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Contractual interpretation by administrators and common sense (Avery-Gee and others v Sibley and others)

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Restructuring and Insolvency analysis: The High Court held that the joint administrators of a collapsed peer-to-peer lending company, FundingSecure Ltd, were not permitted to pay the company five percent of any security asset realisation on defaulting loans before monies were repaid to lenders (investors). This case provides a summary of the principles of contractual construction and an insight into judicial approach to arguments based on commercial common sense. In construing the contract, the judge held that internal ambiguities were to be read against the company, as was the fact that the investors' interpretation led to a sensible outcome which fit better with the commercial reality of the situation as reflected by the parties' respective abilities to assess the risks involved in their dealings. This result was crucial to thousands of investors who stood to lose millions where FundingSecure Ltd had overvalued the security on their loans meaning there was not enough money to pay back investors. It will also be relevant to other similarly failed schemes. Written by Mo Haque QC, partner at CANDEY, who together with other lawyers at CANDEY acted for the investors.

Avery-Gee and others v Sibley and others [2021] EWHC 798 (Ch), [2021] All ER (D) 24 (Apr)

What are the practical implications of this case?

While the law concerning the interpretation of contracts can now be taken to be settled (see *Teesside Gas Transportation Ltd v Cats North Sea Ltd and others* [2020] EWCA Civ 503, para [55] per Lord Justice Males), this does not mean that disputes as to the meaning of contracts will fall away. For as long as ambiguous drafting continues, the courts—and as in this case administrators who take over failing companies, will have to untangle what was meant by certain words sometime after they were written. Administrators should also be wary of favouring the interpretation of a company charge-holder over that of an unsecured creditor, where each has opposing financial interests.

This case offers important lessons for those drafting contracts and those arguing these cases in court.

First, this case emphasises the importance of clear drafting. Hindsight is a wonderful thing with which, unfortunately, no draftsman is imbued. When using the same phrase more than once—especially in close proximity, it is important to consider whether parties intend the phrase to have the same meaning in each case. If not, then parties should use a different phrase to clarify what they mean (see para [63] of the judgment).

Secondly, both sides will often appeal to commercial common sense. This is often a zero-sum game because, as His Honour Judge Pearce noted, '[the] competing arguments each have an attraction from their own point of view' (para [64(c)]). To make such arguments persuasive it is crucial to think commercially to consider all the background including the counterparty's other obligations and the contractual allocation of risk.

Finally, as there are several failed peer-to-peer lending schemes already, and there may be more, the judgment offers useful guidance that the balance of commercial common sense [usually] lies in favour of the investors, who stood to lose the most.

What was the background?

FundingSecure Ltd was one of a number of new investment platforms which promote and manage short-term 'peer-to-peer' loans. Like several other platforms in this sector, it entered administration when it transpired that a combination of poor corporate governance and loan management had led to a black hole in the company's finances.

Following their appointment, and acting on the advice of two law firms, the joint administrators began to deduct five percent of either the original loan value or the amount realised on the sale of the secured asset from all defaulting loans. Prior to entering administration, across thousands of loans, the company had only deducted this five percent fee in a few cases. In circumstances where FundingSecure had accepted gross-overvaluations of many secured assets, deducting the five percent fee in this way compounded investors' losses and presented a multi-million pound windfall for the company.

The key question before the court was whether the terms and conditions, governing FundingSecure's relationship with the investors, allowed the five percent fee to be deducted before returning capital and interest to the investors. In the alternative, the court was asked to consider whether the administrators were now estopped from deducting the five percent fee when the company had previously either not deducted the fee or waived its right to do so, without communicating this to the investors. The administrators' interpretation was supported by their appointed charge-holder, presumably because, if correct, it may well have led to the company assets being swelled and the charge-holder therefore being paid before investors.

What did the court decide?

HHJ Pearce (sitting as a judge of the High Court) found in favour of the investors on the contractual interpretation question, holding that 'the natural meaning of the words used in the context in which they appear and the commercial common sense of the situation favour the […] interpretation that […] the 5% Fee should be payable from the proceeds of realisation of an asset only after deduction of the sums due to the Investors' (para [68]).

The judge referred to the leading Supreme Court and House of Lords authorities on contractual interpretation which have held that 'the ultimate aim of interpreting a provision in a contract [….] is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant' (see *Rainy Sky SA v Kookmin v Bank* [2011] 1 WLR 2900, para [14]). In the context of commercial agreements, this exercise involves considering whether a particular construction is consistent with a commercially sensible outcome (see paragraph 27(g) and the case cited).

In arriving at this conclusion, the judge considered that the 'parties' respective arguments as to the wording of the Terms and Conditions provide limited assistance […] (para [61]). The determinative factors were that the interpretation the investors argued for sensibly addressed the risks to both FundingSecure and the investors and fit better with the commercial reality of the situation by reflecting the parties' ability to assess the risks involved in their loans (paras [66]–[67]).

The estoppel was not made out as there was insufficient evidence of reliance by the named respondent. However, the judge held that had there been unequivocal representations and reliance, this might have resolved the problem (para [76]).

Case details

- Court: Business and Property Courts in Manchester, Insolvency and Companies List (ChD)

- Judge: HHJ Pearce
- Date of judgment: 31 March 2021

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