IN THE HIGH COURT OF JUSTICE No. CH 1998 S. No. 1733
IN THE CHANCERY DIVISION

Royal Courts of Justice

Friday 12th March, 1999

B e f o r e:

MR JUSTICE RIMER

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SUMMIT FINANCIAL GROUP LIMITED
(FORMERLY AURIT SERVICES LIMITED)

Plaintiff

– v –

SLAUGHTER AND MAY (A FIRM)

Defendant

– – – – – – – – –

Mr Ian Mill (instructed by Berwin Leighton) appeared on behalf of the Plaintiff
Mr Gregory Mitchell Q.C. and Mr David Head (instructed by Reynolds Porter Chamberlain) appeared on behalf of the Defendant

J U D G M E N T

MR JUSTICE RIMER :

This is an action for damages for alleged professional negligence. The plaintiff is Summit Financial Group Limited. Summit's former name, and its name at the times most material to these proceedings, was Aurit Services Limited; and I will call it "Aurit". The defendant is Slaughter and May ("Slaughters"), the City solicitors. The writ was issued on 26 April 1996. The action was commenced in the Queen's Bench Division, but on 26 February 1998 it was transferred to the Chancery Division. Mr Ian Mill appeared for Aurit. Mr Gregory Mitchell Q.C. and Mr David Head appeared for Slaughters.

Nature of claim

In July 1985, Aurit reached an agreement in principle with ATC Property Limited ("ATC") as to the basis for the calculation of commission payable by ATC to Aurit for introducing two properties to ATC which ATC subsequently acquired. The special feature of the properties was that they were ones in respect of which 100% first year capital allowances were available to ATC, so enabling it to deduct their acquisition costs in the computation of its profits for corporation tax purposes.

Following the making of that agreement, Aurit and ATC instructed their respective solicitors to negotiate the terms of a formal written agreement incorporating the parties' bargain. Slaughters acted for Aurit; and Ashurst Morris Crisp ("Ashursts") acted for ATC. Aurit's case is that its instructions to Slaughters were so to draft the agreement as to ensure that it incorporated the commission calculation which had been agreed.

Slaughters produced the first draft and submitted it to Ashursts. Aurit accepts that it correctly reflected the bargain it had made. However, the draft then went through various amendments over the protracted period leading up to the final version, which was executed on 17 July 1987. That version, so Aurit claims, failed to incorporate the main element of the commission calculation agreed with ATC back in July 1985, a failure which Aurit claims deprived the agreement of its primary commercial purpose: it provided for the commission to be calculated on a basis which entitled Aurit to a very much lower financial return than had been agreed.

Aurit claims that, when it executed the July 1987 agreement, it was unaware that the agreement incorporated drafting changes whose effect was to achieve this result. It claims it believed the executed agreement duly incorporated the essence of the original bargain, a bargain from which it had never agreed to depart. It claims that Slaughters negligently failed to ensure that the final version of the agreement reflected its original instructions; and that they negligently failed to advise Aurit of the effect and materiality of the drafting changes which were introduced by Ashursts into the agreement. Aurit asserts that the reason why Slaughters failed so to advise it was because they too failed to appreciate the true effect of those changes.

Aurit claims that, had it been aware of the effect of these changes, it could and would have ensured that the agreement was so re–drafted as to reflect the bargain originally agreed. Alternatively, it claims that, if it could not have achieved this, it would have refused to execute any agreement in the terms of the revised form of draft and would instead have pursued a claim against ATC for commission on a quantum meruit basis. It says that such a claim would probably have achieved for it a reward slightly in excess of that which it expected to achieve had the final version of the agreement been in the form in which Aurit claims it should have been. It claims that Slaughters' alleged negligence has deprived it of the chance of recovering the commission to which it ought to have been entitled.

During the course of the negotiation of the formal agreement, Aurit and ATC agreed that its terms should also apply to a third property introduced to ATC by Aurit. Following its execution, and before Aurit discovered the alleged mistake, it also agreed with ATC that the like terms should apply to a fourth property which it introduced. In the events which have since happened, Aurit claims to have suffered a quantifiable loss of £203,500 by reason of Slaughters' alleged negligence: a loss representing the commission which it claims it should have received in respect of one of the four properties, but did not. It claims that it is likely in future also to suffer losses in respect of two others of the four properties, and it claims an indemnity in respect of any such future losses. No claim arises in respect of the fourth property.

Slaughters deny the alleged negligence. They claim that Aurit understood, and agreed to, the terms of the agreement as executed. They deny it has suffered any loss. They say that they cannot be liable for the claim in respect of the property introduced by Aurit after the signing of the agreement. They assert contributory negligence by Aurit. They assert that Aurit should have mitigated its loss by suing ATC for rectification of the agreement. They say the claim is statute barred.

Industrial building allowances

In computing the profits of a trade for tax purposes, no deduction is ordinarily allowed for the acquisition of a capital asset. There are, however, exceptions to that, under which certain allowances have been afforded in respect of capital expenditure on certain types of asset. This case concerns the availability to investors in the 1980s of capital allowances in respect of buildings in Enterprise Zones, a concept introduced in 1980. The then applicable law was contained in the Capital Allowances Act 1968, as amended by subsequent Finance Acts.

A feature of certain property investments which was then particularly attractive from a tax perspective was the availability of Industrial Building Allowances ("IBAs") in respect of qualifying buildings in Enterprise Zones. A 100% first year allowance was given in respect of capital expenditure on the construction of such buildings. It was claimable by the person who incurred capital expenditure on such construction. If, however, before the

building was used, that person sold the interest in the building to which he was entitled when he incurred the expenditure (such interest being known as the "relevant interest"), he could not himself claim the IBA, but it would then become available to his purchaser. For this purpose, the purchaser's expenditure was treated as being the lesser of the actual expenditure on construction or the net price paid to the vendor.

The purchaser would thereafter retain the benefit of the first year IBA except in certain events occurring during the period of 25 years from the time the building was first used. One such event was if the purchaser re–sold the relevant interest in the property. If he did so, a "balancing charge" arose on the amount by which the sale proceeds exceeded the residue of the relevant expenditure. If the relevant expenditure had been wholly relieved by IBAs, then a balancing charge was incurred equal to the whole proceeds, although in no case was the charge more than the total IBAs claimed. The balancing charge was brought into charge to tax as if it were part of the taxable profits of the investor.

It is, however, of particular relevance to this case that no balancing charge would arise if an interest less than the relevant interest was disposed of. For example, if the relevant interest was a freehold, no balancing charge would arise on the disposal of a subordinate interest such as a long lease. Such a transaction could thus ordinarily enable the investor to realise the full economic value of the property, whilst retaining the benefit of the IBA enjoyed on the original acquisition.

These tax benefits were, therefore, potentially very valuable. An investor acquiring the relevant interest in a qualifying building would be entitled to set off the IBA against its taxable profits generally. This reduced the effective cost of the building by the amount of tax not paid or reclaimed and served to increase the potential rental return to the investor. However, a potential downside was that a subsequent disposal of the building in such a way as to incur a balancing charge would result in the tax which had originally not been paid, or had been reclaimed, becoming payable or repayable. If the sale proceeds (net of allowable expenses) were at least equal to the original price, then there would be a balancing charge equal to the difference between the tax written down value and the sale proceeds (net of allowable expenses).

The availability of IBAs in respect of qualifying buildings meant that developers would normally seek and achieve a price exceeding the price achievable for a like building not carrying the right to such allowances. That tax premium would, however, not be available on a subsequent sale of the building, and so the market value of a qualifying building immediately after its purchase by the first investor would be less than the investor had paid for it. It followed that a company acquiring a property attracting an IBA would ordinarily do so only in circumstances in which it contemplated a lengthy ownership of it, so that by the time of its disposal market prices would have risen sufficiently to outweigh the tax premium originally paid; or in circumstances in which it expected to be able to dispose of the property in a way which would avoid the incurring of a balancing charge - for example,

by disposing of a subordinate interest whose commercial value was equivalent to that of the relevant interest (for example, a 999 year lease carved out of a freehold).

Disposals of the latter type became common in the 1980s. Investors would acquire qualifying buildings in Enterprise Zones with the intention of stripping out the IBAs and then selling the economic interest in the building. They would do so by the grant of a long lease at a premium in the case of a freehold; or, in the case of a leasehold interest, by the grant of a slightly shorter lease. They would thereby hope to recover at least the bulk of the original purchase price, whilst retaining the benefit of the first year IBA and without incurring a balancing charge. There were, however, some uncertainties about the efficacy of such strategies. For example, the Revenue might regard the subsequent disposal as pre–ordained and argue that the investor's true expenditure attracting the IBA should discount the premium payable on the disposal of the subordinate interest; or the disposal might be regarded as a trading disposal, so requiring the proceeds to be brought into account as a trading receipt, although this was only likely if the property was disposed of relatively quickly, which would itself be fairly unusual because in the short term the transactions would be unlikely to yield a profit. There might, of course, also be a change in the law by the time of the subsequent disposal.

Aurit's business

During the 1980s, Aurit specialised in managing leasing companies for corporate clients and arranging leasing transactions and other tax–based investments for them, in particular in relation to property. It was a subsidiary of J. Rothschild Holdings plc. Mr Barry Sack was its managing director from 1979 until February 1983.

Mr Christopher Hunter Gordon was employed by Aurit during the period 1983 to 1985, and became its managing director in September 1983. Mr Sack became its chief executive. In 1985, Mr Hunter Gordon and Mr Sack formed The Summit Group Plc ("Group") and they became its joint managing directors. Group acquired Aurit from Rothschilds.

Following this acquisition, Group's activities expanded to encompass leasing, property investment, development and trading and other specialist financial and property advisory business. Mr Hunter Gordon was responsible for overseeing all aspects of Group's activities.

One aspect of its business involved, or became, ascertaining the existence of Enterprise Zone properties in respect of which IBAs might be available, and then introducing them to clients who might be interested in the tax benefits potentially available. In 1984, Aurit began introducing to its clients property investment transactions carrying IBAs. These transactions were potentially more attractive than leasing transactions, since they enabled corporation tax not merely to be deferred, but saved. Such property investments were harder to find than leasing transactions, because they had to be attractive not just from the tax saving

viewpoint but also from the property perspective. However, the right property had great attractions to investors, because of its potential ability to generate superior returns. Equally, the attractiveness of such properties meant that there were too few of them available on the market to satisfy the demand in full.

Because the benefits to clients from these investment properties were potentially so great, Aurit devised in 1984 a scheme whereby its reward for introducing them to clients included not just the arrangement fee of 1% of the purchase price of the property, but also an element of the super–profit potentially available to the investor. The client would enjoy a 100% IBA on its purchase of the property and could at a later stage realise the full economic value in the property by disposing of a subordinate interest in it without incurring a balancing charge. The scheme which Aurit developed was one under which it would acquire an option to purchase a subordinate interest in the property from the investor, at a premium which was calculated to ensure that the investor would make a return considerably in excess of what it would have expected from a very profitable leasing transaction at the time. The agreed rate of return was calculated in the same way as a leasing return would have been calculated, but using after–tax balances and on the assumption that no balancing charge ever fell due. The net effect of the option arrangement would be that both the investor and Aurit would share in the substantial investment profit which the investor had made as a result of its enjoyment of the IBA on the acquisition of the property – with Aurit's share being realised on its subsequent disposal of the subordinate interest acquired.

Aurit's relationship with Slaughters

Slaughters had acted for Aurit in connection with its leasing and other transactions since 1983, when Mr Hunter Gordon joined Aurit. Mr Hunter Gordon's own connection with Slaughters pre–dated that. He had formerly been employed by Morgan Guarantee Limited ("Morgan"), a subsidiary of J.P.Morgan Inc, where he specialised in leasing and tax–based finance, and Slaughters were Morgan's solicitors when he was with Morgan. Prior to the transaction with ATC with which these proceedings are concerned, Slaughters had acted for Aurit in connection with many transactions, including property investment transactions involving IBAs. These included transactions involving the grant to Aurit of its standard option to acquire a subordinate interest in the subject property.

During 1984/1985, Slaughters prepared a form of option agreement for use by Aurit on the introduction of IBA investment properties to clients. Clients were prepared to, and did, grant such options to Aurit since the property investments represented significantly better transactions than had the leasing transactions they had previously engaged in. Further, given the scarcity of suitable property investments, if any particular client was not prepared to agree to Aurit's terms, there were others who would.

Samples of the option agreements so drafted by Slaughters were put in evidence. One such agreement, relating to an investment property at Thatcham, gave Aurit an option to

acquire a subordinate leasehold interest in the investment property, exercisable between five and fifteen years from the date of the option agreement. The consideration for the grant of the lease was the payment by Aurit of a premium calculated in accordance with the somewhat complicated terms of the schedule to the agreement. The premium was to be a sum which, on the date of its calculation, ensured that "the dual rate of return as calculated under the London Business School Programme received by the Owner from the Investment (as illustrated in the Example Cash Flow) is 16 per cent". The schedule then set out various principles and assumptions upon which the premium was to be so calculated, and catered also for the possibility that certain of the assumptions might change or prove to be incorrect. One assumption was that no balancing charge would be incurred by the owner by reason of the receipt of the premium. The essence of the calculations provided for by the schedule was to ensure that the investor enjoyed a return of 16 per cent on its net investment (after the IBA) in the property down to the date of payment of the premium and to enable Aurit to enjoy the excess of value in the property over the payment which the investor required to receive in order to achieve that return. It was fundamental to the premium calculation that no balancing charge should be incurred by the investor on the disposal of the subordinate interest. The schedule was largely the work of Stephen Edge, a Slaughters' tax partner. His familiarity with the law relating to IBAs, and how they worked, is not in question.

Allied Textile Companies Plc ("Allied")

Allied was one of Aurit's established clients. ATC was one of its subsidiaries. The year end of the companies in the Allied group was in September. In about the spring of each year, Aurit (by Mr Hunter Gordon or Mr Sack) would contact Gerald Wightman of Allied with a view to ascertaining the approximate level of taxable income which he expected the Allied group to want to shelter from corporation tax in that year. Aurit would then send details of transactions to Allied which might enable it to defer or save corporation tax.

From about 1980, Aurit introduced equipment leasing transactions to the Allied group. Allied paid Aurit a flat rate percentage commission in respect of those transactions which it took up. From 1984 onwards, Aurit also provided Allied with details of property investments in respect of which Allied could enjoy IBAs. The first such investments which Allied agreed to take up were those to which I now turn. In the meantime, other clients of Aurit had taken up like investment opportunities and had rewarded Aurit for its introduction by entering into the standard option agreement.

The ATC transaction

In July 1985, Aurit introduced to Allied the opportunity of investing in two Enterprise Zone investment properties in respect of which IBAs would be available. It did not identify them precisely until such time as commission terms had been agreed in principle, whereafter it did so. The properties were Plot 2/3 Kansas Avenue, Longworthy, Enterprise Park,

Salford, Lancashire ("Salford") and Phase 9, Saracen Close, Gillingham Business Park, Gillingham, Kent ("Phase 9"). They were introduced to Allied as a result of an agreement reached between Mr Hunter Gordon and Mr Wightman evidenced in two important letters.

The first letter was dated 12 July 1985, when Mr Wightman wrote to Mr Hunter Gordon as follows:

> "Further to our conversation, I am unable to discuss the matter with Russell [Smith] as he is taking a few days away from the office and will not return until next Thursday.
>
> I thought it might be appropriate to set down the sort of arrangement that might form a working document for discussion.
>
> (a) Freehold property in enterprise zone subject to 100% tax allowance.
>
> (b) On disposal of the property, which is at ATC's option and timing, a calculation to be made through London Business School computer to show the theoretical sale price necessary to achieve a return to ATC of 6% over actual cost of funds using the following parameters:–
>
> (i) Original cost to be full carrying cost, i.e. including legal fees, procurement fees, estate agent, stamp duty etc.
> (ii) Actual tax rates and payment dates.
> (iii) Actual cost of funds based on three months rollover.
> (iv) Disposal to be effected without either fees (other than legal) or balancing charges.
>
> (c) The excess of the actual net selling price over the theoretical selling price necessary for the purposes of (b) above to be shared between ATC and Aurit in the proportion 55% ATC 45% Aurit.
>
> Our requirement for this purpose would be to shelter a mainstream taxable profit of the order of £4m.
>
> You are of course aware of our requirements as to quality of covenant and our doubts over investment in some of the enterprise zones. Perhaps before I discuss final arrangements with my colleagues you would indicate the sort of deals you have in mind which might be appropriate."

That letter had apparently been preceded by a telephone conversation between Mr Wightman and Mr Hunter Gordon. Mr Hunter Gordon gave evidence. He could not now recall what was said, but thought he would probably have said that ATC should not dispose of a subordinate interest in the properties for at least five years, because otherwise it might prejudice its retention of the benefit of the IBA by triggering a balancing charge.

The terms proposed in that letter involved a departure from Aurit's standard option terms. First, Aurit was not to have an option to acquire a subordinate interest in the investment property. Instead, ATC was to be entitled to dispose of the property when it

wished, whereupon Aurit's right to commission would crystallise, a commission which would be calculated in accordance with paragraphs (b) and (c). Secondly, Aurit's share was not to be 100% of the super–profit over and above any notional premium necessary to give ATC its guaranteed return, but was only to be 45%. Paragraph (b) (iv) reflected the fundamental point that the calculation of ATC's return should assume that no balancing charge was incurred on the notional disposal giving rise to the theoretical sale price – and it is that point which is at the heart of the dispute in this litigation. Mr Hunter Gordon said that Allied's reason for not wanting Aurit to have an option to acquire a subordinate interest in the property was because that would have given Aurit a registrable interest in the properties, whose presence on the title might have prejudiced ATC's capacity to mortgage them; and, also, that ATC did not want Aurit to be in control of decisions as to when the property was disposed of: Mr Wightman wanted ACT to retain control of this.

On 17 July 1985, Mr Hunter Gordon spoke to Mr Wightman on the telephone and they agreed certain variations to the terms proposed in the letter of 12 July. Mr Hunter Gordon then confirmed the revised terms in a letter he telexed to Mr Wightman of the same day. He wrote:

> "Option Mechanisms
>
> I confirm our telephone conversation this morning where we accepted your letter as the basis for the arrangements between [Aurit] and ATC subject to two caveats as follows:
>
> A) Though disposal of the property is to be at ATC's option, to enable Aurit to realise its investment, if ATC chooses not to dispose of the property then Aurit may at any time after 5 years (subject to a maximum period of say 15 years) have the building valued on the open market and receive a payment from you based on the agreed formula. For tax reasons (and to give the investment some time to appreciate), ATC should not dispose of the property within the first 5 years.
>
> B) As originally suggested we believe the excess of the net sales proceeds over the theoretical price necessary to achieve a 6 pct margin over cost of funds should be shared 50–50 between ATC and Aurit in order to be truly equitable.
>
> I understand that both these conditions are acceptable to you.
>
> Specific investments
>
> We discussed two investments which have to be urgently completed prior to the end of July since both tenants wish to take possession before 1 August. We have both buildings under our control and may possibly take one or both for our own account though we are not exactly sure of our requirements at this early stage of the financial year. We require urgent confirmation of your interest not later than the end of this week otherwise we will probably retain them for our own account."

Mr Hunter Gordon then identified Salford and Phase 9 in general terms, including summaries of the capital commitment involved, the availability of 100% IBAs and the rents and yields of the two properties.

The main features of the revised terms were these. First, even though Aurit was still not to enjoy its standard option, it was to be entitled after five years to require the building to be valued on an open market basis and then to receive a payment based on the "agreed formula", which was a reference back to the formula contained in paragraphs (b) and (c) in Mr Wightman's letter - the open market value taking the place of the actual sale price contemplated by Mr Wightman's proposal. In effect, Aurit was to have an option to trigger the commission formula and its right to a payment. Secondly, the paragraph (c) proportions were revised from 55/45 to 50/50. These two main features involved a departure from Aurit's standard terms with ATC and involved the making by Aurit of concessions to ATC. Mr Hunter Gordon explained Aurit's reason for agreeing to them as being that the Allied group was a longstanding client, which had done "tens of millions of pounds" of business with Aurit over the years, Aurit had a good relationship with Allied and it expected to do more business with it in future.

The net result was, therefore, that the payment of commission to Aurit would arise either on an actual disposal by ATC of the property after five years or (failing any such disposal) at Aurit's election after five years to require a commission calculation to be made by reference to a notional disposal. The effect of the exercise of the latter option was, in substance, that Aurit would receive 50% of the financial benefit that it would have received had it been given the benefit of its standard option entitling it to acquire a subordinate interest in the property. It was of the nature of this option that, if it was exercised, ATC would have to make a payment to Aurit before it had actually realised any interest in the property: and it was inherent in it that ATC might not thereafter be able, on any subsequent actual disposal, to recoup the payment it had earlier so made to Aurit. I add that, although the exchange of letters does not spell this out, Aurit was also to be entitled to an initial 1% arrangement fee on the purchase price of the two introduced properties.

Either during the conversation of 17 July, or following it, ATC indicated its wish to acquire both the properties. Aurit introduced both Salford and Phase 9 to ATC and Aurit and ATC instructed their respective solicitors to negotiate the drafting of a formal agreement incorporating the commission terms agreed between Mr Hunter Gordon and Mr Wightman. Mr Hunter Gordon said that it was Aurit's practice at the time to introduce properties to clients even though no final form of commission agreement was yet in place. He explained that Aurit had close working relationships with most of its customers, there was often a shortage of time within which the acquisitions had to be effected and usually an insufficient time within which to negotiate the commission agreement. Aurit's policy was to trust its clients; and Mr Hunter Gordon said that none of its clients had ever reneged, although in some cases there had been a delay in negotiating and executing the documentation. Aurit's

flat rate 1% commission would, in the meantime, become payable on completion of the acquisition.

The personnel at Slaughters who were, or became, involved in the task on behalf of Aurit were Stephen Edge (a partner), Graham Airs and Russell Jacobs, all in Slaughters' tax department; and David Beales (a partner) and Graham White, in Slaughters' property department. The solicitor at Ashursts who acted on behalf of ATC was Anthony Hurndall.

I have mentioned that the negotiations leading to the signing of the final form of agreement turned out to be extremely protracted, lasting some two years. Even though the agreement was quite a complicated one, by no standards did its negotiation require a gestation period of two years; and had there been a spirit of willingness on both sides to deal with the matter efficiently and expeditiously, I have no doubt that the matter could have been tied up in, at most, a matter of weeks. Aurit and Slaughters levelled criticism at Mr Hurndall as having been the sole architect of the fact that the operation instead took two years. Apart from accusing him of being responsible for the delay, Aurit and Slaughters also regarded him as difficult to deal with, a feature which was aggravated by the fact that they concluded that he had no relevant experience of the type of tax–based transaction which was the subject of the negotiation.

I do not propose to express any views on the soundness of, or justification for, any of these criticisms of Mr Hurndall. Neither he nor anyone from his client, ATC, was called as a witness. Moreover, ATC would have been as aware as Aurit of the delay in the negotiation of the agreement, yet it did not take Mr Hurndall off the job and require him to be replaced by someone who could deal with it more expeditiously. There is no evidence that Mr Hurndall was doing other than carrying out his client's instructions. ATC of course had no particular incentive to tie up the deal as quickly as Aurit would have liked. On the other hand, it had at least a strong moral commitment to co–operate in its due conclusion. Aurit had introduced the two properties to ATC on the faith of the agreement which was negotiated in July and ATC subsequently acquired long leases of Salford and Phase 9 on 23 August and 30 September 1985 respectively. These acquisitions enabled it to make valuable reductions in its corporation tax liability and to enjoy the benefit of very valuable investments. It was only because of Aurit that it was able to enjoy those reductions and benefits.

The negotiation of the agreement

On 22 July 1985, Mr Hunter Gordon sent a fax to Mr Beales at Slaughters giving him instructions to prepare a formal agreement incorporating the terms which had been agreed with ATC. Somewhat optimistically, he opened his instructions by saying:

> "We are purchasing two properties during this week for ATC which require Option Agreements executed before the end of this week. We will need drafts as soon as possible to be submitted to their Solicitors [Ashursts] - Anthony Hurndall. The

Option will be different to those used in the past in that the following provisions have been agreed:".

He then set out the agreed terms as follows:

"1. Sale of property is at ATC's sole discretion but no sale may be made before 5 years have elapsed. This effectively means that Aurit does not need the 'call option' [that was a reference to the call option for the acquisition of a subordinate interest which had been a standard feature of Aurit's previous agreements with regard to IBA properties].

2. In the event that the property is not sold, Aurit is entitled to a payment (as calculated below) during the option period commencing on the fifth year and expiring on the 15th in relation to the open market valuation or price offered by the third party at arms length whichever is the higher. During this period if the property is not sold Aurit can call for a valuation and receive the payment that would have been received as below.

3. The calculation of Aurit's payment is as follows:

a) A Theoretical sale price is calculated using the LBS [London Business School] programme as in previous cases which will achieve a return to ATC of 6% over ATC's actual cost of funds during the period of investment. This return will take into account the following assumptions:

i) Purchase cost of the building qualifies for 100% allowance since it is located in an enterprise zone.

ii) Original cost will include all legal fees, estate agents fees, stamp duty and Aurit's fees.

iii) Actual tax rates and dates of payment of tax.

iv) Actual interest rates suffered by ATC based on 3 monthly Cost of Funds.

v) That no balancing charge arises on disposal and no fees are charged on disposal.

The price will be adjusted to take into account variations in these assumptions.

b) The excess of either the actual net sales proceeds or the open market valuation over the theoretical sales price calculated above, is to be divided equally between ATC and Aurit i.e. the payment due to Aurit is equal to half the excess. Aurit will not be liable in the event of a balancing charge arising though this will obviously give rise to a revision of the theoretical sales price generated above.

c) [This identified the Salford and Phase 9 properties]

> I would be grateful if you could draft the Option Agreements as soon as possible and submit them to me to review before passing to [Ashursts]. We will be completing these transactions by the end of this week and in the light of the trouble we have experienced in completing option agreements after the purchase of the property on previous transactions it is imperative that these agreements are agreed in advance on this occasion, hence the urgency."

On receiving those instructions, Mr Beales decided he needed some drafting assistance from Mr Airs of Slaughters' tax department; and he sent him a note on 24 July 1985, asking for "× help - urgent, urgent, urgent." The division of labour between them was that Mr Beales was going to draft what he called the option part of the agreement and Mr Airs was going to draft the schedule. The former was to set out the circumstances in which Aurit would become entitled to a payment, including the exercise by it of an election to require a payment to be made; the latter was to deal with how the payment was to be calculated.

By 24 July, Mr Beales had done his part of the task and he so informed Mr Hunter Gordon by a fax of that date. Mr Airs had not yet drafted the schedule. Mr Beales' first draft of the option provisions failed to give effect to Mr Hunter Gordon's instructions. Mr Hunter Gordon had made it clear that Aurit was not to be entitled to an option to call for the grant to it of a subordinate interest in the property and had also made clear what it was to be entitled to. Nevertheless, Mr Beales' draft purported to give Aurit an option to call for a lease. He had presumably worked rather too slavishly from the option agreement which Aurit had used on previous transactions and had not read Mr Hunter Gordon's instructions with proper care.

Mr Beales' draft was sent to Mr Hunter Gordon. He went through it clause by clause, marking most of them with ticks and/or question marks. His tickets signified that he agreed with the clause or had found nothing incorrect in it. Mr Hunter Gordon is not a lawyer, but he at least had the benefit of such legal skills as are to be derived from the challenges of Part 2 of the Cambridge Law Tripos. In addition, he is, if I may say so, plainly someone of the highest intelligence and ability; and he has also had to review many lease agreements in his time. On 25 July, and having completed his review of Mr Beales' draft, he telephoned Mr Airs (Mr Beales was apparently not available) to inform him that Aurit did not want an option of the type which Mr Beales had drafted. Mr Airs said he would send him what he had done the following morning, when Slaughters would also do any necessary re–drafting.

By 29 July, the combined efforts of Mr Beales and Mr Airs of Slaughters had produced a draft whose provisions broadly reflected Aurit's instructions. The scheme was that there was to be a ten year "Call Period" commencing on the fifth anniversary of the agreement. The draft provided for two circumstances in which Aurit was to be entitled to payment of 50% of the super–profit. The first did not involve any actual disposal of the property and was dealt with in clause 2, which provided that:

> "× Aurit may at any time during the Call Period require the Covenantor [ATC] to pay to Aurit one half of the amount (if any) by which the Open Market Value of the Property exceeds the Hypothetical Value on the date on which such payment is made."

The second, covered by clause 4, arose in the event of an intended disposal of the property by ATC during the call period, but prior to any exercise by Aurit of its clause 2 election. Clause 4 read:

> "IF at any time or times during the Call Period prior to notice being given by Aurit in accordance with Clause 2 above the Covenantor wishes to dispose of the whole of its estate or interest in the Property to a bona fide third party purchaser at an arm's length value and gives notice thereof to Aurit accompanied by a true copy of the contract or by heads of terms of the proposed disposal agreed with such third party containing all material terms the Covenantor shall pay to Aurit a sum calculated in accordance with that Clause."

Clause 5 provided for a reference to an arbitrator to fix the open market value of the property if it had not been agreed within five days of Aurit's clause 2 notice. The clause 2 "Hypothetical Value" was defined as the sum produced by the calculation set out in the schedule, para.2 of which defined it as:

> "× the sum which if received by the Covenantor on the date upon which payment of the sum due in accordance with Clause 2 of the Agreement is made would ensure that the dual rate of return as calculated under the London Business School Programme received by the Owner from the Investment (as illustrated in the Example Cash Flow) exceeds by 6 per cent the Cost of Funds.
>
> The Hypothetical Value will be calculated in accordance with the Principles and Assumptions set out in paragraph 3 and 4 below."

Paras.3 and 4 then set out those principles and assumptions, whose operation included the debiting and crediting to a cash flow of various classes of payments made and received by ATC, and which formed part of the exercise necessary for the determination of the hypothetical value. Assumption 4(f) provided:

> "that (subject to paragraph 3(o) above) no balancing charge will be incurred by the Owner by reason of receipt of the Premium ×"

That reference to a "Premium" was unhelpful, since it was nowhere defined. Para.4(f) had simply been lifted unthinkingly by Slaughters from the equivalent paragraph in the standard option agreement - and nor was Aurit going to be paying anything to ATC. But, taking the draft as a whole, I interpret para.4(f) as intending to mean that it was to be assumed that no balancing charge would be incurred on an actual disposal of the property in consideration of

the hypothetical value. Its intention was to ensure that balancing charges were left out of account in the calculation of Aurit's 50%, which is what had been agreed.

Para.3(o) provided that:

> "(o) the Tax Rate for the Accounting Period of the Covenantor in which the payment required by Clause 2 of the Agreement is made shall be taken to be determined by the rates last set before the date of exercise by Act of Parliament (and, if appropriate, resolution of the House of Commons) and there shall be deemed thereafter to be no change in the law or practice relating to Allowances or otherwise affecting the taxation of companies that has retrospective effect"

There was also a proviso to the para.4 assumptions which read:

> "PROVIDED THAT if any of the Assumptions change or prove to be incorrect, save where and to the extent that it would not have changed or proved to be incorrect had each and all of the Principles proved to be correct as a matter of fact, the provisions of this paragraph 4 will be taken to be modified accordingly"

The draft raises an important, but imprecisely answered, question, namely: what did clause 2 mean by "the Property"? As the incurring of a balancing charge could only be avoided by disposing of a subordinate interest in the property vested in ATC, it might be thought that it would be consistent with that to provide that, in the case of a clause 2 election, the property interest whose open market and hypothetical values then fell to be determined ought to be a subordinate interest in the property vested in ATC. Different considerations might perhaps apply in the case of an intended actual disposal of the type referred to in clause 4, since ATC might conceivably (although improbably) in fact want to dispose of the entire interest in the property, i.e. the "relevant interest". Curiously, clause 4 in fact expressly contemplates a disposal <u>only</u> of the relevant interest - the one type of disposal which ATC was least likely to want to make, since to do so would immediately cause the incurring of a balancing charge.

In fact, neither this draft nor any of its successors defined the clause 2 "Property" as meaning merely a subordinate interest. This draft did provide for a definition of "the Property", but it was still in blank at this stage and there was nothing in the draft which suggested that its author intended the definition to refer to a merely subordinate interest. However, even if it is interpreted as implicitly referring to, or as capable of including, ATC's entire interest in the property – or the "relevant interest" – it is accepted by Aurit that this first draft did give effect to the essence of its bargain with ATC, at any rate so far as concerns the intended exclusion of balancing charges from the calculation of the hypothetical value on the exercise of a clause 2 election. This is because even if (i) "the Property" contemplated by clause 2 was the "relevant interest" in it rather than merely a subordinate interest and (ii) an <u>actual</u> disposal of such an interest would trigger a balancing charge, nevertheless (iii) para.4(f) imposed an assumption that no such charge was to be regarded as being incurred on

(as I interpret it) such a disposal. This assumption had the effect of reducing the hypothetical value and so increasing the 50% share of the super–profit to which Aurit was to be entitled on the exercise of its option. I add that I do not consider that the proviso to para.4 would have had the effect of pre–ordaining an adverse modification of that particular assumption: I cannot see how that assumption, which was deliberately imposed for the purposes of calculating the hypothetical value on a clause 2 election, was one which was capable of changing or proving to be incorrect within the meaning of the proviso. Slaughters presumably did not think so either: and, if they were wrong about that, then their draft would have failed to give proper effect to this central part of Aurit's instructions.

I should add that Mr Mitchell submitted that if, following a clause 2 election, ATC were subsequently to effect an actual disposal of the property under which it incurred a balancing charge, then the effect of the proviso would be to require a re–running of the cash flow in a manner which would require the hypothetical value to be re–calculated by bringing the balancing charge into account: with the result that Aurit would have to make a repayment to ATC. I do not accept that that is the correct construction of the proviso. The subsequent actual disposal of the property would not, in my view, be an event which resulted in the prior operation of the para.4(f) assumption either changing or proving to be incorrect within the meaning of the proviso. It would be a separate and unrelated event, which had nothing to do with the earlier operation of the assumption.

I have largely confined my comments above to a clause 2 election. I do not propose to discuss what the balancing charge position might be in the case where Aurit's right to a payment were to arise pursuant to a clause 4 notice. This initial draft was one which had obviously been produced in a considerable hurry; it was still very much a first draft; and it did not begin to spell out how the agreement was intended to work in all the various circumstances which might be foreseeable as arising. It did, of course, subsequently undergo considerable amendment.

At the end of July, Slaughters sent copies of their draft to Mr Hurndall of Ashursts. It appears to have been sent in two tranches, with two copies of the option part being delivered on 29 July and a copy of the schedule being provided on 30 July.

There was no immediate progress. In early August, Mr Hurndall spoke to Mr Sack of Aurit and told him that ATC was under pressure to complete the acquisitions of the two properties and that ATC considered it more important to get on with that than to divert its attentions to the draft agreement. Mr Sack agreed to this, albeit with reluctance. Mr Hurndall explained all this to Mr Airs on 9 August.

By October, ATC had acquired both the properties. On 14 October, Mr Sack wrote to Mr Wightman asking him now to turn his attentions to the draft option agreement. Nothing immediate resulted from that; and it also appears that Aurit was exerting pressure directly on Mr Hurndall to apply himself to the draft. Aurit's frustration is apparent from Mr Sack's letter of 10 December to Mr Wightman. He wrote:

> "Kit [Mr Hunter Gordon] and I have been put on the rack and severely tortured for not having put our Option Agreements in place. Gerald, I feel I am now rather embarrassed and need your help in sorting Anthony Hurndall out. I have left countless messages for him over the last few weeks none of which have been responded to and although I loathe wasting your time, I am now left with no choice. Could you please exercise some gentle persuasion - you know the kind you are so well known for!'

There was no reply. Relations between ATC and Aurit appear, however, to have remained good. On 12 December, Mr Sack wrote to Mr Wightman, introducing another property investment to him. He wrote:

> "In the event that you wish to go ahead, MGL [Morgan Grenfell Laurie] would be retained at a fee of 1%, and we would proceed on the basis of the standard Aurit fee and participation agreement with you."

Mr Wightman wrote a courteous reply on 16 December, saying that ATC would prefer to "await a more tax efficient opportunity."

On 7 March 1986, Mr Hurndall wrote to Mr Sack, saying that he was returning Slaughters' draft with his amendments to Mr Edge. His covering letter explained that Ashursts' tax department was considering the draft and his amendments. He explained that the latter fell into two main areas: (i) to extend the draft to cover both Salford and Phase 9; and (ii) to base the calculations on actual rather than notional figures.

Mr Hurndall's amendments were extensive, but it is not necessary to detail them. The most important ones were that he deleted paras.3(o) and 4(f) in the schedule, and proposed a new para.3(n) (drafted as "Rider 4"), which provided that:

> "(n) at the date the Hypothetical Value is to be determined there shall be debited to the Cash Flow the amount of any balancing charges that are or will be made as a result of any disposal of the Properties that has taken place at that time or that could be made as a result of any disposal at that or a subsequent time."

Mr Hunter Gordon was provided with a copy of the amended draft. He went through it with care. He struck out Rider 4 and wrote "Stet!" against the deleted para.4(f). He was concerned that the amendments involved a departure from the original bargain; and, on 24 April, he wrote to Mr Edge, saying:

> "I am enclosing a copy of the original correspondence between ATC and our subsequent telex to them which forms the basis of the Agreement as to the terms of the Option Agreement. These should be incorporated in the Option Agreements that [Ashursts] have sent you.

> However, from the drafts we have seen, there appears to be a considerable amount of changes and we would appreciate meeting soon in order to discuss these changes and get a revised draft round to Ashursts as soon as possible.
>
> ×"

On 9 May 1986, Mr Russell Jacobs, an assistant solicitor in Slaughters' tax department, took over the case from Mr Airs, although he was acting formally under the supervision of Mr Edge. Mr Jacobs had done his articles with Slaughters and was admitted as a solicitor in September 1985. He had then joined Slaughters' tax department, where he had spent three months of his articles. He had spent most of his time since September 1985 working under the supervision of Mr Edge; and had worked on at least two leasing transactions.

In fact, from then on Mr Jacobs handled the case almost alone, with little assistance from anyone else at Slaughters. He received none from Mr Edge, who exercised no material supervision over him at all in connection with the transaction. All that happened was that Mr Jacobs would copy Mr Edge in on redrafts and correspondence, an exercise which, by itself, was necessarily of limited value. Mr Jacobs said that Mr Edge's task was to make "macro comments - commercial or sort of big picture points which would emerge from the draft." It appears that Mr Edge never made any points about the drafts at all, whether macro or micro; nor could Mr Jacobs recall any discussions with him about the transaction. He agreed that, if there had been any, they would have been recorded on Slaughters' timesheets, but none is.

Mr Jacobs did, however, receive limited assistance from Slaughters' property department. That was necessary because he said that it was "beyond [his] technical remit to make property comments" and so on those matters he deferred to the expertise of Mr Beales and, later, Mr White, leaving the consideration of the option part of the draft to them. They, in turn, left the schedule to him. No–one at Slaughters appears to have assumed responsibility at any stage for overseeing the two halves of the document as a whole with a view to assessing whether they fitted together and worked.

It seems likely that Mr Jacobs would have been handed Mr Hunter Gordon's letter of 24 April, but Mr Jacobs said it had not made its way onto the file and he could not recall having seen it, although he agreed that it would have been surprising if it had not been shown to him. There is no dispute that Slaughters received that letter, because they disclosed it on discovery. Mr Jacobs said his first recollection of the case was making a telephone call to Aurit with a view to attending a meeting at its offices. In fact, the first recorded evidence of his involvement is a discussion on 9 May with Mr Airs, which Mr Jacobs thought was probably the occasion when the case was explained and handed over to him. He then spent some 90 minutes reading through the papers and draft option agreement. It is not clear what papers were by then in the tax department's file, but Mr Jacobs did not suggest that copies of the July 1985 exchanges between Aurit and ATC (copies of which had been enclosed with

the letter of 24 April) were not in it or that he would not have read them; but nor was he able to say with any confidence that they were on the file and that he did read them. The thrust of his evidence was that he took Slaughters' initial draft as the reference point for Aurit's instructions; and then focused on Mr Hurndall's amendments with a view to identifying their effect.

After he had read the papers, Mr Jacobs had a meeting on the same day with Mr Hunter Gordon and Mr Alistair Briggs at Aurit's offices. Mr Briggs was a chartered accountant by training and had joined Aurit in 1986. Aurit's intention was that he would in due course take over from Mr Hunter Gordon the day–to–day running of the business. He later became a director of Aurit and Mr Hunter Gordon agreed in evidence that, by the autumn of 1986, Mr Briggs's status at Aurit was equivalent to that of a director. Mr Briggs did not give evidence. He left Aurit in 1992 and was abroad at the time of the trial.

At the meeting on 9 May, the three of them went through Mr Hurndall's amendments. Mr Hunter Gordon could not recall any discussion specifically about Rider 4 or para.4(f). Before the meeting, Mr Jacobs had written in pencil under Rider 4 "? surely within control of ATC"; and, during the meeting, he wrote "stet" inn blue against the deleted para.4(f).

The effect of Rider 4 was that a balancing charge <u>would</u> be brought into account on the calculation of the hypothetical value following a clause 2 election, since it refers to "any balancing charges ... that could be made as a result of any disposal [of the Properties] at that ... time". The reference to "the Property" in clause 2 had by then been amended to be a reference to "the Properties", which were now defined as Salford and Phase 9; and, on the face of it, that reference meant – or at least included – ATC's entire interest in those properties, i.e. the "relevant interest" in them. A disposal of "the Properties" (or either of them) as so defined would inevitably mean that a balancing charge would be incurred: such a charge would only be avoided if a subordinate interest in them was disposed of.

Mr Jacobs said in evidence that it would have been obvious to him that Rider 4 had the effect of causing a balancing charge to be incurred. Whether it was so obvious to him is seriously in contention in this case. I consider that his own note against Rider 4 suggests that it was not so obvious. It suggests he was focusing only – or at least primarily – on an actual transaction and that he had in mind that ATC could avoid a balancing charge by (as I infer) disposing of a subordinate interest. He was not, however, apparently focusing on the position which would arise on the occasion of the exercise by Aurit of its clause 2 election, when there would be no actual disposal – but the effect of Rider 4 would be to require to be brought into account the balancing charge which would be incurred on an actual disposal of the property as defined. Mr Jacobs' note gives rise to the inference that he had missed the main point about Rider 4.

Mr Jacobs sought to meet that point in his evidence by suggesting that, even though Rider 4 would inevitably have caused a balancing charge to be brought into account, its

adverse effect on the calculation of Aurit's commission could subsequently be cancelled out by a re–running of the cash flow. I do not understand how he could have understood that that could have been achieved under the draft in its then state. The notional disposal contemplated by Rider 4 required a balancing charge to be debited; if there was no mistake in the making of the debit or in its amount, then that was the end of the matter; and, as it seems to me, nothing in the then draft would have entitled Aurit to have it subsequently re–opened.

Mr Jacobs in fact gave somewhat inconsistent evidence as to whether he understood at the time that Rider 4 would inevitably require a balancing charge to be brought into account following a clause 2 election. Moreover, he agreed that the point about Rider 4 on which Aurit expressed concern to him was not that it would mean that a balancing charge would inevitably have to be brought into account; but rather that it did or might have the consequence that a subsequent (i.e. post calculation date) change in the law would or might retrospectively require such a charge to be brought into account even though the state of the law as at the calculation date would not have done. The premise of this concern was that Aurit did <u>not</u> understand that Rider 4 would anyway result in a balancing charge being brought into account on the calculation date. Mr Jacobs also agreed that, as at May 1986, he understood that Aurit wanted the benefit of the clause 2 option in order to crystallise its participation; and, in this context, there was this exchange in his cross–examination:

> Q. ... You understood that on the basis of the original agreement, that calculation was to be done without attracting a balancing charge?
>
> A. In the circumstances specified, yes, which were quite narrow. I mean assumption 4(f) I think it was quite a narrow assumption referring merely to the lack of balancing charge as a result of receiving what I think was then defined as the premium and then turned into the hypothetical value. But it was a reference to no balancing charge being incurred were Allied to dispose of a lesser interest by granting or selling the lease subject to a premium. In other words, it was the reference to the initial model agreement with ... Aurit taking out Allied's position with an intermediate lease, sublease, and the receipt of that premium would not, in itself, trigger a balancing charge."

That was an interesting answer, for two reasons. First, Mr Jacobs was referring to Slaughters' first draft of the option agreement, submitted to Ashursts in July 1985. But his claimed interpretation of its para.4(f) was wrong. That draft was not directed at the actual or notional disposal of a subordinate interest in the property, since it made no attempt to confine the property interest which was the subject of any actual or notional disposal to a merely subordinate interest in the property. Secondly, Mr Jacobs' mistake in interpreting that draft as if it related to the actual or notional disposal of a subordinate interest is exactly the same mistake as Aurit claims it made with regard to the interpretation of all the drafts, and also with regard to the form of agreement as eventually executed. The explanation for that claimed mistake is, of course, that Aurit knew perfectly well that balancing charges could

only be avoided on a disposal of a subordinate interest, and it therefore assumed that the agreements were so drafted as to make clear that the hypothetical value related to that of a subordinate interest. It was this mistake which caused Aurit to assume that the only potential vice in Rider 4 was the change in the law point: it claims it did not understand that, if left in the agreement, it would inevitably remove the essence of its bargain with ATC.

This is the problem which, it seems to me, is at the heart of this case and is the source of all the difficulties which have arisen: namely, the way in which the main body of the option agreement defined the property interest which was to be the subject of the actual or notional disposal. Mr Jacobs said that he understood perfectly well that the whole commercial value of Aurit's option was that it should entitle it to a commission calculation which would not bring a balancing charge into account. He admits he understood the concept of a "relevant interest" and how the incurring of a balancing charge could be mitigated by disposing of a subordinate interest. He knew, as I find, that the only way to achieve such a mitigation was to ensure that the interest being actually or notionally disposed of on the occasion of the calculation of Aurit's entitlement was only a subordinate interest, and not the relevant interest. Yet, from the beginning to end, none of the draft agreements ever related to anything other than an actual or notional disposal of ATC's whole interest in the properties – a disposal which would inevitably require a balancing charge to be brought into account in the calculation of Aurit's commission.

The meeting of 9 May was followed on 19 May by a meeting between the same three people and Mr Hurndall, at Ashursts' offices. Mr Hunter Gordon had no recollection of the discussion of specific matters. He did, however, conclude from the meeting that Mr Hurndall was inexperienced in transactions of this sort and was proposing meaningless and inappropriate amendments to the schedule; and some manuscript remarks indorsed by Mr Hunter Gordon and Mr Sack on a telex which Mr Hurndall sent Mr Jacobs on 20 May reflect that they had by then formed a low opinion of Mr Hurndall. Mr Jacobs also said that Mr Hurndall was "at sea with the technicalities and some of the nomenclature of the London Business School programme."

Mr Jacobs claims to recall that meeting and says that he, and also Aurit, properly understood that Rider 4 effectively destroyed at a stroke the whole essence of the commercial bargain which Aurit had made and to which it still wished to adhere. Yet he had not struck Rider 4 through; and nor does he have any recollection of anyone at the meeting, himself included, actually making that point. I find that that point was not made, either by Aurit or by Mr Jacobs; and I find that it was not made for the reason that it was one which had not occurred either to Aurit or to Mr Jacobs. As I have said, Aurit's only point of concern about Rider 4 was the restrospectivity point – not the point that it was inevitably destined to remove the heart of its bargain. The latter point had simply not been spotted. If it had been, then the retrospectivity point would have paled into insignificance since the Aurit team would have seen that there was first a far more fundamental battle to fight. The reason Mr

Jacobs did not spot the point is because, like his clients, he wrongly assumed that the provisions in the schedule were all geared to actual or notional disposals of subordinate interests. He made this assumption because he knew that it was essential that it should be so geared and he did not give proper consideration to the draft agreement as a whole – in particular, he did not give proper consideration to its option part, which he regarded as the exclusive province of Slaughters' property department and thus beyond his area of expertise. He simply assumed that if the property department had done that part of the draft, then it must be all right. Having seen Mr Jacobs at some length giving evidence, I have no hesitation at all in rejecting his assertion that he and his clients understood the full potential impact of Rider 4, evidence which I found to be unconvincing, inconsistent and incredible. The only concern Aurit had, and expressed, about Rider 4 was its potential for retrospectivity. Its concern about that point was such that it decided to go back to Mr Wightman with a view to re–establishing the applicable principles.

The main discussion to that end took place in May during a conference telephone call which Mr Hunter Gordon and Mr Sack had with Mr Wightman. There is no suggestion that Mr Wightman either then, or had at any stage, intended that balancing charges should automatically be brought into account in the calculation of the hypothetical value. Mr Hunter Gordon says that Mr Wightman expressed two particular concerns about balancing charges and that their substance was: (i) that if ATC in fact suffered a balancing charge on an actual disposal, this should be taken into account; and (ii) that if under the law in force when Aurit exercised its option a disposal of a subordinate interest would have attracted a balancing charge, then a like charge should also be taken into account. Mr Hunter Gordon says he and Mr Sack agreed to this. It thus became of the essence of their agreement that the calculation of Aurit's commission should reflect, as closely as possible, ATC's actual or notional tax saving. Mr Hunter Gordon says they also agreed that any changes in the law <u>after</u> the exercise of the option should not have retrospective effect. Those discussions reflected what, Mr Hunter Gordon says, was implicit in the understanding of both ATC and Aurit – namely, that they only had in mind an actual or notional disposal of a lesser, or subordinate, interest in the property, since if the "relevant interest" were to be disposed of they both knew that a balancing charge would be incurred.

Mr Sack did not give oral evidence – I was told he was abroad – but a hearsay statement from him was put in evidence, and he too says that Mr Wightman agreed "that balancing charges would only be taken into account if and to the extent that they were actually incurred by Allied or would have been on a hypothetical disposal." Mr Sack was not involved in the detailed negotiations of the option agreement: he was only involved in chasing up the transaction when its progress seemed slow. He says he was not later told by anyone at Aurit or Slaughters that in fact balancing charges were to be taken into account in all circumstances.

Mr Hunter Gordon made no note of this conversation with Mr Wightman, but he communicated the agreed principles to Mr Jacobs so that he could incorporate them into a re–draft. Mr Jacobs then worked on a re–draft. On 29 May, he sent a copy of it to Mr Hunter Gordon for approval. His covering letter refers to the recent discussion with Mr Wightman. He wrote:

> "Following our telephone conversation yesterday afternoon, I enclose for your prior approval a marked–up copy of the amended option agreement which I hope, reflects the outcome of our fruitful meeting with [Ashursts] and your later conversation with ATC.
>
> I look forward to receiving any comments you have on the document before I send it out to Anthony Hurndall, who, I trust, is 'fully' aware of the discussions between ATC and Aurit."

On 5 June, Mr Jacobs sent Mr Hurndall his revised draft. His covering letter explained that it reflected the outcome of the meeting with Mr Hurndall on 19 May and the more recent discussions between Aurit and ATC. Mr Jacobs provided a copy to Mr Hunter Gordon on the same day.

This draft deleted Rider 4 and reinstated para.4(f), which by now read:

> "(f) that (subject to paragraph 3(o) above) no balancing charge will be incurred by ATC by reason of receipt of the Hypothetical Value"

Para.3(o) was still in essentially the same terms. A new para.6 was added to the schedule. I will not quote it, but it provided a gloss on para.4(f) which was intended to reflect the balancing charge discussions between Mr Hunter Gordon and Mr Wightman. The substance of it was, inter alia, that if at the time of the exercise of the Aurit option the law then in force would cause a balancing charge to be incurred on an actual disposal of the property, then the cash flow would be adjusted so as to bring such a charge into account in calculating the hypothetical value; otherwise it would not. Whether or not such an adjustment was to be required was to depend on the opinion of a leading firm of City solicitors or of leading tax counsel. It is plain that Mr Hunter Gordon had in mind that the disposal to which such experts would be required to turn their attentions was a disposal of "an interest less than the relevant interest", and he wrote those words by way of his own amendment to the draft Mr Jacobs had sent him on 29 May. Mr Hunter Gordon discussed that amendment with Mr Jacobs before the latter finalised the draft he sent to Ashursts. Mr Hunter Gordon's amendment was not, however, adopted precisely by Mr Jacobs. Mr Jacobs' draft of para.6 refers to the interest being disposed of for the purposes of the chosen expert's opinion as being:

> "... the relevant Property (less the relevant interest in respect of such Property, 'relevant interest' bearing the meaning attributed to it in Part 1 of Chapter 1 of the Capital Allowances Act 1968) ..."

Mr Jacobs got this part of para.6 hopelessly wrong. He had, in effect, again made the "relevant interest" the key one, whereas – as Mr Hunter Gordon's draft amendment had made plain – he ought to have been referring to a subordinate interest. It was known by everyone at that stage, including Mr Jacobs, that a disposal of the relevant interest would trigger a balancing charge. The only uncertainty was whether, at the time of the option exercise, the law might by then have changed so that the disposal of a subordinate interest might also trigger one. If it had, then para.6 was intended to ensure that it was brought into account in the calculation of the hypothetical value.

Mr Jacobs agreed in evidence that, at that point in the negotiations, Aurit's instructions to him were clear; and that they were that it expected the calculation of its commission on the exercise of the option to be on a basis which left balancing charges out of account. Leaving aside the confusion caused by Mr Jacobs' drafting of para.6 (which was anyway not destined to enjoy a long life), the revised draft achieved this result. Rider 4 had been deleted; and, even though the draft still only contemplated actual or notional disposals of the entire, or relevant, interest in the property, this did not matter since para.4(f) had been reinstated and imposed an assumption that no balancing charge was to be treated as incurred in calculating the hypothetical value. Mr Wightman's particular concerns, and Aurit's retrospectivity concerns, were met by para.6 (or would have been if it had been properly drafted).

The transmission of that draft to Mr Hurndall in June was followed by another long pause. There was no prompt response and so Mr Jacobs telephoned Mr Hurndall on 23 July to enquire as to progress. He followed that conversation with a letter on 24 July, saying that he looked forward to Mr Hurndall's comments and that:

> "My understanding is that both our respective clients are anxious to conclude this transaction."

There was still no prompt response and so, on 2 September, Mr Jacobs sent Mr Hurndall a reminder, saying that he and his clients were willing to attend a meeting if Mr Hurndall thought it would be useful. He sent Mr Hunter Gordon a copy of his letter, with a compliments slip advising him to "Have faith – it can move mountains; even in Gillingham."

Mr Hurndall replied on 4 September, saying that a meeting might be useful, but that "the immediate points are probably best dealt with any amendments to your revised draft Agreement, which is in hand." Later that month, Mr Hurndall did suggest a meeting and one was arranged for 23 September at Ashursts' offices. On 16 September, Mr Jacobs sent a memorandum to Mr Beales saying:

> "Hurndall wishes to meet with us to discuss, for a second time, the terms of the Option Agreement, a copy of the latest draft of which I attach. I also attach a copy of the original draft which, I assume, you sent out to Ashurst, with Hurndall's comments noted on it. [Mr Hunter Gordon], Alistair Briggs and myself did have a meeting with Anthony Hurndall back in June [in fact it was May] to try and overcome the conceptual problems displayed by his comments on the original draft. After some pressure being put on ATC by Aurit, I think (or at least hope) that Hurndall will not try and re–write the deal as originally agreed between Aurit and ATC when the latter purchased the property. ...
>
> Do you think it might be an idea if [Mr Hunter Gordon] were to attend the meeting so that we can settle the 'commercial points' all at once and be left with drafting points. It would certainly speed things along and remove this nagging doubt that I have that, rather like the last meeting in June, the meeting next week will bring up all the old problems and merely delay things much longer?"

On 17 September, Mr Jacobs telexed Mr Hurndall, saying that:

> " ... it would be very helpful if, before the meeting, you could let me have a mark–up of the draft option agreement and therefore give me an idea whether any commercial (as opposed to drafting) points are likely to be raised, in which event I think it would be helpful if Kit Hunter Gordon were to attend so that any points left outstanding at the end of the meeting can be dealt with solely between lawyers."

On 22 September, Mr Jacobs had a 45 minute telephone conversation with Mr Hurndall, in which he discussed the draft agreement, but there is no note of what aspects were discussed. Mr Jacobs agreed that Mr Hurndall did not suggest that the meeting was to be devoted to a major contractual renegotiation.

The meeting with Mr Hurndall took place on 23 September. It was attended by Mr Jacobs, Mr Beales, Mr Hunter Gordon and Mr Briggs. It lasted five hours. The only part of the draft which was discussed in detail was, I find, the option part: the schedule had not been reached by the time the meeting closed, and was not discussed in any sort of detail. There is no evidence that there was any discussion about balancing charges. It was left for Mr Hurndall to produce his proposed amendments to the schedule. That the schedule was not the subject of detailed discussion at the meeting is shown by the extent of the amendments marked on the drafts which the Aurit team used at it and by an exchange of letters between Mr Jacobs and Mr Hurndall. Mr Jacobs wrote on 24 September that:

> " ... I look forward to receiving your thoughts on the Schedule ... as soon as possible. As discussed, David Beales will be amending the main body of the Agreement to reflect the agreement reached at the meeting and, when you return the amended Schedule, we will produce a revised draft."

That produced a prompt response from Mr Hurndall on 26 September, in which he said that:

> "I am puzzled by your reference to David Beales amending the main body of the Agreement. This was not discussed. The amendments were specifically made to the document, and agreed, as we went through the meeting and those amendments, together with my further comments on the balance of the document, which we did not discuss at the meeting, and which I was to amend and return, namely the principles, assumptions and adjustments, will all be returned to you when I have finalised my drafting."

On 6 October, Mr Hurndall sent his promised amendments to Mr Jacobs and to Mr Hunter Gordon. He said in his covering letter:

> "I enclose a copy of the Agreement, with some typed amendments. Except where asterisked, the typed amendments are in accordance with the amendments agreed at our last meeting ...
>
> The amendments to the schedules are there essentially to bring into place the principles agreed at our meeting in May and I have sought to embody them in the form of (a) principles, (b) assumptions and (c) adjustments, as [Mr Hunter Gordon and Mr Briggs] requested. As most of the schedule was left for me to amend, I have not asterisked all the amendments here."

It was this draft which included the provision that was destined to lead to this litigation. Mr Hurndall introduced a new "Principle" in a new para.3(d)(v), which he identified with an asterisk. It read:

> "(d) the following amounts are to be debited to the Cash Flow on the respective dates set out below: ...
>
> (v) Any balancing charges occurring prior to the Calculation Date or that result from any disposal of the Property or which would result from any disposal of the Property on or before the Calculation Date"

He made no amendment to para.4(f).

Mr Jacobs was on holiday when this draft was received by Slaughters. He read it on 14 October, when he also had a telephone conversation with Mr Hunter Gordon. Mr Hunter Gordon had by then already considered the draft.

From Aurit's point of view the introduction of para.3(d)(v) was an innocuous one <u>if</u> – as Aurit claims it always understood – "any disposal of the Property" meant "any disposal of a subordinate interest in the Property", such a disposal being the only one which, under the then law, would avoid the incurring of a balancing charge. On this understanding, and assuming there was no change in the law by the calculation date, a disposal of a subordinate interest would not trigger a balancing charge and none would be brought into account in calculating Aurit's commission. If, however, by then the law had changed so that such a

disposal would result in a balancing charge, Aurit had agreed with ATC that such a charge would be brought into account in the calculation. On Aurit's claimed interpretation of "any disposal of the Property", para.3(d)(v) appeared to give proper effect to its agreement with ATC. I will call this interpretation of para.3(d)(v) "the Aurit interpretation".

If, however, contrary to Aurit's claimed understanding, "any disposal of the Property" meant, or was capable of meaning, "any disposal of ATC's entire interest in the Property" – i.e. "any disposal of the relevant interest" – then, as the law stood in 1986, it was inevitable that a disposal of such an interest would trigger a balancing charge; and para.3(d)(v) made equally inevitable that such a charge would be brought into account in calculating the hypothetical value, so reducing the difference between that value and the open market value, and so in turn reducing Aurit's commission. On this interpretation, Aurit could, for example, exercise its option in Year 6 and find that it was confined to enjoying the limited benefit (if any) of a commission calculated after bringing a balancing charge into account; and ATC could then dispose of a subordinate interest in the property in Year 7 to a third party and so realise and retain the whole of the super–profit for itself.

It appears to me to be clear that, contrary to Aurit's claimed understanding, the latter interpretation is the correct one. The only type of property interest that this draft, like its successors, appears to have had in mind was the entirety of ATC's interest in the properties: it was not drafted so as to provide that the disposal contemplated by para.3(d)(v) was to be of only a subordinate interest in the property. Thus, the effect of para.3(d)(v), read by itself, was to render inevitable that a balancing charge would have to be brought into account in calculating the hypothetical value on the exercise of Aurit's election. In fact, as Mr Hurndall's draft left para.4(f) unamended, he had introduced an inconsistency between that provision and para.3(d)(v) – with the former imposing an assumption that no balancing charge was to be incurred and the latter imposing a principle that it was. However, that inconsistency was spotted by Aurit and was later resolved by an amendment which made para.4(f) expressly subject to para.3(d)(v).

There is no dispute between the parties that the latter interpretation of the effect of para.3(d)(v) is the correct one. What is in dispute is whether Mr Jacobs and/or Aurit so understood it at the time; or whether they misunderstood it as bearing the Aurit interpretation.

Mr Hurndall had clearly flagged up that para.3(d)(v) was a brand new provision; and, at the meeting of 23 September, the discussion had not got as far as the schedule. It was therefore a crucial, and wholly unheralded, amendment which (i) went to the heart of the commercial bargain which Aurit had made and (ii) had not, so far as Mr Jacobs was aware, been the subject of any negotiation with ACT. If Mr Jacobs had understood that the reference to "any disposal of the Property" in para.3(d)(v) meant, in the context of the draft agreement as a whole – or could mean – "any disposal of the relevant interest in the Property", he ought to have seen that para.3(d)(v) purported to re–write the bargain in a material way and was one which required firm and prompt treatment on Aurit's behalf. The

state of his then instructions was such that he ought to have seen that it would be wholly unacceptable to Aurit and he ought to have marked it up as a provision to which he could not agree without obtaining Aurit's express, and fully informed, instructions.

Mr Jacobs went through Mr Hurndall's draft with apparent care. He read it on 14 October and again on 20 October. At some stage (it is uncertain when – and it may be that it was at the meeting of 22 October, to which I shall come), he made various markings on it. Against para.3(d)(v), he wrote "O/S what has been agreed", a note which at some stage he crossed out. Despite its similarity with the previous Rider 4, which he claims he understood would require a balancing charge to be brought into account – and which he knew Aurit had not agreed to – he made no note against para.3(d)(v) that it must come out, nor did he delete it. What he did do was to note down a proposed manuscript amendment to it whose substantive effect was to put beyond doubt the earlier concerns about possible retrospective changes in the law, his proposed amendment reading:

> "(v) Any balancing charges arising in respect of or that result from any disposal of the Property on or before the Calculation Date (had such disposal occurred) arising under the law and published Inland Revenue Practice prevailing at that time"

He also proposed an amendment to para.4(f), so as to make it subject to para.3(d)(v): that point was drawn to his attention by Mr Briggs. At some stage he also struck out para.6 as now being no longer required in the light of Mr Hurndall's amendments: its substance was now dealt with by para.3(d)(v), or would be if his proposed amendments to it were agreed.

Mr Jacobs' proposed amendments to para.3(d)(v) reflect an apparent concern to make clear that it was the law and practice as at the calculation date which should govern whether or not any balancing charges should be brought into account. That concern invites an inference that he did not understand that para.3(d)(v) had the much more fundamental potential that it would inevitably cause a balancing charge to be brought into account: if he had understood this, his amendments would have been pointless.

Mr Hurndall's amendments were also considered by Mr Briggs and by Mr Hunter Gordon, although Mr Hunter Gordon's attentions were at the time distracted by another major matter and he was not able to give the draft the close attention he had given to its predecessors. The amendments were also considered by Mr Simon Barratt. He and Mr Hunter Gordon had met at Cambridge. Mr Barratt came down from Cambridge in 1980, whereafter he qualified as a solicitor, doing his articles with Herbert Smith and then remaining with them as an assistance solicitor for three years. He had joined Aurit in October 1986. He was, therefore, new to the transaction, although he had been told something about it the previous June when he had spent a week with Aurit. He was asked in cross–examination whether at that stage (October 1986) he was aware of the important distinction between a disposal of the entire interest and a disposal of a subordinate interest.

He said he did not think he would have been. He did not think he had seen the July 1985 correspondence. Nor could he recall having by then been told of Mr Hunter Gordon's conversation with Mr Wightman the previous May. He disclaimed any specialist knowledge of the law relating to balancing charges in connection with property transactions such as this. His evidence showed that, at that stage, he understood very little about the transaction.

There are in evidence copies of the draft bearing the various comments made by Mr Briggs, Mr Barratt and Mr Hunter Gordon. Mr Briggs clearly read para.3(d)(v), since he made various underlinings in it. He noticed that para.4(f) – which was only expressed to be "subject to paragraph 3(o)" – should probably also be expressed to be subject to para.3(d)(v) and he wrote "? 3(d)(v)" above para.4(f) on his copy. That was a correct drafting point for him to raise. If, however, it had occurred to him that para.3(d)(v) rendered certain that a balancing charge would be brought into account on the exercise by Aurit of its option, it is at least quite likely that he would have noted this on his copy of the draft: he was not slow to make comments against other provisions in it. His comments on the draft were consistent with the view that, for reasons I have given, he regarded para.3(d)(v) as bearing the Aurit interpretation and so innocuous from Aurit's viewpoint.

Mr Barratt wrote against para.3(d)(v) "law prevailing at the time". By that he plainly meant that, whether any such balancing charges would arise must be determined by reference to the law prevailing at the calculation date – and words to this effect were eventually included in the final form of para.3(d)(v). It may be that it was this suggestion by Mr Barratt which led to Mr Jacobs marking up his own draft in the way I have mentioned. Mr Barratt's note was consistent with an intention on his part to avoid the retrospectivity problem which had been regarded as the vice of Rider 4. It was also consistent with the Aurit interpretation: as I have said, there would be no point in tinkering with para.3(d)(v) in this modest way if it was known it would render inevitable that a balancing charge would be brought into account on the calculation date and if that is what Aurit understood and intended.

Mr Hunter Gordon amended para.4(f) so that it was also expressed to be subject to para.3(e)(v) [sic], but he did not suggest he in fact intended to refer to para.3(d)(v). He could recall no discussion with anyone at Slaughters as to whether para.3(d)(v) was acceptable. Mr Barratt could recall no conversation with Mr Hunter Gordon or with Mr Briggs specifically about para.3(d)(v) or para.5 – a new paragraph, to which I shall come – or about the definition of "the Property" in the draft.

I should mention at this stage an unsatisfactory piece of documentary evidence on which Mr Mitchell placed some reliance. That is one half of a torn Ashursts compliments slip, whose precise genesis is uncertain but which was apparently at some stage stapled to a copy of Mr Hurndall's letter of 26 September. It reads, in Mr Sack's manuscript, "Kit [Mr Hunter Gordon] – Shit!!", below which Mr Hunter Gordon has written:

"I agree be ...

leave it th ..."

the remainder of Mr Hunter Gordon's observations being on the other, now lost, half of the slip. Mr Hunter Gordon could not recall or explain how the slip came to be torn, or by whom or when, nor could he say what the rest of his comments had been. It was suggested in cross–examination that the remarks reflected Aurit's fury that when Mr Hurndall re–drafted the schedule (a matter he said he was doing in the letter of 26 September) he would re–raise the balancing charge issue. Mr Hunter Gordon denied that, because by 26 September Mr Hurndall had not yet produced his amendments to the schedule so that it would have been premature for him to be expressing frustration about it. Nor had the schedule been discussed in any detail – if at all – on 23 September; and there is no suggestion that balancing charges were then discussed. Whilst it is unsatisfactory that half of the compliments slip is missing, I feel unable, in deciding the issues which are before me, to derive any help from the scrap of it which remains.

On 20 October, Mr Jacobs spoke to Mr Briggs on the telephone and arranged a meeting for 22 October. Mr Briggs and Mr Barratt then had a meeting with Mr Jacobs at Slaughters on that day, when they discussed Mr Hurndall's amendments. Mr Barratt had with him a copy of Mr Hurndall's draft, bearing all the various markings, comments and suggested amendments which had been made by himself, Mr Briggs and Mr Hunter Gordon. They went through Mr Hurndall's revised draft.

Mr Barratt could not recall any discussion about para.3(d)(v) or its interaction with para. 5 at the meeting. He could not recall Mr Jacobs asking him what had been agreed about para.3(d)(v). However, at some stage he appears to have put a pencil line through that sub–para., which he later erased. He could not explain how, when or why he did either of these things, save that he did suggest that the pencil deletion of para.3(d)(v) probably happened during this meeting. After this meeting, Mr Barratt had no further involvement in the negotiation of the terms of the agreement.

Mr Jacobs suggested that para.3(d)(v) probably was discussed at the meeting, including in particular Mr Barratt's point that it should be geared to the "law prevailing at the time". He also suggested, at least initially, that what was or may have been discussed was the interaction between para.3(d)(v) and para.6. He sad that his interpretation of Mr Hurndall's draft and the interaction between paras.3(d)(v) and 6 was that:

> "... what Mr Hurndall was trying to do was to take account of a balancing charge notionally on an actual or theoretical disposal and then ..., having taken into account a balancing charge assumed to have been incurred, you would, once Allied's position was actually known, and it could be some years down the line, you would retrospectively adjust the cash flow to reflect reality and you would be limited there to the law that you could take into account on that calculation by reference to the law and published practice then prevailing."

That interpretation is one which I find difficult to understand; but I anyway find that Mr Jacobs did not have it in mind at the time. I do not propose to quote para.6 in the rather confused form in which it then stood following Mr Hurndall's amendments, but I can see nothing in it which could justify Mr Jacobs' claimed understanding of it. Mr Jacobs eventually accepted in evidence that para.6(a) was in fact probably inconsistent with para.3(d)(v); and para.6 anyway did not survive beyond 20 November, although para.3(d)(v) did. I find that Mr Jacobs' theory as to the suggested interaction between paras.3(d)(v) and 6 was not considered by him at the time, let alone discussed at the meeting of 22 October. If he had understood the true effect of para.3(d)(v), he would have understood that a balancing charge would inevitably be brought into account on the calculation date and that nothing in para. 6 would have entitled Aurit to a subsequent re–running of the cash flow so as to exclude the charge from the calculation.

Mr Jacobs' further explanation in evidence was that what he and Aurit understood at the meeting of 22 October was that, even though para.6 might not be in point, para.5 was. Para.5, or an amended version of it, did survive into the final form of the agreement, and it is worth quoting part of its form in October 1986 to see what Mr Jacobs says he and Aurit then had in mind. Para.5 was headed "Further Cash Flows" and sub–para.(a) read:

> "5. (a) Where any matter or fact that has been claimed notified stated or assumed or any sum that is to be credited or debited for the purposes of any of the Principles falling within any paragraph of paragraph 3(d) or (e) or (i) or (l) or (n) or (o) or (p) and 3(e)(ii) and (v) other than 3(d)(ii) and (iii) above and/or Assumptions referred to in paragraph 4 above subsequently changes or proves to be incorrect or differs from actuality then ATC shall notify Aurit that such change has occurred or that it reasonably believes that such Principle(s) or Assumption(s) or matter or fact has proved or is likely to prove incorrect or different from actuality. Aurit shall then forthwith prepare a Further Cash Flow which shall take account of such change(s) with effect from the date of such change and the Hypothetical Value shall be calculated in accordance with such Cash Flow (as amended) and any sums then paid shall be adjusted accordingly and any further appropriate payment or repayment to be made within 14 days with interest thereafter at the default rate."

Mr Jacobs' evidence was that the supposed interaction between paras.3(d)(v) and 5 meant that, even though Aurit would initially suffer the incurring of a balancing charge on the calculation date, it could hope to recoup the full benefit of its intended bargain by the running of a further cash flow under para.5 at some uncertain later stage. It could do so if, for example, years later ATC disposed of a subordinate interest in the property by a transaction which did not trigger a balancing charge. He admits that this is not what Aurit had agreed to, and he accepts that its instructions down to as recently as 23 September were that it wanted to enjoy the immediate benefit of a commission payment whose calculation left balancing charges out of account. But he says that Mr Briggs and Mr Barratt fully understood the effect of Mr Hurndall's amendment by 22 October; and that Aurit

subsequently agreed to and accepted it. He cannot, however, point to a particular time when Aurit did agree to make that concession. He thought that the "O/S what has been agreed" may well have been written by him at the meeting of 22 October; and he agreed that one possibility was that it reflected that Mr Briggs was to go back to Mr Hunter Gordon and obtain his views about the introduction of para.3(d)(v).

This suggested relationship between paras.3(d)(v) and 5 is not one which appears to have been remembered by Mr Jacobs at the time he prepared his witness statement. The only mention of para.5 which he makes in it is in para.40, in relation to an amendment he made to the draft in March 1987. He there said:

> "40. Having sent out the further draft to Mr Hunter Gordon on 25 March 1987, I took instructions from him over the telephone on 27 March, amending the draft to tie in Principle 3(d)(v) with clause 5(a), which provided for the preparation of a further cash flow if, inter alia, the Principles differed from the Assumptions in the Agreement when the Plaintiff's commission came to be calculated."

The March 1987 drafting amendment in fact introduced nothing new: para.5(a), as amended by Mr Hurndall in October 1986, was already tied into para.3(d)(v). Mr Jacobs, however, nowhere makes the point in his witness statement that the alleged concession by Aurit over para.3(d)(v) was merely a timing point and that para.5 gave it the hope, at some uncertain future date – perhaps years later – of enjoying the benefit of which para.3(d)(v) was inevitably destined to deprive it on the calculation date. This suggested role of para.5 has, however, as a result of a late pleading amendment in 1998, become a central part of Slaughters' case; and it became a central, but wholly unheralded, part of Mr Jacobs' oral evidence. The timing is worth noting: Mr Jacobs' witness statement was dated 8 June 1998; the proposed pleading amendment raising the para.5 point was first produced, in draft, on 12 August 1998; and it was formally served on 10 November 1998.

The first observation I make about the suggested interaction between para.3(d)(v) and 5(a) is that, in my judgment, the point is incorrect. Save that it might subsequently appear that the balancing charge imposed by para.3(d)(v) had been incorrectly calculated – an event which might perhaps justify a further cash flow under the "proves to be incorrect" part of para.5(a) – I do not accept that para.5 could justify the running of a further cash flow which required the original balancing charge to be ignored. On the occasion of a clause 2 election, para.3(d)(v) deems a balancing charge to be incurred. That is a hypothetical event, since there is no actual disposal. It is, moreover, a hypothetical event which is incapable of subsequently changing; and nor can I see how it can prove to be different from actuality. A subsequent – balancing charge free – disposal by ATC of a subordinate interest would no doubt be an "actuality", but it would not justify a conclusion that the prior hypothetical event had proved to be different from that actuality. The two events are different and unrelated. One is a hypothetical disposal of the relevant interest; the other is an actual disposal of a

subordinate interest. The balancing charge deeming which para.3(d)(v) imposed was – mistakes apart – irreversible. In my judgment, para.5, in its then form, did not have the meaning that Mr Jacobs now seeks to attach to it and which he claims he and Aurit understood at the time. Nor did it in any of its later versions. I should add that I recognise that the phrase "differs from actuality" in para.5(a) might perhaps at least enable it to be argued that the the balancing charge required to imposed by para.3(d)(v) should be ignored in a further cash flow run immediately after the first one. I do not, however, regard that as a correct interpretation of the effect of the phrase in the context of para.5(a) as a whole; and the "differs" was soon to be amended to "different" – which, in my view, and again interpreting para. (5) as a whole, made the argument an impossible one. I shall later set out para.5(a) in its amended form.

Secondly, and more importantly, I have no hesitation in finding that at no stage during the negotiations did Mr Jacobs ever construe para.5 as being related to para.3(d)(v) in the way he now suggests. Not only did I find Mr Jacobs' evidence about this confused and unconvincing, he himself (as I shall explain) was later to propose an amendment to para.5 which was fundamentally inconsistent with the interpretation he now seeks to attach to it – an amendment which invites the inference that it had not yet occurred to him.

I find that the suggested interaction between paras.3(d)(v) and 5 was not mentioned by Mr Jacobs during the meeting of 22 October or at any stage in the negotiation of the option agreement. I find that Mr Jacobs misunderstood para.3(d)(v) as bearing the Aurit interpretation. On this basis, subject only to removing all doubt about the retrospectivity point – which Mr Jacobs did – the paragraph was regarded by everyone in the Aurit team as innocuous and as giving proper effect to the agreement made with Mr Wightman the previous May. It follows that I find that Mr Jacobs did not explain the true effect of para.3(d)(v) to Mr Briggs and Mr Barratt: he did not do so because he had failed to identify it himself. A further pointer to the conclusion that Mr Jacobs misunderstood para.3(d)(v) is that he proposed an amendment to para.4(f) so as to make it also subject to para.3(d)(v). On the Aurit interpretation of para.3(d)(v), that made sense. On the correct interpretation of it, it was pointless, as Mr Jacobs agreed in evidence. The retention by Mr Hurndall of paras.4(f) and 6 in the draft perhaps suggests that even he did not appreciate the true effect of para.3(d)(v), although I make no finding on that either way.

Resuming the chronology, Mr Jacobs' evidence was that, at the meeting of 22 October, it was left that Mr Briggs would obtain Mr Hunter Gordon's instructions on the acceptability or otherwise of para.3(d)(v). Mr Jacobs had to admit, however, that he did not know if Mr Briggs had done so. All he could say was that, as he at some point crossed out his "O/S what has been agreed", he inferred that, at some uncertain stage, para.3(d)(v) ceased to be an issue as far as Aurit was concerned. Bearing in mind that Mr Jacobs admitted that para.3(d)(v) introduced a "very important, very important change" to the transaction, it is surprising that, in the light of what he claims was Aurit's understanding of the effect of

para.3(d)(v) by the meeting of 22 October, there is no noted record by him of the receipt of subsequent instructions from Aurit as to its attitude to that paragraph.

Following this meeting, Mr Jacobs sent a memorandum to Mr Beales reporting on it, and pointing out seven specific drafting points which had been raised by Aurit. None was directed to the para.3(d)(v) point, and in part they related to points arising under the option part of the draft, which Mr Jacobs regarded as the exclusive province of Mr Beales. Mr Jacobs did, however, finish his memorandum with this paragraph:

> "I have arranged a meeting with Anthony Hurndall for Monday 3rd November at 3pm AMC's offices, primarily with a view to discussing points of principle still outstanding of the schedule. If you feel happy that the points you need to make on the main body of the deed can be discussed with Anthony Hurndall over the telephone, then it might be worthwhile for the meeting on the 3rd merely to discuss the schedule; experience and intuition tells me that, by the time we get round to page 6 of the agreement tempers have already frayed, rendering meaningful discussion worthless! I shall, unless you tell me otherwise, let Hurndall know that we (i.e. Aurit and myself) only intend to discuss the schedule. At least then, we might get past page 7. Having been through the schedule with Aurit, our overwhelming impression is that Hurndall is still attempting to re–write the transaction and the commercial points already agreed between Aurit and ATC."

On 29 October, Mr Jacobs sent a fax to Mr Hurndall confirming the meeting fixed for 3 November. He wrote that:

> "... As you are aware David Beales is dealing separately with the main body of the Agreement and will be commenting on your redraft as soon as possible."

He raised two specific points (immaterial for present purposes – and not relating to para.3(d)(v)) which he wanted Mr Hurndall to consider; and he finished by saying:

> "I think it is important to resolve these preliminary points so that we can, on Monday, sort out the outstanding conceptual and drafting issues."

In the event, the meeting was postponed to 14 November. On 3 November, Mr Jacobs telexed Mr Hurndall saying:

> "... You may feel that, if we are to settle all of the outstanding points of substance, it might be more productive to have someone from ATC present at the meeting."

On 4 November, Russell Smith of ATC wrote to Mr Sack, saying:

> "... I understand the draft has been with you for some time – that a meeting arranged to progress the matter yesterday was necessarily postponed by yourselves and that a meeting is now to be held on 14th November. From my understanding of the matter

> it should be possible to finalise outstandings at that meeting and I have urged Ashursts to do all they can to try and bring things to a satisfactory conclusion."

On 6 November, Mr Hurndall wrote a rather impatient letter to Mr Jacobs. Its essence is that he was concerned at Mr Jacobs' suggestion that there was likely to be an extended meeting about "outstanding points of substance", since he regarded the substance as having already been agreed.

On 7 November, Mr Sack replied to Mr Smith saying:

> "... I very much look forward to resolving the option agreements, and do not really want to get in to correspondence about Ashursts response. Suffice it to say, I would like to talk to you about it all face to face one day!
>
> At the meeting scheduled for the 14 November at Ashursts' offices, it would be very helpful if either yourself or Gerald [Wightman] were present to finally resolve this matter."

The meeting fixed for 14 November was further postponed and took place on 20 November at Ashursts' offices. Only Mr Hurndall was there on behalf of ATC. On Aurit's side it was attended by Mr Jacobs, Mr Hunter Gordon and Mr Briggs. Mr Hunter Gordon believed that he remembered the meeting but had no recollection of what was said at it. Mr Jacobs said he had not received any express instructions on para.3(d)(v) from Aurit prior to the meeting. Although he claims that he understood that it introduced a fundamental change to the transaction, being a change of which Aurit was fully aware, he says he went into the meeting not knowing what Aurit's attitude to the amendment was. His evidence was that Aurit conceded the point during this meeting, although he could not remember the meeting. He could not remember being surprised that Mr Hunter Gordon, whose instructions to Slaughters as to what he had agreed had been unbending and unambiguous, should now have agreed to concede the point. He said it was anyway really a timing point rather than one of fundamental commercial importance, a reference to the adjustments which he claimed would be permitted by para.5. He admitted that he had not advised Mr Hunter Gordon about para.3(d)(v).

The schedule was agreed at the meeting, although later some further amendments were made to it.

Mr Hunter Gordon's evidence is that Aurit was wholly ignorant of the true effect of para.3(d)(v), that it was at no stage advised of it and that, if it had been so advised, it would not have agreed to para.3(d)(v). He claims that he believed that it would only have an adverse impact if the law had so changed by the time of the option exercise that a balancing charge would arise on the disposal of a subordinate interest in the property. That is what he had agreed with ATC back in May. He says that he assumed – wrongly, as he now accepts – that para.3(d)(v) was geared to a notional disposal of a subordinate interest in the property,

not to a disposal of the relevant interest. He says he continued so to misunderstand the true effect of the agreement.

Mr Jacobs sent a note to Mr White (of Slaughters' property department) on 22 November to tell him that agreement had been reached. Mr White had been introduced to the transaction earlier in the month. Mr Jacobs told him that ATC was also proposing to invest in another IBA property introduced by Aurit, and that it was intended to incorporate a like commission arrangement in relation to that property into the proposed agreement. That property was Phase 21, Gillingham Business Park ("Phase 21"). In fact, ATC had acquired that property on 30 September 1986. In this connection, Aurit makes the point that if, by 20 November, it had understood that the form of agreement to which it was proposing to commit itself would inevitably require balancing charges to be added to the hypothetical value calculation, and so remove the heart of the commercial bargain agreed in principle back in July 1985, not only would it not have added a third property to the transaction, it would not have signed an agreement in that form at all.

Mr Jacobs wrote in his note to Mr White:

> "Hopefully, the good news is that, apart from minor drafting points, this will be the end of the matter. The bad news, from what Kit [Hunter Gordon] has said, is that there are more Option Agreements on their way. The important thing from Aurit's point of view is that this Option Agreement never sees the light of day – it represents excessive concessions on their part, both from a commercial and legal/drafting standpoint. A far better precedent is the Hopkinsons Option Agreement.
>
> If you want a word on any of my comments or amendments, please <u>do</u> hesitate to contact me."

Mr Hunter Gordon said that it was correct that Aurit had made major concessions, in particular by agreeing to a share of only 50% of the super–profit over and above ATC's guaranteed return and to give up its usual claim to a call option for a lease. Those concessions were, however, made in July 1985. Afterwards Aurit also made certain further concessions, which Mr Hunter Gordon regarded as minor and of no commercial significance, relating mainly to various tax matters. The thrust of his evidence was that, contrary to the implication of Mr Jacobs' note, Aurit had not made any major concessions since July 1985. Mr Mitchell, of course, placed reliance on that note as referring, inter alia, to Aurit's alleged surrender in the balancing charge battle.

On 26 November, Mr Jacobs sent Mr Hurndall an amended draft of the agreement, incorporating the amendments agreed at the meeting of 20 November. He suggested that, if Mr Hurndall had any points on the option part of the agreement, he should refer them to Mr White. On the same day, he also sent a copy of the amended draft to Mr Briggs. By then, para.3(d)(v) read:

> "(v) any balancing charges arising in respect of or that result from any disposal of the Property or which would result from any disposal of the Property on or before the Calculation Date (had such disposal occurred) and arising under the law or published Inland Revenue practice prevailing at that time, on the relevant Tax Payment Date;"

and para.4(f) now read:

> "(f) that (subject to paragraphs 3(o) and 3(d)(v) no balancing charge will be incurred by ATC by reason of the receipt of the Hypothetical Value."

The schedule no longer included para.6. But it did still include an amended para.5, headed "Further Cash Flows". Para. 5 now read:

> "5(a) Where any matter or fact (including any sum that is to be credited or debited) that has been assumed claimed notified or stated for the purposes of any of the Principles falling within paragraphs 3(d) (i) (iv) (v) or (vi), (e) (i) (ii) or (iv), (i), (j), (k), (l), (m), (n) or (o) and/or any of the Assumptions referred to in paragraph 4 above subsequently changes or proves to be incorrect or different from actuality, then ATC shall subject as herein provided notify Aurit that such change has occurred or that it reasonably believes that such matter or fact has proved or is likely to prove incorrect. Aurit shall prepare a Further Cash Flow which shall take account of such change(s) with effect from the date of such change and the Hypothetical Value shall be calculated in accordance with such Further Cash Flow (as amended).
>
> (b) For the purposes of the preparation of the Further Cash Flow under sub–paragraph (a) above and the calculation of the Hypothetical Value, all information known to ATC (or to Allied Textiles Companies PLC) (except information which is known by such companies' agents and is not actually known by such companies themselves) and required by Aurit for such purposes shall be supplied to Aurit (where possible) within one month of it becoming known as aforesaid and in any event (insofar as it shall be possible and reasonably practicable) no later than one month after the service of the relevant notice under Clause 2 above."

Mr Hunter Gordon saw this draft and went through it with care, putting ticks against most of its clauses. He underlined the words "which would result ... Date" and "prevailing at that time" in para.3(d)(v), placed three ticks against it and wrote "OK!" to its left and "OK" to its right. He ticked para.4(f). Against the various references in para.5(a), he wrote a "No!" against the reference to para.3(o) and also wrote in the margin "Alistair [Briggs] are these the ones?" He then wrote, at the top of the first page of the draft, "Alistair Please check when you can. I think its OK!! (I don't believe it)".

Mr Briggs did check the draft and sent a post–it note to Mr Hunter Gordon reading "I agree doc is OK (except page 16). I have told [Mr Jacobs] to incorporate Gillingham Phase 21." Page 16 was the one including para. 5(a), which Mr Hunter Gordon had particularly asked Mr Briggs to consider. Mr Hunter Gordon said that he inferred from his annotations on the draft that he would have discussed the schedule as a whole with Mr Briggs and thought that he had done so. He thought that they discussed para.3(d)(v) and that Mr Briggs

explained to him that its purpose was to replace the former para.6, which had by now been deleted. He thought he wrote one of his two para.3(d)(v) "OKs" before speaking to Mr Briggs and one afterwards. He said that the point which he wanted to be sure about was that "any disposal" referred to in para.3(d)(v) was one occurring on or before, but not after, the calculation date: only then could the applicable law or Revenue practice be ascertained as at that date. He was not sure whether he wrote the "No!" against the para.3(o) reference before or after speaking to Mr Briggs. He thought that the question he was asking Mr Briggs to consider with regard to the para.5 references was "Are these the ones which it is OK to permit to be varied within the cash flow?"

The reason for Mr Hunter Gordon's concern at the suggestion that the para.3(o) principle might be capable of subsequent adjustment was because that was the principle which provided that, after the calculation date, there was to be deemed to be no change in the law or practice relating to allowances or affecting the taxation of companies that had retrospective effect. He had earlier agreed that the law as at the calculation date was to govern whether or not balancing charges should be brought into account: but Aurit and ATC had also agreed that that was, in effect, to be the cut off point; and subsequent changes in the law, including those which had retrospective effect, were to be ignored. The significance of Mr Hunter Gordon's stance on this was that it is an improbable one for him to have taken if he had understood the true effect of para.3(d)(v). If he had understood that it pre–ordained that balancing charges would be brought into account on Aurit's exercise of its option, and he had understood that Aurit had agreed to commit itself to that, then, if anything, the inclusion of para.3(o) in para.5(a) was potentially of benefit rather than of injury: since there was always at least the possibility (however remote) that the law might one day be changed in Aurit's favour, and with effect retrospective to the calculation date. However, his concern about para.5(a)'s reference to para.3(o) is more obviously explained as being because he assumed that, subject to there being no change in the law by the calculation date, no balancing charge would arise: and he wanted to ensure that subsequent retrospective changes in the law did not take that benefit away from Aurit.

It was put to Mr Hunter Gordon in cross–examination that para.3(d)(v) was one of the provisions to which para.5 was capable of applying, being one which he ticked, and that the reason he agreed to this was because he knew that the effect of para.3(d)(v) was that there would inevitably be a debiting of a balancing charge to the cash flow on the calculation date. He denied that and said that the notion that a balancing charge would be so debited:

> "... would fly completely in the face of my entire negotiations with Allied, with the example cash flow, with my negotiations and, as a matter of fact, with my understanding at the time."

Mr Mitchell placed considerable reliance on a document produced at an uncertain date by Mr Briggs, but which was probably prepared in relation to the draft which Mr Jacobs produced following the meeting of 20 November. It was in the nature of a type of sensitivity analysis. Part of it listed a great many of the provisions in the schedule, under the headings "Principles" (including para.3(d)(v)) and "Assumptions" and appears to reflect that Mr Briggs identified some of them

[PAGE 56 MISSING]

various further proposed amendments to it (none material for present purposes) and agreeing to the inclusion of Phase 21. On 17 March, Mr Hunter Gordon wrote to Mr Edge. He regarded the task as having finally been concluded, although the agreement had still not been signed, and he asked him to convey Aurit's gratitude to Mr Jacobs "who has done a superb job on our behalf." He confirmed in evidence that that expression of gratitude was a sincere one.

On 25 March, Mr Jacobs sent Mr Hunter Gordon a further draft of the agreement, into which he had incorporated Mr Hurndall's latest proposed amendments. On the same day, he also provided a copy of the draft to Mr White. He asked Mr White to "check that the property aspects are okay." He also told him that Aurit was happy with the revised draft.

On 27 March, Mr Jacobs spoke to Mr Hunter Gordon and also to Mr Hurndall on the telephone and made some further amendments to the draft. On 1 April, he sent Mr Hunter Gordon and Mr Hurndall copies of the draft as so amended. The amendments he made included amendments to para.5(b) (quoted earlier), being amendments whereby he deleted the words "(where possible)" and "(insofar as it shall be possible and reasonably practicable)". That purported to impose a short time limit on ATC for the provision to Aurit of information requisite for further cash flows. As I have said, it is Mr Jacobs' evidence that he and Aurit understood that para.5 operated as a timing mechanism under which balancing charges brought into account on the calculation date (following the exercise of a clause 2 election) could subsequently be cancelled out, perhaps years later, on an actual disposal of a subordinate interest. Yet here was Mr Jacobs attempting to impose a cut off date for the provision of information for the purposes of further cash flows at the expiry of one month from the service of the clause 2 notice. The amendment was fundamentally inconsistent with what he now claims was the intended effect of para.5, being one which had (on Mr Jacobs' evidence) become of the utmost commercial importance to Aurit. Mr Jacobs made an unimpressive attempt in evidence to defend his proposed amendments but then conceded that they were a mistake. The amendments show that his then understanding of the effect of para.5 was not that for which he now contends. I cannot accept that he could have proposed them if he really regarded para.5 as doing the vital work which he claimed in his evidence he

and Aurit both understood. They were, on his case, fundamentally damaging to Aurit's interests. It is only because Mr Hurndall refused to agree them that para.5 remained in a form which enabled Mr Jacobs to place the reliance on it which he did in his evidence.

On 1 May, Mr Jacobs telexed Mr Hurndall, pressing him to tie the matter up and asserting that the draft was ready to be engrossed. The pressure appeared to have no immediate effect on Mr Hurndall or ATC.

On 15 June 1987, Aurit introduced a third property in Gillingham Business Park to ATC, ("Phase 20"). On that day, Mr Hunter Gordon spoke on the telephone to Mr Wightman about this property and also wrote to him with general information about it. There is no evidence that Slaughters were aware of this introduction at this time; and I find that they were not.

In about May or June 1987, Mr Hurndall left Ashursts to become a partner of Blyth Dutton, solicitors. On 16 June, there were exchanges between Mr Hurndall and Mr Jacobs about the latter's proposed amendments to para.5(b) of the schedule. Mr Hurndall disagreed with them, pointing out that the words in parentheses which Mr Jacobs wanted out had been agreed at the meeting of 20 November 1986; and Mr Hurndall wanted them back in, to which Mr Jacobs agreed. Mr Jacobs counter–proposed, however, that there should be an overall "cap" to that proviso of three months, adding:

> "Please let me know whether this is acceptable to ATC. It is, as you will no doubt agree, in all parties' interests that there comes a time when the parties can say ‘enough is enough' and not be required to produce further cashflows."

I infer that Mr Hurndall did not agree to this and Mr Jacobs does not appear to have pressed for its inclusion: the three months' "cap" does not appear in the final version of the agreement. The inconsistency between Mr Jacobs' counter–proposal and the explanation of para.5 which he now advances requires no further comment.

The agreement was finally signed by Aurit and ATC on 17 July 1987. Example cash flows were annexed to it, which were prepared by Mr Hunter Gordon in May 1987. In preparing them, as he explained in his evidence, he assumed that no balancing charge would be incurred.

I should record the final form of clause 2 and para.5. Clause 2 provided that:

> "2. IN consideration of the assistance of Aurit in identifying the opportunity to invest in the Properties and arranging for ATC to invest in them, ATC agrees that Aurit shall receive in respect of each of the Properties a commission payable in two parts the first part payable on the introduction of the Properties in the sum of 1% of the Purchase Price and the second part calculated and payable in accordance with the following provisions of this Clause:–

(a) if no enforceable contract for any disposal contemplated by sub–clause 2(b) below has been entered into prior to the date of the exercise by Aurit of the option herein contained, Aurit may at any time during the Call Period and in respect of any of the Properties serve written notice on and require ATC to pay to Aurit one half of the amount (if any) by which the Open Market Value of that Property exceeds the Hypothetical Value as at the date one calendar month from date of the service of the notice hereunder ("the Calculation Date").

(b) if at any time or times during the Call Period prior to notice being given by Aurit in accordance with sub–clause (a) above, ATC enters into an enforceable contract which is completed to dispose of the whole of its estate and interest in a Property to a bona fide third party purchaser at arm's length and on bona fide terms and gives written notice thereof to Aurit accompanied by a true copy of the contract and all available information necessary to determine the Hypothetical Value, then ATC shall pay to Aurit a sum equal to one half of the amount (if any) by which the Open Market Value of the Property on the date set for completion under the said contract exceeds the Hypothetical Value at such date. Subject to the provisions of Paragraph 5 of the Schedule the rights and obligations of ATC and Aurit in connection with the said Property shall cease forthwith upon the payment of the said sum following such completion date."

Para. 5 provided that:

"Further Cash Flows

5. (a) Where any matter or fact (including any sum that is to be credited or debited) that has been assumed, deemed, claimed, notified or stated for the purposes of any of (A) the Principles falling within paragraphs 3(d) (i) (iv) or, (e) (i) (ii) or (iv), (i), (j), (k), (l), (m) or (n) and/or (B) the debiting to the Cash Flow of any balancing charges or corporation tax arising under the Principles falling respectively within paragraphs 3(d) (v) and/or (vi) and/or (C) any of the Assumptions referred to in paragraph 4 above subsequently changes or proves to be incorrect or different from actuality, then ATC shall subject as herein provided notify Aurit that such change has occurred or that it reasonably believes that such matter or fact has proved or is likely to prove incorrect or different from actuality. Aurit shall then forthwith prepare a Further Cash Flow which shall take account of such change(s) or matters which are incorrect or different from actuality with effect from the date of such change or matter and the Hypothetical Value shall be calculated in accordance with such Further Cash Flow (as amended) and any sums then paid shall be adjusted accordingly and the appropriate payment or repayment shall be made with interest thereafter at a rate equal to the Cost of Funds.

(b) For the purposes of the preparation of the Further Cash Flow under sub–paragraph (a) above and the calculation of the Hypothetical Value, all information known to ATC (or to Allied Textile Companies Public Limited Company (except information which is known by such companies' agents and is not actually known by such companies themselves) and required by Aurit

> for such purposes shall be supplied to Aurit within one month of it becoming known as aforesaid and in any event (insofar as it shall be possible and reasonably practicable) no later than one month after the service of the relevant notice under Clause 2 above."

On 11 August, Mr Hunter Gordon wrote to Mr Jacobs, saying:

> "Amen! and many thanks for your patience and perservance [sic] throughout the entire performance!
>
> Best regards to the new family."

Subsequent events

At some stage, ATC acquired Phase 20. On 20 April 1988, Mr Hunter Gordon proposed to Mr Wightman that Aurit's commission entitlement in respect of that introduction should be dealt with by way of an addendum to the July 1987 agreement, applying its terms also to Phase 20. He enclosed a proposed draft, which dealt with the matter succinctly in one page. Mr Wightman replied on 29 April 1988 agreeing to this and saying that he had forwarded the draft to Mr Nisse of Ashursts with instructions to incorporate it with the original documentation.

On 27 October 1988, a further investment opportunity at Gillingham was proposed to ATC by Mr Barratt, who finished his letter with the proposal that:

> "If you are interested we would be paid our normal 1% fee and have the usual option arrangements in respect of the transaction."

I interpret this to be a reference to the arrangements which already applied to Salford and Phases 9, 20 and 21. In the event, ATC did not take up this proposal.

The Salford sale

In December 1991, ATC sold a subordinate interest in Salford for £590,000. On 18 December, Mr Hunter Gordon wrote to Mr Wightman and claimed a profit participation under the July 1987 agreement. Completion of the sale was due on 23 December and Mr Hunter Gordon wrote that it would be necessary "to calculate the Hypothetical Value on 23rd December 1991 in accordance with the [1987] Agreement so as to establish what (if any) sum is equal to half of the excess of £590,000 over this figure." This involved obtaining information from ATC which could then be put into the computer model so that a cash flow could be produced and the hypothetical value ascertained. Mr Hunter Gordon's letter indicated that he had not seen Mr Wightman for several years and that this was the first contact he had had with him for some considerable time. Mr Wightman replied with a friendly letter of 3 January 1992 in general terms, but indicating that the requisite information needed by Mr Hunter Gordon could be obtained.

Mr Hunter Gordon produced a cash flow and sent it to Mr Wightman on 14 January, with certain accompanying explanations. His calculations produced an open market value figure of £578,610 and a hypothetical value figure of £433,090.19. Aurit's claimed entitlement was 50% of the difference, £72,759.91. The cash flow did not bring any balancing charge into account, and none was or would have been incurred by ATC on the disposal of the subordinate interest.

Mr Wightman responded on 20 January, with a less friendly letter. He set out two pages of argument as to why no payment was due to Aurit. It appears from Mr Wightman's letter that, when he wrote it, he had not reminded himself of the terms of the July 1987 agreement, upon which he said he could not "immediately put [his] hand". It is unnecessary to detail Mr Wightman's arguments. They did not include an argument to the effect that a balancing charge should be brought into account.

Mr Barratt took up the cudgels on behalf of Aurit, replying to Mr Wightman on 24 January. He had done some re–calculations and now claimed that the amount due to Aurit was £55,058.49. This apparently led to Mr Wightman telling Mr Hunter Gordon that he considered that the option agreement did not reflect the terms which had been originally agreed, to which Mr Barratt responded on 31 January, saying:

> "I attach a copy of a letter which you wrote to [Mr Hunter Gordon] dated 12 July 1985, and a copy of a telex which [Mr Hunter Gordon] sent to you on 17 July 1985. [Mr Hunter Gordon] and I have read the correspondence carefully and believe that it is very clear from it that both you and he were talking about the same thing – namely, that Aurit's participation would be 50% of the excess of the actual net sales proceeds realised over the theoretical sale price – and that this carried into effect by the option agreement. Indeed, I cannot see any area which is raised in these two documents which has not subsequently been included in the option agreement which was finalised.
>
> On this basis, I can see no argument against the option agreement being the document which governs Aurit's participation."

In a reply to that, on 19 February, Mr Wightman said this:

> "I obviously have copies of the July 1985 telex and letter in my files and these only seek to strengthen my understanding that it was always the intention that ATC should retain the 100% first year allowances and that Aurit should participate in 50% of the property investment 'and to give the investment some time to appreciate ATC should not dispose of the property within the first 5 years.'"

That interpretation is not one which, in my view, finds support in July 1985 correspondence. Further correspondence was exchanged, which I do not consider it necessary to detail. Eventually, by the end of March, ATC agreed to pay Aurit £30,000 in settlement of its claim, and it duly did so. No claim is made against Slaughters with regard to the commission recoverable in respect of the Salford property.

The exercise of the Phase 9 option

On 19 August 1994, Aurit exercised its option in respect of Phase 9, so triggering the need for a determination of its open market and hypothetical values. Aurit had by then been provided with the information it needed to feed into the computer model with a view to arriving at the latter value, which it claimed was £2,703,189 as at 25 September 1994. It asserted that the open market value was £4.185m. It claimed 50% of the difference, or £740,905.50. The letter was written by Mr Barratt. It attached the London Business School printout, which showed that Aurit did not bring any balancing charges into account in doing the exercise.

Mr Wightman's substantive response came on 7 October. He indicated a disagreement as to the open market value and suggested both sides' valuers should attempt to agree it. He raised a point that no allowance had been made in the calculations for some unrelieved advance corporation tax. He also said in the final paragraph that:

> "The only other matter which concerns me is the tax position on disposal – on the Salford sale we were dealing with a complete transaction but on this occasion we are dealing with a hypothetical situation and therefore can only assume a full tax charge will be payable and deal with the tax issue when ultimately that position has been resolved."

Mr Wightman did not in terms say that he was there referring to the question of the balancing charge, and he could perhaps have been referring to a capital gains tax charge; and Mr Barratt's letter in reply of 11 October appears to show that that is how he interpreted Mr Wightman's letter. However, Mr Barratt said in evidence that, shortly after the letter of 7 October, he had a telephone conversation with Mr Wightman in which the latter told him that he considered that a balancing charge should also be taken into account; and, on 10 November, Mr Wightman wrote that he understood that an arbitrator was about to be appointed to determine the open market value of Phase 9 and that:

> "... I would refer you to my letter of 7 October 1994 and our subsequent telephone conversation and remind you that when we utilise the hypothetical value you will need to take into account the balancing charge and/or capital gains tax charge which may result. I cannot calculate the capital gains tax charge until the open value is known, but I can advise that the balancing charge will be approximately £866,000 and will be payable on 1 July 1995."

The £866,000 represented the tax allowance that was received by ATC on the acquisition of Phase 9. The reference to such sum being payable on 1 July was not a reference to any sum which would in fact then be due, it was a hypothetical payment. If Mr Wightman was right that it fell to be added to the hypothetical value, then, on the figures proposed in Aurit's letter

of 19 August, the further commission claimable would have been dramatically reduced, perhaps extinguished.

Mr Barratt responded to this on the same day. He wrote that:

> "As I said on the telephone, the valuation that we will be having carried out is on the basis that you dispose of a lesser interest than you currently own. (That is, if you own a 125 year leasehold interest, then the interest to be sold would be say 124 years).
>
> On this basis and under the current legislation, there will be no balancing charge. I understand that all the original cashflows were prepared on the basis that no balancing charge becomes due. Indeed, this forms the basis of the calculation of the Hypothetical Value in the Option Agreement, where it is specifically to be assumed that 'no balancing charge will be incurred by ATC by reason of receipt of the Hypothetical Value'.
>
> In the circumstances I am not quite sure of the relevance of the points you raised in your letter."

Coming from a solicitor, as Mr Barratt is, that was a surprising letter. It included a selective quotation from para.4(f) of the schedule. Mr Barratt must have read that paragraph before so quoting it and must have seen that it was expressed to be "subject to paragraphs 3(o) and 3(d)(v) above". A glance at the latter, and a consideration of (as it appears to me) its fairly obvious effect in the context of the agreement as a whole should have told him that Mr Wightman was right.

Mr Wightman stood his ground, replying on 16 November by a letter in which he said:

> "On this occasion the only position is that the property is 'hypothetically sold' at the 'open market price' and that the tax consequences, i.e. a hypothetically [sic] balancing charge, will be incurred and that the hypothetical value is accordingly increased."

Mr Barratt also stood his ground, although he did not attempt to argue it further. He simply said, in a letter of 17 November, that if agreement could not be reached Aurit might have to sue. He asserted that his belief at the time was that the type of disposal which para.3(d)(v) was talking about was the disposal of a lesser, or subordinate, interest in the property. He said that he had understood from the outset – by which he meant when he was first told about the transaction back in June 1986 – that any disposal would be of a lesser interest. It appears Mr Barratt never considered the definition of "the Property" in the option agreement. Mr Hunter Gordon gave similar evidence that he understood para.3(d)(v) to be talking about the disposal of a subordinate interest.

On 22 December, Mr Burling, a valuer who had been appointed as arbitrator to determine the open market value of Phase 9, gave his award. He valued it at £3.3m. At that valuation, the inclusion of a balancing charge in the computation of the hypothetical value

would mean that no further commission at all was payable to Aurit. If no balancing charge was included, commission of over £200,000 would be payable.

The balancing charge dispute remained a live one. On 17 January 1995, Mr Barratt again asked Mr Wightman to agree that "there will be no balancing charge payable on the theoretical disposal, as the agreement states", but Mr Wightman declined to do so. On 2 February, Mr Wightman drew Mr Barratt's attention to para.3(d)(v) of the schedule to the option agreement. Mr Barratt wrote an unimpressive reply on 3 February. He wrote:

> "Whilst there are references in clause 3(d)(v) to a balance [sic] charge, that is clearly on the basis of the law as it stands as at 30th September 1994 and Inland Revenue practice at that date. What is more important are the provisions of clause 4(f) which assumes that there will be no balancing charge. This it seems must be the case, on the basis that it is possible – as you did with Salford – to dispose of the property under current legislation and Inland Revenue practice without incurring a balancing charge, by disposing of a lesser interest."

Taking that at face value, Mr Barratt appears to have had no understanding of the relevant provisions of the option agreement.

On 6 February, Mr Barratt instructed Richard Grandison of Slaughters on three areas of difference which had arisen with ATC, the main one being the balancing charge dispute. He asked him to "set the ball in motion to have these three issues resolved."

What then happened was that Slaughters took the advice of counsel, who advised in March 1995 that the court was likely so to construe the option agreement as requiring a balancing charge to be taken into account. That advice was relayed to Mr Barratt. On 22 March, Miss Hale of Slaughters made a note of a telephone conversation with him in which he had expressed unhappiness with her advice and had made the point that it "conflicts with those which he believes were [Aurit's] instructions to [Slaughters] when the option agreement which is the basis of the present claim was drafted."

Miss Hale referred the matter to Mr Edge. Mr Jacobs had left Slaughters in 1992 to become a partner at Wilde Sapte, and he is now a partner of Cadwalader Wickersham & Taft. Mr Edge gave her his preliminary response on 28 March, which did not really attempt to grapple with the point. It did, however, include this paragraph:

> "The other thing that I thought was quite interesting about the document was that it did not contain a 'whole agreement' clause (at least as far as I could see). [Mr Hunter Gordon] told me that there was clear extrinsic evidence as to the precise deal they had done and I wonder whether we would be able to bring that in."

That was a reference to the July 1985 correspondence. Mr Hunter Gordon's reliance on it was consistent with what he claims has been his understanding, intention and agreement all along. Miss Hale responded to Mr Edge saying that it might be open to Aurit to argue that

any ambiguity in para.3(d)(v) could be resolved by a reference to the correspondence and that:

> "Depending upon the form which ATC's defence takes, we could also seek an order for the rectification of the agreement in any Reply served."

On 7 April 1995, Mr Barratt notified Miss Hale that Mr Hunter Gordon's attempts to settle with ATC had failed and that Aurit would like to sue ATC. In the event, further attempts to persuade ATC to see things Aurit's way were embarked upon, including a further letter from Aurit, incorporating the essence of a draft deriving from Mr Edge. One argument he advanced was based on para.5, although it was quite different from the one which Mr Jacobs claims he had in mind back in 1986 – and, indeed, different from that which Mr Edge sought to support in his own evidence to me. His point was along the lines of the argument to which I earlier briefly referred, namely that para.3(d)(v) would deem a balancing charge to be immediately incurred and would require it to be debited to the cash flow; but that as no such charge had in fact been incurred it would be a charge which "proves ... different from actuality", so that para.5(a) would require an immediate re–running of the cash flow which cancelled the initial debit. With respect, I do not regard that argument as correct; and it is not one which Mr Mitchell sought to support in his argument.

The other main point made in Mr Edge's draft was that:

> "As you may have noted, there is no ‘whole agreement' provision here. It was quite clearly part of the deal between us that any disposal that you made here would be done on the grant of a lesser interest basis if that still worked as a matter of tax law. The fact that that is the case is borne out by the fact that we have made other disposals of other properties on <u>exactly</u> that basis. We believe that we could introduce extrinsic evidence to that effect, claim that the agreement did not record this term and ask for it to be included as part of the contract between us (supported by the practice followed on other properties)."

ATC responded to Aurit's letter on 4 August 1995 with a succinct demolition of the arguments. Following this, Slaughters advised Aurit that they could no longer act for it and that it should obtain advice on the matter from other solicitors. Aurit instructed Berwin Leighton and then in due course launched this action. In the meantime, ATC had remained uncompromising and made no payment to Aurit.

The issues

Aurit's claim against Slaughters is brought solely in tort. It concedes that any claim in contract is time barred. There is no dispute that Slaughters owed Aurit a duty of care at common law in performing its instructions received from Aurit. Its initial instructions were to act for Aurit in preparing and negotiating with Ashursts a formal agreement incorporating

the terms which had been agreed in principle with ATC in July 1985. Those instructions required Slaughters to devote their attention to many aspects of the transaction on Aurit's behalf, few of which are material for present purposes. The one aspect which is relevant was the treatment of balancing charges in calculating the hypothetical value. Aurit's case is that its original instructions (about which there is no dispute) were that these were to be left out of account at the calculation date. Mr Jacobs accepts that those instructions remained essentially unchanged, at any rate down to October 22 1986, the only change being the clarification resulting from the Aurit/ATC discussions in May 1986 which spelt out the circumstances under which it was agreed that balancing charges would be brought into account on the calculation date: namely, if ATC incurred such a charge on an actual disposal; and if, on a notional disposal pursuant to a clause 2 election, ATC would have incurred such a charge on an actual disposal.

The effect of Mr Hurndall's amendments to October 1986 was that, on the exercise of a clause 2 election by Aurit, a balancing charge would inevitably be brought into account on the calculation date. This represented a material change to the commercial bargain. Aurit's case is that it did not understand this; was not advised of it by Mr Jacobs or anyone else at Slaughters; and believed that at no stage had the commercial bargain been changed in this way. It claims that, had it been advised about the change, it would have insisted on the original bargain being adhered to; and it claims that ATC would and could have had little choice but to agree. Had ATC not agreed, Aurit claims that it would not have proceeded further with the proposed formal agreement but would have sued ATC for a quantum meruit. That is the essence of Mr Hunter Gordon's evidence. He of course read all the drafts with care, including para.3(d)(v). His evidence, however, is that he regarded it as innocuous because he interpreted it as being drafted against a backdrop in which the only property interest which was the subject of the type of disposal referred to in it was merely a subordinate interest.

Slaughters does not, I think, contend that Mr Jacobs, or anyone else at Slaughters, ever positively advised Aurit about the true effect of the introduction by Mr Hurndall of para.3(d)(v). Slaughters' case has undergone something of a development in its progress towards trial. Its original pleaded contention was that Aurit conceded the para.3(d)(v) point at the meeting of "22 September 1986", a mistaken reference to that of 23 September 1986. That shot was wide, because the schedule was not discussed at that meeting and para.3(d)(v) was not introduced until October 1986. So Slaughters instead pleaded an amended case that Aurit thereafter conceded the point by 20 November 1986, the date of the next meeting with Mr Hurndall.

Mr Jacobs' evidence is that, by the meeting of 22 October 1986, Mr Briggs and Mr Barratt understood the true effect of para.3(d)(v), and in particular its relationship with para.5, but he concedes that they had not yet agreed to it on behalf of Aurit. His further evidence is that he did not subsequently receive Aurit's express instructions on the point and

that he went into the meeting of 20 November 1986 without knowing what those instructions were. He claims that it was during that meeting that Aurit conceded the point, although he has no recollection of the discussion in which it did so. The point was, he says, anyway only a matter of timing. The commercial consequence was that, on the calculation date, Aurit would receive no commission which reflected any of the saving represented by the enjoyment of the IBA (and so would in practice be lucky to receive any commission at all), but that it might receive some commission later, perhaps years later, when ATC sold a subordinate interest. This was because, so Mr Jacobs claims, the machinery of para.5 would then entitle Aurit to require a further cash flow to be run which would cancel out the earlier debiting of a balancing charge. Remarkably, however, by May 1987, Mr Jacobs was seeking to put a short time limit on the operation of the para.5 machinery which, had it been accepted by Mr Hurndall, would have made his timing point unarguable.

I comment on the evidence. I did not hear evidence from Mr Briggs. I was told that he is no longer employed by Aurit, was out of the country and that Aurit had also taken the view that it did not wish to subpoena him. I have already indicated the basis on which Mr Mitchell submitted that I should infer that Mr Briggs understood the effect of para.3(d)(v); and he made a considerable play of the fact that Mr Briggs was not called as a witness. I have, however, also indicated that I do not feel able to draw the inference about Mr Briggs' supposed understanding which Mr Mitchell invited me to draw. Nor do I consider that I should draw any inferences about Mr Briggs' understanding from the fact that he was not called as a witness. I did not hear any oral evidence from Mr Sack either. He too was out of the country, but at least in his case a hearsay statement was put in evidence.

I did, however, have the benefit of oral evidence from Mr Barratt and Mr Hunter Gordon. The latter's evidence was the more important, since Mr Barratt played only a limited role in connection with the negotiation of the terms of the 1987 agreement. On the other hand, Mr Hunter Gordon was obviously Aurit's directing mind and will throughout its negotiation.

I have already commented that Mr Hunter Gordon is obviously a man of the highest intelligence and ability; and he went through all the drafts with meticulous care. That combination of facts caused me at least some anxiety as to whether I can safely accept his evidence that he did not understand the true effect of para.3(d)(v). My concern was, quite simply, that its true effect in the context of the drafts as a whole is, as it seems to me, tolerably obvious. Did he, therefore, contrary to his evidence, in fact understand it?

I have come to the conclusion – ultimately with no doubt – that I can and should accept Mr Hunter Gordon's evidence. He was in every respect a most impressive witness. He dealt with all that was put to him in a thorough and able cross–examination in a careful, considered and measured way – as well as with great charm and courtesy. Above all, and most important, I have no hesitation in finding him to be a witness of truth. Whilst I have been a little surprised that someone of his ability did not spot the inadequacy of the drafts, I

must not forget that he is not a lawyer. Part 2 of the Cambridge Law Tripos confers on its consumers undoubted benefits which no doubt continue to serve them well. But it does not turn them into practical lawyers who will thereby, and without more, acquire the skills sufficient to act as their own lawyer in the negotiation and interpretation of complicated commercial documentation. Mr Hunter Gordon fully recognised that – which is why he retained the services of a distinguished firm of solicitors to act for Aurit. As an intelligence and interested client, he also brought his own skills to bear on the documents the lawyers produced. Those skills were, however, those of an intelligent layman, not those of a lawyer.

I can well understand how – as I accept he did – Mr Hunter Gordon approached the drafts on the assumption that they must have been talking about subordinate interests, because he knew that dealings in subordinate interests were the only ones that could avoid balancing charges. He claims he did not understand that in fact these drafts were only talking about the "relevant interest". I believe him.

Mr Hunter Gordon's understanding of the agreement is also supported by his subsequent acts. Aurit claimed a commission payment on the Salford sale and did its calculations on the basis that no balancing charge was incurred. This was an actual sale of a subordinate interest, an event which, under the agreement in its final form, in fact gave Aurit no entitlement at all – since, by clause 2(b), and remarkably, Aurit's right was expressed only to arise on a sale of (as I interpret it) the "relevant interest" in Salford. ATC therefore had more than one point it could have run as to why not a penny was payable to Aurit, although it did not take them. None of them appears to have occurred to Aurit; its claim was based on leaving balancing charges out of account; and in due course a compromise payment was agreed and paid. Aurit's actions in this respect were consistent with its claimed understanding of the option agreement. So were its later actions with regard to Phase 9. There, however, the figures were much larger. ATC looked at the position with more care and, perhaps inevitably, took the point that balancing charges had to be brought into account. That appears to have come as a surprise to Aurit, which persisted in the claim that it had agreed that they should be left out of account. Aurit's attitude was not "Oh yes, of course that is what we agreed, but we had forgotten". It was to threaten litigation and to instruct Slaughters to start the ball rolling. At that point, however, Aurit was advised by counsel that ATC was correct. Aurit has, therefore, been consistent throughout.

In Attorney General v. Drummond (1842) Dr & War 353, at 368, Lord St Leonards said "tell me what you have done under such a deed, and I will tell you what that deed means". In so far as that observation ever was, or still is, good law, it relates only to ancient instruments and does not apply to the interpretation of contracts and deeds generally (see generally James Miller & Partners Ltd. v. Whitworth Street Estates (Manchester) Ltd. [1970] A.C. 583 and L. Schuler A.G. v. Wickman Machine Tools Sales Ltd [1974] A.C. 235). Aurit's subsequent actions and assertions are of course irrelevant to the true construction of the 1987 agreement. On the other hand, I do not see why I cannot at least regard Aurit's

post–agreement actions as good corroborative evidence of what it claims it understood to have been the effect of the agreement.

As regards Mr Jacobs' understanding of the matter, I can deal with this shortly since have already made clear my main findings. I regret to have to say that I disbelieve Mr Jacobs in his evidence that he understood the true effect of Rider 4 and, more importantly, para.3(d)(v). His amendments to the latter, his retention of para.4(f) and the course of events as a whole all tend to show that he did not. I also have no hesitation in rejecting his evidence that he and Aurit regarded the commercial essence of the bargain as becoming a timing matter and as depending on the suggested interaction of paras.3(d)(v) and 5. For reasons I have given, I regard para.5 as substantially irrelevant to the balancing charge point; and the possibility of deploying it in Slaughters' defence appears only to have been a late afterthought. If Mr Jacobs really had believed that Aurit's commercial hopes lay in a re–running of cash flows under para.5, perhaps years later, it is in my view obvious that: (a) he would have devoted some effort to re–drafting it so as to spell that out unambiguously, and (b) he would not have attempted to impose the time limit in its operation which he did. The latter point reflects that he regarded para.5 as in the agreement primarily for ATC's benefit rather than for Aurit's. His stance now is that Aurit's commercial bargain was essentially dependent on para.5. Mr Edge also sought in evidence to breathe the type of life into para.5 – "with all its flaws and defects, which are many, I am afraid" – which Mr Jacobs claimed that he and Aurit always fully understood. I was unconvinced by his analysis of it and do not accept it. Para.5 is a provision on which Slaughters have fastened in this litigation as providing them with a justification for Aurit's agreement to sign the option agreement in a form which included para.3(d)(v). I find that it played no part in Aurit's or Slaughters' reasoning at the time.

It follows that I find that Mr Jacobs did not explain the true effect of para.3(d)(v) to Aurit. He did not do so because he too interpreted it against an assumption that it was only referring to subordinate interests. How he could have arrived at such assumption is surprising because, unlike Mr Hunter Gordon, he is a solicitor. But I think it probable that the reason for his error was that he approached the draft on the assumption that the property department had sufficiently brought their own expert skills to bear – skills which he regarded as beyond his own province – and on the basis that anything they had done in the option part of the draft must be what Aurit needed. On that assumption, he regarded his task as confined to dealing with the schedule. The mistake he made was a surprising one and, once identified, appears to have been an obvious one. But that can be said about most mistakes.

I find, therefore, that Aurit misunderstood the true effect of para.3(d)(v) and that it signed the final agreement believing that balancing charges would (subject to the qualifications agreed with Mr Wightman in May 1986) be left out of account on the exercise of a clause 2 election. They did so because Slaughters did not advise them of its true effect.

I find that, in failing to do so, Slaughters were negligent and breached the duty of care they owed Aurit. The reasons for Slaughters' failure were, I find, as follows.

First, it is inherent that if the drafting of the two parts of a document is split between different departments, there is a potential for a mismatch between the two parts. To avoid this, it is essential for someone with a sufficiently general legal experience to have overall responsibility for reviewing the document as a whole with a view to seeing that it works and that it achieves the commercial bargain it was intended to achieve. In this case, it appears that no–one was charged with, or assumed, that responsibility. Mr Edge said that the responsibility was a joint one between the tax and property departments, in particular between Mr Jacobs and Mr White. That is not a particularly satisfactory explanation, because Mr Jacobs disclaimed any property expertise; I presume, although do not know (he did not give evidence), that Mr White would be correspondingly modest about his tax expertise; and anyway it does not appear that the two of them ever got together and discharged this joint responsibility. Secondly, whilst I do not doubt that Mr Jacobs has matured into a lawyer of experience and ability, when he took on this case in May 1986 he was only recently qualified and was still inevitably very inexperienced. The case was quite a complicated one and I regard it as unfortunate that he was left to handle it on his own. The result was that he made a mistake.

Proof by Aurit that Slaughters breached the duty of care does not, however, by itself get Aurit home. It must also prove that it has suffered a loss. In addition, Slaughters have raised other defences which I must consider.

Has Audit suffered any loss?

(i) Para.5 of the schedule

As I have said, by its re–amended Defence, which was served on 11 November 1998, Slaughters raised the para.5 point. I have already indicated its substance – namely, that the initial debiting of a balancing charge on the calculation date will, or is likely to be, cancelled out by subsequent re–runs of the cash flow. For the reasons I have given, I regard the argument as involving a misinterpretation of para.5. I find that the true effect of para.3(d)(v) was that a balancing charge was required to be brought into account on the calculation date in relation to Phase 9. It may be that, if it was subsequently realised that the wrong amount was debited, then that would be capable of being corrected under the "proves to be incorrect" element of para.5(a), although I find it unnecessary to decide this. Otherwise, however, I consider that the debiting of the balancing charge remains irreversible. I reject this defence.

(ii) Rectification

Slaughters' pleaded case is that, if Aurit is right in its arguments, it could and should have sought to have the option agreement rectified. As Slaughters themselves advised Aurit that such a claim was unlikely to succeed, that defence does not overflow with merit,

although that consideration, by itself, is not sufficient to defeat the point if it is otherwise a good one.

In my view, it is a bad one. A claim for rectification against ATC would have been at best a speculative one. ATC's attitude in 1995 was that the agreement meant what is said; and precisely what its intentions were from October 1986 onwards (when Mr Hurndall produced para.3(d)(v)) were and are necessarily unknown. If Aurit were to have any hope of succeeding in a rectification claim, it would have to prove either that ATC made exactly the same sort of mistake as it made itself; or else that ATC understood the true effect of the agreement, but also realised that Aurit was mistaken about it and signed it knowing of the mistake under which Aurit was labouring. To prove a case against ATC on either basis would obviously have been difficult. The case would have been a thoroughly uncertain one. The basic principle is that, whilst a plaintiff must ordinarily take reasonable steps to mitigate his loss, that does not extend to embarking on complicated and difficult litigation against a third party. See Pilkington v. Wood [1953] Ch. 770.

Mr Mitchell referred to Walker v. Geo H. Medlicott & Son (a firm) [1999] 1 All E.R. 685 as assisting his argument that Aurit should have mitigated its loss by suing for rectification. I do not consider that case assists him. There the plaintiff sued the defendant solicitors for, so he claimed, negligently failing so to draft a will as to ensure that he received the benefit he claimed the testatrix intended for him. Following the decision in White v. Jones [1995] A.C. 207, the existence of a duty of care was recognised, but the case failed at first instance on the facts. The Court of Appeal upheld the judge's decision. They also added what I interpret to be a strictly obiter view that the claim ought also to have failed on the ground that, if the plaintiff was right in the allegations he advanced in support of the negligence claim, then "a fortiori he would have had a good claim for rectification of the will": see per Sir Christopher Slade, at p. 697, who went on to say:

> "... in my judgment, notwithstanding the decision in Pilkington v. Wood this is a situation in which, as a general rule, the courts can reasonably expect the plaintiff to mitigate his damage by bringing proceedings for rectification of the will, if available, and to exhaust that remedy before considering bringing proceedings for negligence against the solicitor (for example in relation to costs incurred in the rectification proceedings)."

The special feature of that case which led to that view, as was also made clear in the judgment of Simon Brown L.J., was that if the plaintiff had a claim for damages, he must a fortiori have had a claim for rectification; whereas if he succeeded on the rectification claim, it did not necessarily mean that he had a claim for damages. It was in those special circumstances that the court considered that he ought first to mitigate his loss by suing for rectification. The case was an exceptional one; and it is plain that the Court of Appeal was not casting doubt on the general principle which was recognised in Pilkington v. Wood.

This case is not in the same exceptional class as the Medlicott case. A successful rectification claim against ATC would no doubt have mitigated Aurit's loss. But the advancing of such a claim would have been complicated, difficult, speculative and uncertain. Success in it might well mean that Aurit would then in turn have had a claim for damages against Slaughters (if only for any unrecovered costs). But success in a claim for damages against Slaughters would not mean that Aurit would necessarily succeed in a claim for rectification against ATC. The issues would be substantially, or materially, different.

In my judgment, the Medlicott case is distinguishable from the present one. I consider that Aurit had no duty to mitigate its loss by suing ATC for rectification.

(iii) Would ATC have agreed to re–negotiate para. 3(d)(v)?

Slaughters argue that Aurit suffered no loss because, they claim, Aurit was in a weak bargaining position and ATC was insisting, or would have insisted had the point been expressly raised, upon retaining para.3(d)(v) in the agreement.

As to that argument, since neither Aurit nor Mr Jacobs understood the effect of para.3(d)(v), there was no discussion about its effect with Mr Hurndall or ATC. From Aurit's viewpoint, it was simply left in the agreement by default. Had Aurit been advised of its effect, or spotted it for itself, it would undoubtedly have sought to negotiate an amendment to the agreement and restore the draft to its pre–October 1986 status: that is, so as to give effect to the substance of the treatment of balancing charges which was agreed with Mr Wightman in May 1986. Of course, it is not known with certainty whether ATC would have agreed or disagreed or would have sought to negotiate something different – there is no evidence from them or from Mr Hurndall. I do not, however, consider that the absence of such evidence precludes me from making a finding about this aspect of the matter based on such evidence as is before the court.

As to that, I consider that Aurit's bargaining position was strong. True it is that ATC had, by October 1986, already acquired three of the properties and so had already enjoyed the benefit of the IBAs. It is possible, therefore, that it might have taken the stance that it could decline to negotiate further with Aurit. But that ignores the fact that the only reason it had enjoyed such benefits is because Aurit had introduced the properties to ATC; and that it had introduced them on the faith of the agreement negotiated with ATC in July 1985. The July 1985 exchanges made it clear that part of the essence of the deal was that balancing charges were to be ignored; ATC had only enjoyed the tax benefits which it did because it had agreed to those terms; and so it was under the strongest moral commitment to stick to them. I also accept Mr Hunter Gordon's evidence that, in May 1986, he and Mr Wightman affirmed that (in short) balancing charges were to be left out of account on the calculation date unless the then applicable law required them to brought into account. Further, if ATC wanted any further introductions from Aurit – and one inference is that it did, because Aurit later introduced at least one more property to it – it had every incentive to honour its word.

Moreover, this was a fairly specialised field of activity and I accept Mr Hunter Gordon's evidence that, in the mid 1980s, there were only a few companies such as Aurit which introduced this type of property to clients – he thought that there were only about four others which did so. I accept also that, at that stage, Aurit and ATC had a good working relationship, which both regarded as valuable, and I regard it as improbable that ATC would have wanted to adopt a stance which would have soured that relationship and, almost inevitably, cut off a source of valuable tax saving investment opportunities.

Quite apart from the obviously strong moral commitment which ATC was under to honour the July 1985 terms, Aurit also had a strong case for claiming that, had ATC declined to negotiate further so that no formal agreement was signed, ATC would anyway have been liable to pay a commission to Aurit measured by reference to what was agreed in principle in the July 1985 correspondence. That is not because the July 1985 exchange constituted a binding contract: that is not suggested. It is because, having introduced the properties to ATC on the basis that ATC would reward Aurit by way of commission calculated in accordance with the principles which were then agreed, Aurit would have had a good claim against ATC for the payment of a quantum meruit measure by reference to those principles. It might be that the court could not have finally fixed the quantum had such a claim been brought in, say, 1986 – since Aurit expected no reward for at least five years and the precise figures would depend on future values. But the court could at least have made a declaration as to how the quantum would be assessed, although it might have been a relatively complicated one. Mr Mill relies on Way v. Latilla [1937] 3 All E.R. 759 for the principle that Aurit would have had a good quantum meruit claim; and I accept that it supports his submission: see, in particular, per Lord Atkin, at 763ff, especially at 764BC to 764H.

Against these considerations, I consider that I have to ask myself whether, had Aurit identified the para.3(d)(v) point in, say, October 1986 and asked ATC agreed to amend the draft so as to give effect to the balancing charge principles agreed in May 1986, would ATC have (i) agreed, (ii) refused, or (iii) negotiated some sort of compromise on the point with Aurit. There is of course no evidence from ATC and so I do not know what was going on in Mr Wightman's mind at the time. Nor do I regard it as at all surprising that he has not been called as a witness. I do not, however, regard the absence of evidence from him as precluding me from making a decision on the point.

I have come to the conclusion that the strong probabilities are that, had the para.3(d)(v) point been raised with ATC, it would have agreed to amend the draft so as to give effect to the May 1986 principles. ATC had in the meantime enjoyed the enormous benefits represented by the introduction of the properties and had done so on the faith of its July 1985 and May 1986 agreements with Aurit. It owed Aurit a strong moral obligation. It faced the prospect that, had negotiations broken down, Aurit could and would probably have sued it for like commission on a quantum meruit basis; and it would have been advised that Aurit would have had a strong case in any such action. I accept also that relations between

ATC and Aurit were good, that Aurit represented a source of future valuable investments and that it was in ATC's interests to maintain those good relations.

In these circumstances, I find that, had the para.3(d)(v) point been raised by Aurit, ATC would have agreed to amend the draft. It follows, in my judgment, that Aurit's loss is measured by reference to the commission it has lost, or will lose, by reason of the failure of the agreement as executed to give effect to the balancing charge provisions agreed in July 1985 as affirmed (with modifications) in May 1986.

If that conclusion is wrong, then in the alternative I would have held that Aurit would at least have had a high percentage chance of persuading ATC to agree to amend the draft in the way I have indicated. Slaughters' negligence has deprived it of that chance. Whilst I regard it as difficult to arrive at the right percentage by any process of science, I would fix the percentage chance which Aurit has lost at 75%. On this alternative basis, I would assess its loss at 75% of its claim. See, generally, Allied Maples Group Ltd. V. Simmons & Simmons (a firm) [1995] 1 W.L.R. 1602.

(iv) Contributory negligence

Slaughters pleaded that Aurit was guilty of contributory negligence. The essence of this is that Aurit was a sophisticated operation, which I accept; that Mr Hunter Gordon, who was rightly described by Mr Mitchell as highly skilled, failed to read Mr Hurndall's amendments with sufficient care to notice the true effect of para.3(d)(v); and that neither Mr Barratt nor Mr Briggs instructed Mr Jacobs that para.3(d)(v) was unacceptable – an allegation built on the premise that they had understood its effect.

I reject this defence. Slaughters were retained by Aurit in this transaction because of their specialist knowledge and experience in this area. Their instructions were unambiguous. They were never told that Aurit had agreed or intended to change the essence of the bargain it had made in July 1985. Mr Hunter Gordon and Mr Briggs are not lawyers and cannot be expected to have picked up points which the specialist lawyers at Slaughters failed to pick up. Mr Barratt is a solicitor, but he only came into the transaction at a late stage. It is true that he might have been expected to pick the point up. I cannot, however, regard his failure to do so as constituting contributory negligence on Aurit's part. Slaughters were retained because Aurit wanted their skill and experience in negotiating a potentially complicated agreement. It was Slaughters' duty to pick up the sort of point which has been debated in this trial, to advise Aurit of it and to obtain their instructions. They did not do so and Aurit has suffered loss. I do not regard that loss as having been caused or contributed to by Aurit.

(v) Limitation

Slaughters also pleaded a defence under the Limitation Act 1980. I regard this defence as misconceived and no reliance was ultimately placed on it. Aurit only had the

knowledge necessary for bringing the action when it learnt in 1995 of the true effect of para.3(d)(v). It thereafter brought the action well within the three year period provided for in s.14A(4)(b) of the Limitation Act 1980.

(vi) Quantum

Aurit makes no claim in respect of the Salford property. It of course received £30,000 additional commission in that transaction. I consider it was lucky even to receive that.

It makes a claim for damages in respect of Phase 9. The figure claimed in the re–amended statement of claim is £204,541, of which £203,500 is lost commission and £1,041 represents disbursements (mainly counsel's fees) paid in connection with the obtaining of the advice from Slaughters that ATC's arguments on the construction of the option agreement were likely to be upheld. Slaughters themselves raised no charge for their own time and advice. £203,500 is, to the nearest £, 50% of the difference between (i) a hypothetical net sales proceeds figure for Phase 9 as at 30 September 1994 of £3,231,000 and (b) a hypothetical value at that date of £2,824,246.86. Those figures and calculations assume that no balancing charge was required to be brought into account. They were proved by Mr Barratt and have not been challenged. In the event, the effect of para.3(d)(v) was that no commission was recoverable from ATC.

At the beginning of the trial, Mr Mitchell suggested that, were I to find against Slaughters on liability, there should be an inquiry as to damages, although I did not understand him to persist in that suggestion. I see no reason to direct such an inquiry. Slaughters have had months of notice of Aurit's quantum claim and they have not sought to question or challenge it. Nor has there been a direction for a split trial.

I should record that Aurit claims that it would also have recovered at least £203,500 on any quantum meruit claim against ATC: in fact, it claims that it would have recovered some £34,500 more on that claim, because certain costs concessions were made in the course of the negotiation of the formal agreement. It does not, however, invite the court to regard its quantum meruit claim as worth more than £203,500.

Having regard to the conclusion to which I have come as to the measure of Aurit's loss, I fix the damages recoverable by it for its loss in respect of Phase 9 at £203,500, plus £1,041, i.e. a total of £204,541. In addition, Aurit is entitled to interest at an appropriate rate from the dates of loss and payment respectively of those two items. Mr Mill has already given me a figure for that, but it needs to be updated to the date of judgment.

(vii) Phase 20

Slaughters argue that they owed no duty of care to Aurit in respect of Phase 20. This was not a transaction of which they were aware during the negotiation of the option

agreement. Phase 20 was introduced to ATC in June 1987, and was, in effect, annexed to the option agreement in 1988.

I have found this issue more difficult than most in this case. On the one hand, Slaughters were not being asked to draft a standard form of agreement which was to be applied to future properties: they were negotiating an agreement which was specifically tailored for three particular properties. On the other hand, it must have been foreseeable by them that the option agreement would be, or would be likely to be, or at least might be, used by Aurit and ATC for further like transactions: if it was regarded as serving their purposes for three properties, why should it not also serve their purposes for a fourth and fifth? Slaughters knew that there was and had been a continuing relationship between Aurit and ATC, being one under which Aurit introduced tax sheltering or saving opportunities to ATC. There might of course come a time when Aurit and ATC would want to change their terms of business and would need a new draft, or one which incorporated material changes. But, in principle, I consider that Slaughters could and should have foreseen the likelihood that Aurit would use the option agreement as a draft for other transactions as well.

I hold, therefore, that it was foreseeable that Aurit would, as they did, use the same draft for the purposes of further properties; and they did use it for Phase 20. I find that Slaughters are also answerable to Aurit for any losses flowing from the deficiencies in the draft in so far as it causes Aurit loss on Phase 20.

Result

There will be judgment against Slaughters for £204,541, plus interest, in respect of Phase 9. Aurit also claims an indemnity by Slaughters against any commission losses it may hereafter suffer in respect of Phases 20 and 21. I will make an appropriate declaration. I will hear counsel as to the precise form of relief I should grant.