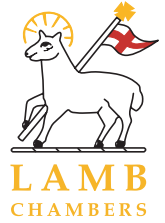


# Law or equity? - A question of construction



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A fascinating conclusion has been reached in yet another branch of the myriad litigation spawned by the collapse of BCCI in 1991. The decision of the House of Lords in *Bank of Credit and Commerce SA v Ali* [2001] 2 WLR 735 (HL(E)) is interesting on the facts of the case, but also has implications for everyone involved in the construction of contracts. It marks the latest stage in a series of cases showing an evolution in the approach of the modern lawyer to contractual interpretation.

This particular dispute first came before Lightman J in 1998. Mr Naeem had been made redundant by the bank in 1990 and in consideration of a payment by the bank, had signed an agreement by which he accepted that payment:

“...in full and final settlement of all or any claims whether under statute, common law, or in equity of whatsoever nature that exist or may exist..., except the [employee’s] rights under the [bank’s] pension scheme.”

The bank went into insolvent liquidation in 1991, and amidst a blaze of publicity, it soon became clear that a large part of its business had been conducted in a corrupt and dishonest manner. Mr Naeem and other employees (one of whom was the Mr Ali in the title of the case) sought to bring claims against the bank for damages arising out of the stigma caused by their association with the bank, and which, they argued, handicapped them in their search for other employment. In separate litigation, the House of Lords ruled that such damages were sustainable in principle. They also argued that they had been induced to work, or continue working, for the bank by various false representations, which again had induced loss. The bank’s liquidators then argued that the claim was barred by the agreement the employees had signed, which was in the wide terms set out above. For the purposes of this litigation, the bank was prepared to proceed on the basis that it (the bank) must be treated as having knowledge at the relevant time that it was involved in a dishonest and corrupt business and that Mr Naeem conversely had no such knowledge. Mr Ali’s case had been compromised by the time the case reached the House of Lords, but Mr. Naeem’s case (representative of others also) proceeded.

Lightman J. at first instance rejected the employee’s claim and held that the substance of the agreement entered into had been the settlement of all possible claims by former employees, whether or not they knew of the facts giving rise to such claims. Moreover, in the case of such a compromise, there was no duty of disclosure on the part of the bank. The general approach of construing the words of a release by reference to the matters in the contemplation of the parties at the time of the release could be rebutted by a contrary intention manifested by the parties. In this case, the judge held that such intention had been manifested by the words “that exist or may exist” which were only apt for such purpose.

The bank thus triumphed, but the employees went to the Court of Appeal. Although the Court of appeal was unanimous in allowing the appeal, each member of the court reached this conclusion by the adoption of very different, and in some cases, conflicting reasoning. Each judge approached the case on the basis that two issues arose for decision. The first was a question of construction. Was the effect of the agreement, on its proper construction, to release the bank from all unidentified claims, including the claim for stigma damages, notwithstanding the fact that the employees, to the knowledge of the employers, were ignorant of the facts founding such a claim? If the answer was “yes”, should equitable principles be applied in circumstances where it would

be unconscionable to allow the bank to take advantage of the employees' ignorance, of which it must have been aware at the time of the agreement?

Sir Richard Scott V.-C. was in no doubt that the construction point had to be resolved in favour of the employees:

"The words used in the general release must be construed by reference to the state of knowledge of the releasor at the time of the release. I find it almost inconceivable that a unilateral general release would ever be construed so as to bar a claim based on facts of which the releasor was unaware. How could it have been his intention to release such a claim?"

However trenchantly expressed, both the other members of the court (Chadwick and Buxton L.JJ.) profoundly disagreed with both this reasoning and conclusion. Chadwick L.J. held that:

"For my part I find it impossible to hold that, as a matter of construction, the employee did not intend the release in the present case to apply to unidentified claims... it seems to me that that was so plainly the purpose of the agreement that no other interpretation is open to the court. ... I find an insuperable illogicality in the proposition that a general release of unidentified claims can extend to some unidentified claims and not to others"

On the second issue, Sir Richard Scott and Chadwick L.J. were at one in concluding that in any event, the court should not allow the bank to rely upon a construction which precluded the claim. This was because a court of equity has power in proper circumstances, to give relief from the unintended consequences of the words used in a document of release such as this - a power which in this instance should be exercised. Buxton L.J. also invoked the principle of unconscionability, albeit on somewhat narrower grounds.

No doubt spurred on by these divergent analyses and conclusions, the bank took the matter to the Lords. The Lords upheld the Court of Appeal decision - but only by a majority, and again there was a twist. Four of their Lordships sided with the minority finding of Sir Richard Scott V.-C that, as a matter of construction, the claim for stigma damages was not barred. This being so it became unnecessary for them to express a view on questions of unconscionability, and they chose not to do so.

In a strong dissenting speech, Lord Hoffman disagreed with everybody, preferring the result achieved by Lightman J. in the same case, over two years previously. The twist is that, in so doing, he was compelled to expand upon the principles of contractual construction he had set down in *Investors Compensation Scheme Ltd. v West Bromwich Building Society* [1998] 1 WLR 896, which principles were paradoxically invoked by Lord Bingham in reaching the opposite conclusion! Thus, Lord Bingham at p739:

"In construing this provision, as any other contractual provision, the object of the court is to give effect to what the parties intended. To ascertain the intention of the parties the court reads the terms of the contract as a whole, giving the words used their natural and ordinary meaning in the context of the agreement, the parties' relationship and all the relevant facts surrounding the transaction so far as known to the parties. To ascertain the parties' intentions the court does not of course inquire into the parties' subjective states of mind but makes an objective judgment based on the materials already identified. The general principles summarised by Lord Hoffman in *ICS Ltd. v West Bromwich B.S.* [1998] 1 WLR 896, 912-913 apply in a case such as this."

So saying, Lord Bingham concluded that, as a matter of construction, the parties could not possibly have intended to provide for a release of rights and surrender of claims of which they had no knowledge or contemplation at the time of the agreement. With this, three of the other Law

Lords agreed. The result achieved by the Court of Appeal was upheld, although the reasoning of its majority was not followed. The employees' claim for stigma damages lives on.

Lord Hoffman's dissension was thoroughgoing. Not only did he hold against the employees on the construction issue, but he could see no reason why principles of unconscionability should be invoked against the bank either. His starting point on construction was to ask:

"What would a reasonable person have understood the parties to mean by using the language of the document against all the background which would reasonably have been available to them at the time?"

In posing such a question, he was adopting very much the approach famously propounded by him in the earlier case of *Mannai Investments Co.Ltd. v Eagle Star Life Assurance Co. Ltd.* [1997] AC 749. In that case (which split the Lords 3:2) the approach produced what might be perceived as a purposive or commonsense result as opposed to a strict or literal conclusion. Thus a break notice containing an error as to the intended date of termination of the lease was held nonetheless to be a good notice. The adoption of the selfsame set of principles brought Lord Hoffman down on the opposite side of the fence however in this instance. His reasoning is instructive:

"The language of the document is very wide. The impression it conveys is that the draftsman meant business. He has gone to some trouble to avoid leaving anything out. He uses traditional style: pairs of words like "full and final settlement", "all or any claims", "that exist or may exist" and phrases like "whether under statute, common law or in equity" and "of whatsoever nature". Admittedly, he could have gone further... I have seen American documents in which the release covers an entire page. But most people in this country would regard this as overkill... So I think that anyone reading the document without preconceptions would accept that the draftsman was not leaving deliberate gaps."

Lord Hoffman then proceeds to itemise his reasons for rejecting the claim by the employees as a pure matter of construction. In so doing he takes fully into account "...anything which a reasonable man would regard as relevant." This involves looking at the so-called "matrix of fact", as it was characterised by Lord Wilberforce in *Prenn v Simmonds* [1971] 1 WLR 1381, 1384-1386 (a speech from which Lord Hoffman drew support also in the Mannai case). He sees as particularly relevant the fact that in this case there was no existing dispute between the parties at the time of the release agreement. However, a payment of £2,772.50 had been made by the bank specifically for the release to be signed. In the absence of any existing dispute, what else could have been the consideration for such payment? If it was intended that the release should be confined to claims within the contemplation of the parties, it was getting no consideration whatever. The more improbable the claim, the more likely it was that the bank was paying "...to draw a final line under the employment relationship." It was on this basis also that he distinguished the many cases on contractual construction which were cited on behalf of the employees, since they all involved agreements in the context of disputes.

There was another reason why Lord Hoffman found the authorities unhelpful and which he said, "goes to the root of interpretation". :

"If interpretation is the quest to discover what a reasonable man would have understood specific parties to have meant by the use of specific language in a specific situation at a specific time and place, how can that be affected by authority? How can the question of what the bank and Mr. Naeem meant by using the language of an Acas form be answered by examining what Lord Keeper Henley said in 1758 (*Salkeld v Vernon* 1 Eden 64)?"

But what of the fact that the bank knew of its misconduct and knew that it was unknown to the

employee? That was not, said Lord Hoffman, admissible background; to take it into account in interpretation would involve the creation of “another artificial rule of construction.” He did not pray in aid (although he might have) the observation of Sir Richard Scott V.-C. in the Court of Appeal, (cited with approval by Lord Bingham) that:

“In my judgment, there are no such things as rules of equitable construction of documents.”

Could it however be taken into account on the second main issue, as to whether equity should intervene to prevent the bank relying on its own unconscionable conduct? The answer was that in principle such conduct could be taken into account, but that in this case it had no application. The breach of trust and confidence, though extremely reprehensible in respect of depositors and the public at large, had not been relevant to the bank’s dealings with Mr. Naeem (and presumably the other employees) in 1990 at all. It had caused him no loss in the past and there was nothing to suggest that it would cause him loss in the future. Even if the bank had suspected the possibility of such loss and had taken advice in 1990, it would have been told that such losses were too remote to form the substance of a claim. It was not until the resolution of the issue by the House of Lords in 1998 in the separate litigation that the claim for stigma damages would have occurred to anyone. Game, set and match.

Except that it was not of course, because Lord Hoffman was outnumbered 4:1 by his brethren.

So where do we, the lowly practitioners, stand in this battle of the intellectual powerhouses? Contractual interpretation is a frequent, if not daily, exercise for the busy contentious commercial lawyer. If such a glittering array of judicial talent can come to such widely divergent conclusions on identical facts, what prospect do we stand of extracting the relevant principles to enable us to advise clients with a reasonable degree of confidence? In a sense this tension between law/equity, literal/purposive, has always been present in the jurisprudence, but it appeared that the application of the principles of construction set out in the ICS case might lead to reasonably predictable conclusions on a given set of facts and words. The course of this most recent litigation suggests that the development of these principles may not yet be complete.

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