

JERSEY / JUDGMENT

1998/162 - Harris v Crichton

[1998] UR 162 (24 July 1998)

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JUDGMENT

THE COMMISSIONER: Although this is a Representation it will be convenient to call the parties "the plaintiff" and "the defendant" respectively.

The plaintiff and the defendant are certified accountants. The defendant is also a chartered accountant. They practiced as a partnership at Queensway House, Queen Street, St. Helier, Jersey. Across the corridor were the offices of David Morgan and Co., a firm of English Solicitors. In 1988 the plaintiff, without warning, asked to see the defendant and at a meeting said that he wished to dissolve the partnership. Accordingly they drew up heads of agreement and sent it to David Morgan and Co., for Mr Morgan to draw up a formal dissolution of partnership which he did. The parties then made certain alterations to the draft and then asked Mr Morgan (it is immaterial who actually did this) if it was "watertight". He assured them it was and both parties signed the amended agreement on the 23 August 1988. There is a dispute about whether there was a meeting between the parties and Mr Morgan at which the draft heads of agreement were discussed. The plaintiff says that there was, and that, at that meeting, some manuscript additions were made in the margins of page one and two. The addition on page two reads :

"3½% R.t.n. on 1.68 M. L."

The relevance of this addition will be mentioned later. Neither the defendant nor Mr Morgan recollects the meeting and Mr Morgan identified the manuscript additions as being in the handwriting of his son, Mr Nicholas Morgan, a partner in his firm. Mr Morgan further said that the original heads of agreement had been lost as a result of an incompetent filing clerk. It was not, therefore, possible for the court to see it, but he felt sure that the additions were added not at the time the heads of agreement were drawn up but at a later date in 1995 when a dispute arose between the parties over the meaning of some amendments that had been proposed at the request of the defendant.

The relevant clauses in the original agreement are as follows:

"4. By way of compensation for goodwill Crichton shall pay to Harris with effect from 1 June 1989 a capital amount ("the Goodwill Payment") by equal monthly payments as follows:

(a)with effect from 1 June 1989 and for the year ending 31 May 1990 the Goodwill Payment shall be £60,000 (Sixty thousand pounds) plus such percentage of £60,000 as shall be equal to the difference between the Jersey Cost of Living Index on 1st June 1988 and such Index on 1 June 1989.

(b)After 31 May 1990 the annual Goodwill Payment shall be equal to the last preceding annual Goodwill Payment plus a percentage increase equal to the percentage increase in the Jersey Cost of Living Index for the preceding period.

(c)The Goodwill Payments shall be made to Harris during the joint lifetime of Harris and Crichton and on death of either of them by way of finality Crichton or his Estate will pay to Harris or his Estate a sum ("the Death Payment") equal to ten times the Goodwill Payment paid to Plaintiff for the year preceding his death or in the event of his death after 1 June 1995 the multiple of ten times shall be reduced to eight times. On payment of the Death Payment Crichton or his Estate shall be released from all obligations towards Harris or his Estate.

Crichton agrees with Harris to secure such Goodwill Payments by maintaining adequate insurance.

5. In the event that Crichton shall dispose of his interest in the Harris Crichton Business or any successor business to such Business within one year of such disposal he shall pay to Harris ("the Business Sale Payment") a capital sum which shall be the greater of

(a)£96,000 plus the amount payable under 3(b) above multiplied by the effective net multiple of net earnings that Crichton receives for the business; or

(b)the annual Goodwill Payment currently being made to Harris multiplied by ten (but after 1st June 1995 by eight).

In the event that Crichton sells a proportion of the business to outside parties then he shall pay to Harris the appropriate proportion of the amount due under this clause. Consequently he shall proportionately reduce the annual Goodwill Payment."

Both clause 4 and 5 are connected by a common method of calculating the respective amounts due by using a multiple of the annual goodwill payments.

We stop here to say that there is no dispute about the meaning of those clauses nor for that matter about any of the other provisions. It is clear that the Plaintiff was entitled to an annual sum until one or other of the two eventualities, death of either of the parties or the sale, in whole or part of the business by the defendant. That annual sum was to be increased annually but upon a capital sum becoming due, and calculated according to the appropriate formula, the annual payments would cease either to the plaintiff or to his estate. The dispute over the proposed variations arises because the plaintiff says that these were an attempt to erode his entitlements under the dissolution agreement. We heard both parties and Mr Morgan but not, strangely enough Mr Nicholas Morgan who was not called by either party. As it was claimed by the plaintiff that certain figures were inserted at the disputed meeting, and the defendant denies that such a

meeting took place at all, it seems to us that the plaintiff, who sets up the meeting and relies on the inserted figures, ought to have called Mr Morgan. It does not appear that even a witness's proof was taken.

Whilst the evidence we heard in court has assisted us to determine the issue about the disputed meeting the proposals for variation were all contained in the correspondence and it is the normal rule that extrinsic evidence cannot be considered if the intention of the parties can be ascertained from the documents that purport to set out the intentions of the parties. See *Sarum Hotels -v- Select Agencies (Jersey) Ltd & Ors.* (1987-1988) JLR 343. It is mainly therefore to the correspondence that we have looked to ascertain the intentions of the parties.

In the original agreement no provision was made to capitalize the annual goodwill payments (AGP). The defendant proposed to do this because he found that the rate of inflation was hurting him. There can have been nothing improper in this. However the plaintiff claims that, on a proper construction of the variations as evidenced in the correspondence, the capital sum due in respect of the business sale payment has not been extinguished, whilst the defendant says that the capitalization of the AGP extinguishes the contingent sale of the business payment.

To support this claim the plaintiff relies, in part, on a calculation that stems from the alleged meeting with the defendant and Mr David Morgan at the time the heads of agreement were being discussed. He said that the defendant felt that the PE should be 12, whereas he felt it should be 15 and that led to some tension. Whether it was 12 based on his last years share of the profits at £140,000 or 15 based on earnings of £110,000, the result would be a total capital payment of £1.68 Million or a sum near it. We must therefore look at the evidence in rather more detail about the figure of £1.68 Million. Before we do so, however, we should note that there is a conflict of evidence between the parties; the plaintiff considers that the defendant was being dishonest, mistaken or both. As regards the plaintiffs assertion that there had been such a meeting with Mr David Morgan, and at that meeting the figure of £1.68 Million had been mentioned, we have already noted that Mr Morgan did not recollect it, although in cross-examination he was not quite so positive. Mr Morgan said he was telling the truth and had a photographic memory. Moreover the defendant as an accountant would have remembered such a figure. This latter comment applies equally to the plaintiff. We heard nothing to suggest that Mr Morgan was not telling the truth.

The plaintiff said that he told the defendant about the figure. The defendant denies that he did. The plaintiff was not certain of the date of the meeting which was in the middle of 1988 nor where it had taken place. The defendant said that he had first heard of the figure in a letter from the plaintiff in July, 1995. The plaintiff suggested that the figure of £1.68 million which was added to the heads of agreement had possibly been added by Mr David Morgan at the meeting about the heads of agreement and that Mr Morgan had asked: "what's the figure?" and on being told it he calculated that based on an annual payment of £60,000 it represented a return on the capital of 3½ per cent.

This part of the evidence was in the main dependent on the recollection of the parties. Indeed the plaintiff said that the figure of the multicipland was not of great importance as he was expecting a life payment (subject to the two contingencies of death and sale) of £60,000 per annum increased according to the dissolution agreement. It follows that in examining the correspondence there was clearly no meeting of minds of the parties on this question. This much is clear from the correspondence. It may be noted also that in that correspondence at the time of the variations there is no mention of the figure of £1.68 million. Moreover it was not until some five years after the variation in a letter from the plaintiff to the defendant that the figure was mentioned. Where their evidence diverged on this point we preferred that of the defendant. Accordingly we are far from satisfied that the meeting took place and that the defendant was aware of the plaintiffs capital expectations.

It seems to us that the annual payments were a convenient way of spreading the load for the defendant. Nevertheless the reference to goodwill payments contemplates a capital amount because if the defendant had sold the business shortly after the dissolution there would have been one substantial capital payment to the plaintiff and that would have extinguished any further obligation towards him.

It seems to us that the important question to be answered is whether the alternative capital payments due either upon the death of either partner or the sale, in whole or in part, of the business by the defendant can be separated from the annual goodwill payments so as to create a separate legal obligation. The plaintiff recognized in a memorandum he prepared at the time of the proposed variation that the defendant could make capital payments instead of only being payable on death or sale:

"(a)ADC can make capital payments instead of capital only being payable (1) on death or (2) on sale of business.

(b)Annual goodwill increase shall be 6% not JRPI

(c)A bonus will be paid to CAH if business is sold:

(£110,000 x sale profits multiple) - cash paid to CAH already = bonus"

This supports our view that the obligation to pay the annual goodwill payment was not a separate and severable arrangement from the capital payments envisaged upon either partys death or the sale of the business. One substantial payment was intended under the goodwill arrangements and the fact that they could be made in instalments does not alter that intention. In our opinion bearing in mind that the defendant may have indicated that he might sell fairly early on and that death would put an end to the annual payments then the provisions under clauses 4 and 5 were a kind of "fall back" position to protect the plaintiff. The letter of the 18 March 1989 from the plaintiff to the defendant is interesting. In it the plaintiff says -

"You have said that you wish to have the option of settling some or all of the Business Sale payment even though you may not have entered into sale arrangements yourself. I understand this, because of your concern over the inflation effect on the Business Sale and Goodwill Payment, and thereafter your wish to reduce the payment. As I have said, I have no objection to this in principle and if you wish to make a firm proposal I am sure it will be fair and I will go along with it."

On the 27 March, 1990 the defendant wrote to the plaintiff, the relevant parts of the letter are as follows:-

"I mentioned to you at the Capital Hotel last year that I did wish to seek your agreement to a modification of the goodwill payments to you as a result in the rise of inflation which was unforeseen, certainly by me, when we were deciding upon our dissolution arrangements. The JCOLI annual increase at March 1988 was in fact 5.4% and at June that year 6.7%.

I would therefore like to amend the Dissolution Agreement so that the annual increase in the goodwill payment is fixed at 6% each year effective from 1 June 1990.

When we were drafting the Agreement, you wished to include the fail-safe multiples so that the enterprise could not be sold at an under-value. The best way to achieve some capital buy-out without reference to a sale of the enterprise is for this multiple principle (as per 5b) to be applied at my option. Such reductions would only take place on 31 May each year and would be subject to one months notice to yourself. Naturally the reduction would also affect the annual goodwill payment.

Therefore if the multiple was 10 and the annual goodwill payment was

£60,000 a repayment of £100,000 on the relevant date would lead to a goodwill payment for the following year of £50,000 (increased by 6%)

It is my intention to discharge my obligation to you within the next five to eight years."

Given that the protection to the plaintiff was in the alternative it is hard to see how the plaintiff can contend that he thought that any of the capital sums did not relate to a notional sale of the business. On 4 May 1990, the defendant wrote to the plaintiff as follows:

"Dear Colin,

Our Dissolution

Further to our meeting yesterday I confirm our discussions as follows:-

- a. I will send you a cheque on 21 May for £6,548 (£850 and £5,698). I believe this is to be the correct amount due to you but I prefer to verify this with Nick when he returns from holiday since it was he who prepared all the schedules.

- b. With effect from 1990 (ie the next revision) your annual goodwill payment will be increased by a fixed amount of 6%.
- c. I will advise you by 30 April each year of any capital reductions I wish to make from the capitalized goodwill amount.
- d. Any such capital reductions will reduce the annual goodwill payment proportionately. Until 1995 the capitalized goodwill will be by a factor 10 and after 1995 by a factor of 8 - to which the capital repayment will be proportionately applied.
- e. I will devise a method to calculate a bonus payable to you in the event of a profitable sale of the business. As we agreed. It is important to note that this will not involve any share ownership but will just be by way of an extra capital payment.
- f. I confirm that it is my intention to discharge all contractual obligations to you within the next five to eight years.

For the sake of good order would you kindly acknowledge receipt of this letter and your agreement to its contents.

Finally I confirm that I will be arranging for the cancellation of your obligations under the guarantee to Barclays Bank Plc, Whetstone.

Best Wishes

Yours sincerely

A D D Crichton

PS I look forward to seeing you on Friday 18 May subject to Toms confirmation."

The plaintiff replied on the 9 May as follows.

"

Dear Andrew,

Thank you for your letter dated 4 May 1990. I confirm my agreement to all the points in your letter. I had a look at Nick's figures again and I made the balance due £6390 before I got a headache.

With regard to point 'e' we spoke on the phone and I think agreed the following. In the event of a sale, the sums paid to me previously in full satisfaction of 'the Business Sale Payment' shall be deducted from a figure (which shall be £110,000 multiplied by the effective net multiple of net earnings that you receive for the business) and the balance if any shall be paid to me. I'll assume that's O. K. with you unless I hear to the contrary.

I enclose a resignation letter from Sue which I found in my papers. I'm sure there must be some other things to sign with regard to the dissolution, do let me know.

Kind regards

Colin"

In his evidence he said that the reference to the business sale payment was a mistake for annual goodwill payments. We do not think it was. We cannot ignore the normal commercial usage. Once the continuing partners in a dissolution have paid for the goodwill they are free to dispose of the business as they wish. Clause 5 was inserted as a protection for the plaintiff and not, we repeat, to create an additional obligation.

If there was a typographical error in the plaintiffs letter then it was not for some seven years that he said that it was.

The so-called "bonus payment" on the face of it might seem to conflict with the defendant's understanding that he had paid off all his obligations under the agreement as varied.

A look at the hand written note we have already mentioned indicates to the contrary.

If further evidence were needed that the payments on death or sale were in the alternative this note provides it. The defendant says that the plaintiff has accepted the money and now cannot renege.

We are satisfied that the bonus payment was something devised by the defendant to compensate the plaintiff because once he had the option to make a capital payment that would extinguish the plaintiffs chances of participating in a profitable sale. Again that is clear from the letter of the 9 May 1990. The proposals for calculating the bonus payments were not accepted by the defendant. He later thought he should have. Those proposals meant that the plaintiff would only receive a payment if there was any balance.

We agree with Mr Sinel that the substantive question to be answered is this: Is there a remaining obligation upon the defendant to make further payments to the plaintiff apart from the "bonus payment" however calculated, now that he has extinguished his obligations in respect of the goodwill payments?

For the reasons mentioned above we conclude that there is none and accordingly we decline to make the declaration asked for by the representor.

Authorities

In the matter of a settlement

(1996) JLR 226

Le Pennec -v- Romeril (1995) JLR N.17

Sarum Hotel Limited -v- Selected Agencies (Jersey) Limited & Another (1987-1988) JLR 343

Le Ruez -v- Le Ruez & Another (1980) JJ 229

Blackburn -v- Kempson

(1971) JJ 1747

Arbaugh -v- Leyland

(1967) JJ 745

Dormy Hotels Limited -v- Stewart & Ors.

(1969) JJ 1247

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