see paragraph 31 above. Clause 4 contemplates payment of a single deposit on or before service of the Option Notice. It does not contemplate two deposit payments, one before and one after service of the Option Notice.

(5) Mr Harpum also objected that the deposit provisions of Clause 4 were for the Seller's protection. The deposit was intended to provide the Seller with security for the performance of the contract. He said that if the Claimant's argument in relation to Clause 4 is correct, the Buyer can unilaterally limit the amount at risk to an amount which may well prove to be less than 5% of the Purchase Price as ultimately ascertained. That, I accept, is so. But I do not consider that, in consequence, the Claimant's

argument lacks business common sense. 5% of the stated purchase price (minimum £1.5m) still provides substantial security for the Seller. The alternative approach championed by the Defendants seems to me to be much more lacking in business sense.

34. For these reasons, therefore, I will make the declarations sought by the Claimant in paragraphs 2.1 and 2.2 of the Claim Form. I will also make, by consent, a declaration in relation to the Completion Date in the form set out in paragraph 15 above.