Neutral Citation Number: [2022] EWHC 190 (Ch)

Case No: BL-2021-LDS-000017

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS IN LEEDS
BUSINESS LIST (ChD)

Leeds Combined Court Centre
1 Oxford Row, Leeds LS1 3BY
Date: 03/02/2022

Before :

HH JUDGE DAVIS-WHITE QC
(sitting as a Judge of the High Court)

- -

Between :

WHITEHALL CAPITAL LIMITED	**Claimant**
- and -	
LAND SOUTH EAST LIMITED	**Defendant**

- -
- -

Mr Victor Steinmetz (instructed by DLA Piper LLP) for the Claimant
Mr David Evans (a former director of the Defendant) for the Defendant
Hearing date: 21 September 2021

- -

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.

.....

HH JUDGE DAVIS-WHITE QC

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HH Judge Davis-White QC :

1. This Part 8 Claim seeks declaratory relief as to the meaning of a side letter entered into between the parties. On the basis that its construction of the side letter is correct, the claimant seeks payment of some £213,000 said to be due to be paid to it under the side letter from the proceeds of sale of a Property owned by the defendant when such sale completes. The dispute between the parties is one as to construction of the side letter.

2. The claimant, Whitehall Capital Limited (the "Claimant" or "WCL"), is a company incorporated in the British Virgin Islands. Its primary business is the making of short-term loans or bridging loans against the security of real property.

3. The main evidence in this case on behalf of WCL comes from Mr Anthony Bodenstein, its founder and one of its directors.

4. In November 2018, an English incorporated company, Whitehall Lending Limited ("WHLL") was set up. Mr Bodenstein is its main shareholder and one of its directors. WHLL carries on the same core business as WCL and was set up in circumstances where the large majority of transactions being carried out by WCL related to UK real property such that it made it sensible to have a UK company making and managing the relevant loans. After November 2018, loans have been made by WHLL rather than WCL.

5. The defendant, Land South East Limited (the "Defendants" or "LSEL") carries on business buying and selling real estate and purchasing and developing properties.

6. The main evidence on behalf of the Defendant comprises a witness statement of Mr David Evans ("Mr Evans"), a former director of the Defendant who had an involvement in the relevant history of the matter on behalf of the Defendant.

7. Before me, the Claimant was represented by Mr Victor Steinmetz of Counsel. Until shortly before the trial before me, the Defendant had solicitors on the record, Bermans (2012) Limited. Those solicitors ceased to act shortly before the trial and came off the record at about 4pm the day before the trial commenced. The Defendant now acts in person. At the start of the trial, Mr Cunningham, a director of the Defendant, confirmed that it would like Mr Evans to speak for it. To the extent necessary, I gave permission for Mr Evans to address the court on behalf of the Defendant.

8. I am grateful to Mr Steinmetz for the number of helpful documents he put before the court including of course his skeleton argument and authorities bundle. I am also grateful to him for his helpful and concise oral submissions. Mr Evans represented the Defendant with skill and moderation. I am grateful to him too.

9. I should point out that Mr Evans' written submissions, served with little time to be considered before the hearing, appeared to contain a number of submissions based on factual assertions that were not contained in the evidence.

The Background

10. In about July 2015 the Defendant, then ERSG Land South East Limited, purchased for development a twin tower block in Poole, Dorset for a sum of some £2.8 million or so.

This was funded in part by Mr Evans and in part by a facility from an entity referred to in the evidence as "Dragonfly". The site address was 1, 3, 5 and 7 Serpentine Road and land on the West Side of Serpentine Road, Poole (the "Property"). It is also known as "St Johns House".

11. Revised planning permission was obtained after the acquisition. Two possible plans were then pursued by the Defendant in tandem. One was to develop the Property and to sell units on the open market. The alternative was to undertake a joint venture with a housing association whereby the association would fund the development and take ownership of the site when completed.

12. In about July 2018, LSEL was looking for new capital to pay off its existing indebtedness thus giving it time either to obtain secured development funding itself to complete the development of the Property or to finalise a deal with a housing association along the lines that I have referred to.

13. LSEL was introduced to WCL at this time. On 4 September 2018 the parties entered into a written secured loan facility agreement (the "Loan Agreement"). The facility was for a one year loan (less a day) of just over £2.8 million. Although the purpose of the loan was defined as being for the purchase of property this was not in fact the purpose of the loan. Rather the purpose was as I have stated, namely to pay off earlier lending. WHLL had not at this time been set up.

14. It was a condition of the loan that the same was guaranteed by LSEL's then parent company and that that guarantee was also secured by a Second Legal Charge over certain land and buildings at Bradford Street, Birmingham. This security was duly entered into. Also as part of the security package for the loan, on 4 September 2018, LSEL entered into a legal mortgage of the Property and a debenture in favour of WCL.

15. There is a certain amount of dispute about the detail and about the appropriate characterisation of the position during the period of the WCL contractual facility and the circumstances of the eventual default that I mention below. At the end of the day it did not seem to me that most of these differences were material for the purposes of the issue of construction that I have to resolve. I refer to the more contentious disputes of fact below.

16. Following default under the Loan Agreement, fixed charge receivers were appointed over the Property by WCL by a written appointment dated 2 December 2019. They were subsequently discharged later that month following payment by LSEL of a sum of £60,000, towards default interest owed under the Loan Agreement and with a view to LSEL achieving a sale and/or refinancing of the Property.

17. Negotiations then took place between Cynergy Bank ("Cynergy") and LSEL with a view to Cynergy Bank re-financing the loan under the Loan Agreement. As matters ended up, Cynergy was not prepared to re-finance the entire WCL loan as in principle it had been envisaged that it would. This seems to have been as a result of the valuation placed on the Property by valuers acting for Cynergy. The result was that there was a shortfall of some £155,000 or so between the re-financing monies that Cynergy was prepared to provide and the sums required to discharge the WCL loan under the Loan Agreement.

18. By about 23 January 2020, as evidenced by an email of that date from Mr Bodenstein to Mr Evans, it was then agreed in principle that WHLL would, in effect, refinance that part of the WCL debt that would not be met from the Cynergy loan. That new loan would be from WHLL and would be secured by a charge. Mr Bodenstein was also looking for a guarantee, as WCL had had in relation to the Loan Agreement. As the existing guarantee would not carry over, Mr Bodenstein sought a new parent company guarantee or one from Mr Evans personally. At this stage Mr Bodenstein was apparently of the belief that Cynergy would not object to a second charge on the Property ranking after its charge.

19. Mr Evans was not able to offer a personal guarantee, instead what he was offering was that repayment would be made from future sale proceeds of the Property:

> "If the property can be sold or developed as we all believe then I have offered this to cover any shortfall. However I have nothing more I can offer so to agree to this would be fraudulent. At the time of agreeing the previous PG as stated above I had funds available and the PG was also joint with a third party.
> As such the refinance and confirmation that any balance will be covered from the future receipts on the sale of St. Johns is where we are at the moment. You need to decide whether £3,270,000 this week with the £155,000 at the point of sale is acceptable or whether because I cannot make a commitment I cannot keep, you will be better off looking to sell the property hoping that a third party purchaser will agree with the basis of the valuation we have managed to achieve with Colliers and that any professional fees do not destroy any remaining equity.
> I think it is sensible to finalise the refinance now but I that decision is not mine to make."

20. A written loan agreement between WHLL and LSEL, a document granting a charge to WHLL by LSEL and associated documents (board minutes of LSEL approving the transactions, a director's certificate and a Land Registration application to enter a notice of an equitable charge on the title to the Property) were prepared. These were returned to WHLL in escrow signed by appropriate persons at LSEL. At that stage WCL was requiring such documents as a condition of it signing a Deed of Release as regards its security over the Property, to enable the Cynergy refinancing to take place.

21. As part of the completion arrangements it emerged that Cynergy was not prepared to agree to a second (equitable) charge to be granted to WHLL (or WCL) and sought an undertaking in that regard. To deal with that position, under some pressure of time, a side letter was agreed and signed by WCL and LSEL (the "Side Letter"). Completion then took place and the existing charge of WCL over the Property was released as part of that process.

22. These matters appear to have emerged in (or at the least to be confirmed by) an email dated 3 February 2020 from Fieldfisher LLP solicitors acting for Cynergy to the solicitors acting for LSEL, Bermans (2012) LLP ("Bermans"). In that email a number of outstanding points were highlighted which included, at point 7:

> "7. Please confirm that you are not aware of any intention of the Borrower to enter into an equitable charge with Whitehall Capital following completion."

23. On 4 February 2020, a draft of the Side Letter was put forward by Mr Evans, following a discussion with Mr Bodenstein.

24. There was a meeting between Mr Bodenstein and a Mr Sonny Gowans, director of LSEL, that day. There is a dispute as to precisely what was discussed at that meeting. Mr Gowans and Mr Evans have given witness statements on this point for LSEL. Mr Evans' witness statement recites his understanding of what was discussed at the meeting having himself subsequently had discussions with Mr Gowans. Mr Gowans makes clear that the use of the term profit share was to avoid any suggestion that there was a loan or any security as these matters were, as he understood it, unacceptable to Cynergy. However, he also confirms that:

> "I do not recall that there was any detailed discussion about the precise workings of how a preferred profit would be calculated, however there was no discussion that the arrangement was to be a loan (or effectively a loan), as above, or that the 'profit share' was to be understood in any way differently to the usual definition of 'profit'."

25. Mr Evans goes further in saying:

> "Based on the discussions that I had with Mr Gowans, I believe that he discussed with Mr Bodenstein that the company had incurred significant accumulated costs in relation to the development, which would need to be taken into account when calculating profits, but that with an anticipated sale price of £5.7m or higher, the profit would exceed the difference which was due to WCL after the Cynergy refinance."

26. Mr Bodenstein denies that there was any discussion about profits, or likely profits, of LSEL along these lines or as suggesting in any way that payment of WCL would be dependent upon profits being made on overall transactions involving the Property.

27. In an email from Mr Gowans to Mr Bodenstein on 4 February 2002, Mr Gowans stated:

> "Following our discussions today, you are aware the attached agreements cannot be legally completed / executed as they are not acceptable under the terms of the Cynergy loan.
>
> David has sent the preferred profit share agreement as an alternative solution".

The preferred profit share agreement is a reference to a draft of the Side Letter.

28. Various slightly different drafts of the Side Letter were exchanged by email on 4 February 2020.

29. In an email from Mr Evans to Mr Bodenstein about the Side Letter in its then proposed form he said:

> "This I believe provides the protection you need without breeching [sic] the agreements allowing Bermans to give the undertaking"

30. In infer that by this Mr Evans was referring to point 7 of the earlier email of Fieldfisher LLP that I have referred to above.

31. I should mention that there was a dispute before me as to whether Cynergy only refused to permit a second charge to be created or whether it also objected to there being any loan. Mr Steinmetz fairly pointed out that no Cynergy loan documentation had been adduced into evidence and which showed any prohibition on any other loan or any subsequent charges. It may be however that the prohibition was a condition of the Cynergy facility documents being entered into. The emails provided do suggest that Cynergy was not prepared to allow a second charge to WCL/WHLL but do not go so far as to show that any other loan was also prohibited. In any event, says Mr Steinmetz, the Side Letter creates neither a charge nor a loan.

32. Both parties relied upon the course of the negotiations of the Side Letter and various drafts that preceded the final version. In my judgment this evidence is inadmissible as forming part of the negotiations. However, if I am wrong about this, nothing in those drafts would cause me to change the conclusions that I have reached below.

The Side Letter

33. The Side Letter in its final form and as signed is in the following terms:

> "Date : February 2020
> Agreement between the Parties as follows: -
> 1. Party 1: Whitehall Capital (BVI), registered address Trident Chambers, Tortola, BVI
> 2. Party 2: David Evans
> 3. Party 3: Land South East Ltd, registered in the UK under company number 09070471
>
> 4. Purpose:
>
> a. The Parties enter into this Agreement on the Terms set out to pay a sum of £213,000 by way of a preferred profit as set out below from the proceeds in the event of a sale or refinance of the asset known as St Johns House, Serpentine Road, Poole.
>
> 5 . Terms:
>
> a. The Parties have agreed to a payment in respect of the amount in 4(a) by way of a preferred distribution of profits.
>
> b. The preferred profit will be paid after repaying the 1st charge loan, legal fees and related transaction costs.
>
> c. No further profit distribution will be made to any party thereafter before Party 1 receives the sum in 4(a).
>
> d. Party 2 will provide a monthly update to Party 1 regarding progress of a sale of the asset or any other means by which the preferred profit can be achieved."

After the side letter

34. During 2020 a sale of the Property was under negotiation. This eventuated in a sale contract entered into on 18 December 2020. The sale contract was between LSEL as vendor and Stratton Land (St Johns) Limited. At the time of the hearing before me I was told that the sale had not then completed as the matter was quite complicated.

35. During 2020, and despite the terms of clause 5d of the Side Letter, WCL and its lawyers chased for information about the progress of the proposed sale.

36. By email dated 28 May 2020 Mr Barr of BBS Law Ltd ("BBS Law"), WCL's lawyers wrote as follows:

> "My client has become aware that the property at Poole is due to shortly be sold. The proceeds should be sufficient to pay the shortfall of monies that are still due to my client. You will be aware that David Evans entered into a commitment on behalf of himself and the Company to pay the balance still due of £213,000 to my client. I should be grateful if you would confirm that you have instructions to pay this sum over; presumably, you will want to pay this to our firm and I am attaching our bank details. Please quote reference AB.WHI.POOLE.
>
> If you could let me know as soon as possible that you have instructions to pay this sum, that would be appreciated."

37. This elicited a response from LSEL's solicitors, Bermans to the effect that the sale was not anticipated to complete before August at the earliest.

38. By a further email of 1 February 2021, Bermans gave further details to BBS Law about the state of the sale but also stated:

> "Your client is incorrectly asserting it holds security which it does not and when advised this was not given as it would have breached the terms of the Cynergy facility is threatening to contact Cynergy. All my client's in this regard are expressly reserved, I trust you will advise your client of the possible consequences of making an incorrect statement of the position"

39. By email dated 3 February 2021, BBS Law wrote:

> "Thanks for this email. Appreciate the update. My client was concerned that notwithstanding the terms in the attached side letter my client was not being kept updated. It does look like things are moving in the right direction and in that respect I should be grateful if you would confirm:
>
> 1. Either you or your client will commit to providing updates at least once every two weeks from now until completion;
> 2. On completion you will retain in your client account the sum of £213,000 which you will remit to our client account from the completion funds."

40. By email of 18 February 2021, Bermans wrote to BBS Law saying (among other things):

> "My client has instructed me to retain £213,000 in client account on completion until such time as the extent of the liability of my client to yours under the Agreement has been agreed between them or determined by an independent third party expert."

The Parties' respective positions

41. Mr Steinmetz submits that however the payment is described or characterised the Side Letter is clear as to the circumstances in which sums are to be paid to WCL: in the

event of a sale or a re-financing WCL is to receive £213,000 which is to be paid from the proceeds of sale or refinancing after the repayment of the items specified in clause 5b (i.e. the repayment of the Cynergy loan, and payment of the transaction costs). He says that both a textual analysis of the Side Letter, a consideration of the consequences of the two constructions advocated for by the parties and of the background factual context all support his construction. If, on the other hand, he is incorrect on his textual analysis then his construction is to be preferred based on the other two factors on the basis that the language of the Side Letter must somehow be taken to have "gone wrong".

42. Mr Evans for LSEL, and as set out in his witness statement, says that what is payable is a portion of profit and that before anything is payable there must be a profit out of which the £213,000 is to be paid. On the facts he asserts that the sale in question has or may have resulted in a net loss so there is (or may be) no sum due under the Side Letter to WCL. As regards the three pillars of textual analysis, surrounding circumstances and effect of differing constructions, he says that all point in favour of his construction over that advocated by Mr Steinmetz on behalf of WCL.

Construction of contracts

43. The courts have had to consider the question of the construction of contracts on numerous occasions.

44. It is possible to cite in extenso from a number of speeches in the House of Lords and judgments of the Supreme Court. In this case, the essential principles were not in dispute and it seems to me that the most convenient course is to set out the convenient summary contained in the judgment of Jacob J in *Global Display Solutions Limited v NCR Financial Solutions Group Limited* [2021] EWHC 1119 (Comm).[1] The key is that the overall process is a unitary exercise involving an iterative process which involves not just a consideration of the words of a contract but a consideration of the same against the relevant background knowledge and the commercial consequences of competing constructions. However, in general, the parties' negotiations are inadmissible as an aid to construction of an agreement.

45. Turning to the judgment of Jacob J in the *Global Display* case the key passage is set out in paragraphs [316] to [321]:

> *"[316] The basic legal principles as to the interpretation of contracts were not in dispute. They are conveniently summarised in the judgment of Popplewell J. in Lukoil Asia Pacific Pte Ltd v Ocean Tankers (Pte) Ltd [2018] EWCL 163 (Comm), which is quoted in Chitty on Contracts 33rd edition paragraph 13-047:*
>
> > *"The court's task is to ascertain the objective meaning of the language which the parties have chosen in which to express their agreement. The court must consider the language used and ascertain what a reasonable person, that is a person who has all*

[1] Permission to appeal against the decision made by the Judge on the construction of the relevant agreement was refused. An appeal succeeded on a separate point regarding an award of exemplary damages: [2021] EWCA Civ.1399.

> *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. The court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to the objective meaning of the language used. 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. Interpretation is a unitary exercise; in striking a balance between the indications given by the language and the implications of the competing constructions, the court must consider the quality of drafting of the clause and it must also be alive to the possibility that one side may have agreed to something which with hindsight did not serve his interest; similarly, the court must not lose sight of the possibility that a provision may be a negotiated compromise or that the negotiators were not able to agree more precise terms. This unitary exercise involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated. It does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language in the contract, so long as the court balances the indications given by each."*

[317] This summary is a synthesis of the principles that have been authoritatively stated in a trilogy of Supreme Court decisions in the past 10 years: Rainy Sky SA v Kookmin Bank [2011] UKSC 50; Arnold v Britton [2015] UKSC 36; Wood v Capita Insurance Services Ltd. [2017] UKSC 24.

[318] In Rainy Sky, Lord Clarke described the exercise of construction as being essentially a "unitary exercise" in which the court must consider the language used and ascertain what a reasonable person, with the relevant background knowledge, would have understood the parties to mean. 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. Where the parties have used unambiguous language, the court must apply it: Rainy Sky paragraphs [23] and [25].

[319] Whilst this unitary exercise of interpreting the contract requires the court to consider the commercial consequences of competing constructions, commercial common sense should not be invoked retrospectively, or to rewrite a contract in an attempt to assist an unwise party, or to penalise an astute party. This is clear from the judgment of Lord Neuberger in Arnold v Britton [and what] *he said at paragraphs [15] – [22]. At paragraph [20], Lord Neuberger said:*

> *"Fourthly, while commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed. Experience shows that it is by no means unknown for people to enter into arrangements which are ill-advised, even ignoring the benefit of wisdom of hindsight, and it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice. Accordingly, when interpreting a contract a judge should avoid re-writing it in an attempt to assist an unwise party or to penalise an astute party".*

[320] In Wood v Capita, Lord Hodge set out the applicable principles following Rainy Sky and Arnold v Britton as follows:

> *"[10] The court's task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. It has long been accepted that this is not a literalist exercise focused solely on a parsing of the wording of the particular clause but that the court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning. In Prenn v Simmonds [1971]* 1 *WLR 1381, 1383H1385D and in Reardon Smith Line Ltd v Yngvar HansenTangen (trading as HE Hansen – Tangen) [1998] 1 WRL 896, 912-913 Lord Hoffmann reformulated the principles of contractual interpretation, some saw his second principle, which allowed consideration of the whole relevant factual background available to the parties at the time of the contract, as signalling a break with the past. But Lord Bingham of Cornhill in an extrajudicial writing, "A New Thing Under the Sun? The Interpretation of Contracts and the ICS decision" (2008) 12 Edin LR 374, persuasively demonstrated that the idea of the court putting itself in the shoes of the contracting parties had a long pedigree.*
>
> *[11] Lord Clarke of Stone-cum-Ebony JSC elegantly summarised the approach to construction in the Rainy Sky case [2011] 1 WLR 2900, para 21f. In the Arnold case [2015] AC 1619 all of the judgments confirmed the approach in the Rainy Sky case: Lord Neuberger of Abbotsbury PSC, paras 13-14; Lord Hodge JSC, para 76 and Lord Carnwath JSC, para 108. Interpretation is, as Lord Clarke JSC stated in the Rainy Sky case (para 21), a unitary exercise; where there are rival meanings, the court can give weight to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense. But, in striking a balance between the indications given by the language and the implications of*

> *the competing constructions the court must consider the quality of drafting of the clause (the Rainy Sky case, para 26, citing Mance LJ in Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2) [2001] 2 All ER (Comm) 299, paras 13, 16); and it must also be alive to the possibility that one side may have agreed to something which with hindsight did not serve his interest: the possibility that a provision may be a negotiated compromise or that the negotiators were not able to agree more precise terms.*
>
> *[12] This unitary exercise involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated: the Arnold case, para 77 citing In re Sigma Finance Corpn [2010] 1 All ER 571, para 12, per Lord Mance JSC. To my mind once one has read the language in dispute and the relevant parts of the contract that provide its context, it does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language in the contract, so long as the court balances the indications given by each.*
>
> *[13] Textualism and contextualism are not conflicting paradigms in a battle for 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 the 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 contracts 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."*

[321] There is discussion in the case-law as to the circumstances in which consideration of the factual matrix or context may lead to an interpretation of

> *words which is not, according to conventional usage, an "available" meaning of the words or syntax which the parties had actually used, and the correction of an obvious drafting mistake by interpretation. I consider that argument in context below*."

46. Later in his judgment, Jacob J returned to the issue referred to in his paragraph [321]. He considered the argument in context but cited the following:

> "*[353]…..In that regard* [that is a conclusion that a submission addressed to him sought to place a meaning upon words used in the relevant agreement that the words could not bear], *Lewison: The Interpretation of Contracts 7th edition, paragraphs 3.167 – 3.168, states:*
>
> > *"Fourth, reliance on background must be tempered by loyalty to the contractual text. It is not permissible to construct from the background a meaning that the words of the contract will not legitimately bear.*
> >
> > *Fifth, the background should not be used to create an ambiguity where none exists. The court must be careful to ensure that the background is used to elucidate the contract, and not to contradict it".*
>
> *[354] NCR referred to the seminal judgment of Lord Hoffmann in Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 WLR 896. He stated, as his fourth proposition, that the relevant background "may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax."*

47. I turn first to the words of the agreement as they stand. As to this Mr Steinmetz submits that the words of the Side Letter make clear that the £213,000 is to be paid from the sums received either on sale or on refinancing. They do not, he submits, provide for payment to be made out of profits.

48. Mr Evans position is diametrically opposed to this. He says (as is set out in his helpful skeleton argument):

> "This is not the case and there is no reference to any payment being due from the sale proceeds in the Side Letter. The Side Letter clearly states any sum is to be paid from the profit arising from the sale hence the use of the phrase "Preferred Profit Share" rather than Sale Proceeds."

49. On this basic point I am against LSEL. Clause 4(a) seems clear to me: it is a payment "from the proceeds in the event of a sale or refinance" of the Property (not from any profit). Furthermore, the sum falls due to be paid "after repaying the 1st charge loan, legal fees and related transaction costs." The source of the payment is from the relevant proceeds.

50. The question is whether the characterisation of this payment as a "preferred profit distribution" overrides or affects the clear words of clauses 4(a) and 5(b) regarding when and from where the payment is to be made.

51. In my judgment the words of the agreement so far as they refer to "preferred profit" are seeking to characterise what the payment of £213,000 is, not when it falls due nor where the payment is to be sourced from. Further, that characterisation does not further limit the clear words of the clauses providing for the payment of the fixed sum to be made from the proceeds, after the discharge of the Cynergy loan and the transaction costs.

52. Further, if the payment was only to be made if and to the extent that LSEL had made a profit on the overall holding of the Property then, in my view, the Side Letter would have needed to say so expressly. This is the case not least because the Side Letter provides for payment out of the proceeds of sale or refinancing. It is difficult to see how a standard refinancing by way of further loan can give rise to a profit or indeed how a profit can begin to be calculated until the Property is in fact realised. This also gives rise to a further conundrum. If a refinancing gives rise to a sum sufficient to pay the sum of £213,000 as provided for by the Side Letter (i.e. after discharge of the other prior liabilities), it seems commercially unthinkable but also inconsistent with the text of the Side Letter if the result would be that LSEL would have to retain £213,000 out of the re-financing unless and until in due course the Property was sold and the issue of whether LSEL had made a (sufficient) overall profit on the acquisition and holding of the Property established. This is especially so when (as I find) there was no certainty as to if and when any sale might be agreed and might complete.

53. Of course a profit may be identified (but not be realised) if e.g. at the time of the re-financing, a valuation of the Property was undertaken as at an anticipated sale date and existing and anticipated liabilities in achieving that sale were valued and calculated. Again, however, there is simply no mechanism in the Side Letter to provide for any such process or to identify on what basis it would be carried out.

54. Indeed, one of the problems is what profit is being talked of and how it would be calculated.

55. Mr Evans' submission is to the effect that the profit being referred to is realised distributable profit within the meaning of the Companies Act 2006 and (at least at one point of his written submissions) that a sale would be necessary to generate the same. As such he says that the word "profit" has a very specialist meaning. I have to say I would have expected any such specialist meaning to be clearly identified in the Side Letter if it had been meant to apply. "Profit" by itself does not naturally carry that meaning and the Side Letter seems to have been tied to the concept of proceeds of sale or of refinancing rather than to the overall financial position of LSEL as a matter of company law. Further, and looking at the matter for the moment against the background circumstances, WCL was not a shareholder and on any view it would seem odd if the shortfall on the original WCL loan (between the sum due and the sum paid off as a result of the Cynergy financing) apparently covered by the Side Letter was only recoupable in circumstances where a shareholder could receive a distribution.

56. This submission by Mr Evans creates an ever greater level of complexity in determining "profit".

57. Leaving aside for the moment the concept of "distributable profit" in a Companies Act sense, it might also be said that a re-financing might not be a conventional refinancing by way of further loan but, for example, by way of an equity investment. In that situation it might be said that there could be some form of "profit" arising as debt would be converted into equity. This seems to be Mr Evans' position too. However, the Side Letter does not restrict re-financing in this manner.

58. That the focus is on payment of a sum of £213,000 is also shown by clause 5d which provides that WCL is to be kept updated as to the progress of the sale or any other means by which the "preferred profit" can be achieved. I would construe this reference as a reference simply to the payment of £213,000.

59. I also accept Mr Steinmetz's submission that the natural reading of clause 5b is that the £213,000 payment comes out of the proceeds of sale or proceeds of refinancing after the other payments there mentioned have been made. There is no provision that e.g. any other creditor would be paid out of such proceeds nor that there would be any delay whilst overall distributable profits of LSEL are calculated and verified.

60. The issues discussed above regarding "profit" become even more acute when the meaning of "profit" put forward by Mr Evans for LSEL is applied. As I have said, he submits that the profit in question is defined:

> "..in the context of the UK Companies Act 2006 and UK Generally Accepted Accounting Practise (UK GAAP), Section 830 of Companies Act 2006 states that a company's profit available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made. The Institute of Chartered Accountants in England and Wales sets out in its Technical Release 02/17BL guidance on how profit should be calculated."

61. Mr Evans accepted in his skeleton argument, in terms, that on his interpretation then no sum would be payable under the Side Letter unless and until there was a sale of the Property (and only then if there was a distributable profit). As I have said, this however flies in the face of the provision that payment be made out of the proceeds of refinancing and the anticipation that monies might become available to pay the £213,000 other than by way of a sale. Later in his written submissions, however, Mr Evans asserted that a distributable profit could arise from a re-financing and I consider that next.

62. Mr Evans submitted that a distributable profit could be generated on a sale of shares in LSEL and thus a re-financing. It was unclear to me precisely what was being suggested. On the face of things one would expect the selling shareholders to receive the purchase monies on a sale of the shares. As I understand it, Mr Evans was suggesting that part of the consideration would be paid by way of equity investment into LSEL. I am far from certain that this would give rise to a distributable profit but even if it would, as I have said the wording of the Side Letter does not restrict itself to that sort of refinancing,

63. As I shall explain below, it seems to me that characterising the payment as being a profit distribution may have been done so as to remove any suggestion that a charge had been created so as to deal with the Cynergy objection to a subsequent charge.

64. Mr Steinmetz submitted, as a matter of construction of the Side Letter, that "profit" is simply a synonym for "proceeds" (of sale or refinancing) and that the payment of the Cynergy charge and transaction costs are treated as distribution of profit by reason of the use of the word "further" in clause 5.c which he says means further to the payments in clause 5.b. I do not accept that this is the natural meaning of the words used. The natural reading of the Side Letter is that "profit" means something different to "proceeds", at least in clause 4. The reference to "further" distribution I would take to be further to any distribution to WCL.

65. I turn to the precise factual background. To some extent there is a difficulty in identifying what is admissible background context relevant to construing the Side Letter and what is inadmissible negotiations. What however both parties agree on is that the Side Letter came about because of the refusal of Cynergy to permit WCL to obtain any security. There is a dispute as to whether Cynergy would not even countenance a loan. As the evidence was not tested in cross-examination I assume in LSEL's favour that this was also the position. This might make sense in any event, any lender in the position of Cynergy may have been concerned if there was a creditor that could at any time bring unwelcome pressure to bear (for example by a winding up petition) or, more certainly, if there was a fixed term loan which had that effect and which contained the usual sort of conditions regarding events of default, the provision of information and so on.'

66. It seems to me therefore that the background is that LSEL and WCL were initially agreed in principle, as between themselves, that WCL would receive the balance of sums owed to it (agreed at £213,000) by way of further secured refinancing through WHLL. On the basis that Cynergy would not accept this, the Side Letter attempted to provide a mechanism that would (a) delay any right to repayment of WCL until after repayment of the Cynergy loan, without for example any acceleration clauses for default or the like and (b) provide a contractual right to repayment out of future sale/refinancing proceeds but no equitable security right to the same (i.e. one valid as against third parties or on insolvency). This was why the "preferred profit" language was used to characterise the nature of the payment. As I have said, it did not (as a matter of language) determine when and from where (the mechanism) the payment had to be made. Of course, normally an agreement to pay a sum from a specific fund will create a charge but it seemed to me it is open to the beneficiary of such obligation to agree that it should not do so. Further there was no registration of any charge (either at the Land Registry or Companies House) so as to attempt to bind third parties. I do not accept Mr Evans'that submission that the Side Letter, on WCL's construction, did amount to a charge and that therefore that construction must be incorrect.

67. There may have been an interesting question as to whether WCL was or was not a contingent creditor prior to the sale in this case and/or whether WCL was entitled to assert the same as against Cynergy, other creditors or an insolvency officeholder of LSEL. Assuming that WCL was a contingent creditor, it seems to me that that is simply a result of the parties not being able to achieve in full what Mr Evans says that, or hints at, they were seeking to achieve. I did not understand it to be seriously contested by Mr Steinmetz that the effect of the Side Letter was to prevent any "loan" arising. Indeed, his submission is that his construction of the agreement has that effect. I did not understand Mr Evans to suggest that that construction did indeed create a "loan".

68. It is difficult to see the practical magic in the circumstances of the difference in effect between a debt arising from a contract of loan as opposed to one arising in the sort of circumstances set out in the Side Letter (as construed by WCL). I am not satisfied that the general (assumed) background of the parties seeking to avoid a contract of loan arising would be a powerful enough consideration to cause the court to re-write the Side Letter that was agreed. As I have said though I consider a textual analysis supports WCL's construction. Further, even on Mr Evans' construction of the Side Letter I do not see why WCL would not be a creditor, albeit a contingent one. In those circumstances, it is difficult to understand why his construction is to be favoured as wholly meeting Cynergy's concerns. Either Cynergy's concerns were limited to there being neither a loan contract nor security with WCL (which is met by WCL's suggested construction) or it went wider and included there being neither security for WCL nor a creditor position for WCL. In the latter event Mr Evans' construction would not have met the second point and it is not voiced in the evidence as being a concern expressed by Cynergy at the time.

69. I do not consider that the evidence of negotiations on 4 February 2020 between Mr Bodenstein and Mr Gowans to be admissible evidence. However, if it is admissible it simply confirms the difficulty inherent in the Side Letter in not identifying in any manner how and when a "distributable profit" would be identified. It cannot be suggested that these matters had been discussed and/or agreed orally on 4 February or that the parties used any particular special meaning to the term "profit" or as to how the Side Letter was to operate. Further, if admissible, the evidence on behalf of LSEL suggests at most that there was an assurance of profit being available not that any detailed workings or information about the same were provided nor that there was any certainty as to when a sale might take place, nor indeed of the date of or type of "refinancing" which might give rise to a profit. I consider the relevant evidence of negotiations not to be admissible (on either side) and leave it to one side. However, if I am wrong and it is admissible, I consider that it supports the Claimant's construction of the Side Letter rather than the Defendant's. This is with regard both to the changing wording of the drafts and also what was (or more importantly what was not) discussed during those negotiations. I do not go through the successive changes of the drafts but accept Mr Steinmetz's submissions on that point.

70. The absence of any proper mechanism to determine profit (and the uncertainty as to what it means) and the inability of the Side Letter to apply to refinancing (as it clearly does) if sums can only be paid to the extent that LSEL has distributable profits in a Companies Act sense, point me to the conclusion that the Side Letter did not require the payment under it to be made only from distributable (or indeed any other) "profits" of LSEL).

71. Mr Steinmetz also relied on the fact that WCL was a short-term lender and not interested in equity investments. In my judgment this carries little, if any, weight. The question is whether, given the circumstances at the time and in which it was already committed, WCL might have agreed to what was, on LSEL's ow Lconstruction, something approaching an equity investment rather than a loan. The difficulty with Mr Steinmetz's point is that it seems to me that this was a situation where WCL was already tied into the situation. It was not being asked to lend money afresh but had already done so. This factor relied upon by Mr Steinmetz (i.e. the scope or nature of WCL's usual business) seems to me a neutral one.

72. I also accept Mr Steinmetz's point that the agreed evidence appears to have been that WCL was ultimately intended to recover a sum equal to that which it would have received under the Loan Agreement. If, as suggested by Mr Evans, WCL was truly moving from receiving back a sum equal to the shortfall on the Loan and instead participating in profit share one might have expected to see a possible participation in profit in excess of the same return as it would have had under its original Loan Agreement, dependent on what profit was generated. This may not be a strong factor but seems to me a relevant factor.

73. I do accept however that the absence of any express mechanism to determine profit and LSEL's acceptance, through Mr Evans, that no payment could be made until after a sale of the Property (or possibly in very limited circumstances of a particular type of refinancing) are sound commercial reasons why it is unlikely that the words of the Side Letter should be construed as submitted by Mr Evans and why what I have held to be the natural construction of the words used should apply. Further, I accept that a factor weighing in favour of this construction is that the only difficulty in the way of WCL (or WHLL) being a secured creditor was because of Cynergy's stance. The construction I prefer does not involve WCL having the benefit of security but only a contractual right enforceable against LSEL. I add that I reject Mr Evans' submission that a speedy sale was envisaged on all sides. There is no evidence of that. Further, the evidence suggests the contrary. There had been a number of promises made to refinance the WCL facility over time which had not been realised. As matters have turned out a contract has taken a long time to be entered into and even then was not completed for many months. I do not consider that WCL had any expectation of a speedy successful sale.

74. As part of the background facts, Mr Evans also relied on what he asserted was a (knowingly) false statement by Mr Bodenstein, prior to the execution of the new WHLL facility agreement and charge, that Cynergy had agreed to the same. It seems to me that the burden of proof on this issue is on LSEL and I am not satisfied on the balance of probabilities that it is made out. In any event, it seems to me irrelevant.

75. Mr Evans also relied, by way of background fact, on what he asserted was the common knowledge and/or assumption at the relevant time that there would be a profit (and presumably distributable profits) if a sale of the Property were to occur and in a sufficient sum to enable a distribution of distributable profit to WCL. This is alleged common knowledge/assumption is disputed by Mr Bodenstein. It seems to me that the burden of proof of establishing such fact lies on LSEL. In the absence of cross-examination I am not satisfied that it is established and so leave it out of account. In any event, even on the Defendant's evidence, I do not regard what is asserted to have been said as establishing knowledge of Mr Bodenstein of an expectation that there would be "profits" of LSEL sufficient to cover the payment under the Side Letter. Finally, I am also concerned that this may properly be viewed as being part of any negotiations which are of course inadmissible, though I assume in LSEL's favour that that would not be the case.

76. Considering the matter therefore from the textual context, in light of the considerations flowing from the two different constructions and against the relevant factual context in which the Side Letter was agreed, I am satisfied that on its true construction the Side Letter does provide for payment of the £213,000 from (inter alia) the proceeds of sale of the Property and irrespective of whether LSEL has distributable profits (within the Companies Act sense or any other sense) of at least such sum.