

CONSENSUS OR CONTRACT: WHICH COMES FIRST?

You often hear clients say “the personality of your business partner is more important than the best crafted agreement”. This school believes that no matter how air tight an agreement, the duly appointed representatives of Mr. Bad faith will arrange to be in breach. How true! However very often a lot of disputes arise not because either of the parties to the contract is deal breaker but because one or both of them signed a contract with an erroneous interpretation or perception of a part of the contract. Those of us who are given to the word art (lawyers most guilty) know that you can write or say one thing which may be subject to different interpretations - depends on the background of the party or what side of the contract they are on. Both parties may actually be right in a dispute that borders on a dual interpretation. For example a situation where a Tenant takes a 3 year lease and pays rent for 3 years in advance. The rent renewal clause in the tenancy agreement simply said “the rent increase shall be 20%”. The landlord who is a banker naturally interprets this to mean “20% per annum” while the tenant who is a university mathematics lecturer prefers the ordinary interpretation of “an additional 20% on the annual rent at the end of 3 years”. But would you blame the Banker? I think not! His interpretation is by force of habit. Most percentages on the loan transactions are on a per annum basis. Neither would the tenant be wrong, the ordinary interpretation is probably more likely to pass the ordinary man’s test. Again it suits him fine to hold unto that meaning. To drive the point home in this scenario it is important to note that at the time landlord and tenant signed the agreement they both had their respective interpretations in mind and safely assumed that the other party’s interpretation was the same as theirs. In other words they all assumed a consensus where none existed. What went wrong? They had a contract but they did not have a consensus ad idem (a meeting of the minds). Consensus is the heart of every contract. It navigates beyond the letters of the contract to the minds of the parties. Many disputes are a failure of consensus rather than a lack of good faith and it is the duty of every Solicitor to use his best endeavour to gain consensus between the parties at a preliminary stage. This duty is owed to all the parties: your client, the other lawyer, the other lawyers’ client and any other signatory to the agreement. But then how do we discharge this duty of ensuring consensus? The simple answer is by taking time to jaw-jaw on salient issues before the Solicitors begin the drafting process. This discussion which should be in simple English (no legal jargons) is a methodical way of assisting the parties in understanding their respective rights and obligations. It helps them to know exactly “what they mean by what they say”. This process is usually aided by what is called a “Heads of Agreement” which are pre-emptive discussion questions/points drawn up by the solicitors. The points are discussed one after the other usually in a sequential manner, one item flowing into the other. The spin off and incidentals from the points on the list are also taken as discussion points and trashed out. It is a painstaking process, but anything that aids the process of consensus is time well spent. It is one of the best proactive mechanisms for dispute avoidance (as opposed to dispute resolution). This process is particularly important with agreements governing long term relationships e.g Partnerships or Shareholders Agreements. You may have heard the saying: “there is no shortcut to anything good”. Every Solicitor should therefore see himself as a duly appointed craftsman and draftsman - working at producing a piece of art that depicts the consensus of the client (not what he thinks the client has in mind or ought to have in mind.) By the time the clients have taken time to discuss the points on a heads of agreement and trashed out the areas of discord, it is time to prepare a first draft for review. With this process even the client can read a draft and know the intent and spirit of each clause because it was discussed extensively. i.e consensus was reached before the draft contract went to the mill. Let us look at a few “life savers” in a typical heads of agreement for a Joint Venture Contract. Some key items for discussion in such a contract would be:

Scope of Joint Venture; Profit Sharing; and Decision Making. Permit me to demonstrate the importance of consensus using these items.

Scope of Joint Venture

Mrs X a client had top level contacts in Equatorial Guinea (the oil rich west African country) and had opportunities in different sectors of the economy. She however lacked the financial base to pursue these opportunities. She was introduced to Mr. Man who had lots of money (at least he had the trappings of it). They agreed in principle to work together and needed a lawyer to help them put a Contract in place. She briefed her Solicitor and at the first meeting the Solicitor places a Heads of Agreement on the table as the best place to start. One of the first questions on the list is – What is the scope of the Joint Venture? The Solicitor explains further by asking the prospective partners - What categories of business will this partnership cover in Equatorial Guinea? Are you going there to be partners in every business available from mining to poultry farming or you have agreed on a few in which you intend to collaborate? Mrs X says “We are looking only at Engineering, that is Mr Man’s area of speciality. I will work with other partners on other sectors. Mr Man says “yes we said engineering but you know engineering is a wide field and covers almost anything from road sweeping to bakery. As long as it involves the use of some form of technology it is covered by engineering”. He goes further to say: “I am going to invest heavily in this and I see no reason why we cannot work together on every opportunity.” The tone is set for a potential disagreement. Are we going to work our way to a consensus or we agree to disagree? In this typical scenario it may be possible for the parties to reach a consensus on the scope. However many times that may be the last meeting and you may hear Mr. Man say to Mrs X “I knew we would never make progress the minute you called your lawyer into this matter”. Depends on how you look at it they probably made ample progress discovering at the early stage their incompatible notions. The danger with this early exit of both parties is that the “bad” lawyer who is seen to have scuttled the deal (albeit doing a marvellous job of creating consensus) may never get paid for his efforts. Hazards of the trade!

Profit Sharing

Discussing profit sharing in any multiparty deal will go beyond merely asking if the split is 50-50 or 60-40. It entails questions like: Will profits be shared yearly, quarterly or on each deal? What exactly constitutes profits? The exact definition of costs of the business is also crucial to determine profit. Are loans from partners a first charge on the profits until final liquidation? What percentage of profit is for recapitalisation? This last issue is key in situations where one partner is forward thinking and frugal and another lives for the day. On one occasion two people proposed to start a printing business. One had the know-how and the other was the financier. The financier was going to disburse his contributions and part was a loan and the other part equity contribution. The question asked as part of discussions on the heads of agreement was: How is repayment of the loans structured into the financial planning? The financier then requested that the agreement be such that his loans are repaid fully before the other partner could make any monetary drawing on the business. The projection was that it would take at least 24 months to pay off the loans. The other partner who was going to be working hard daily thought it was downright unfair to keep his belt tight for 24 months. After all should we muzzle the ox that threads the corn? They would have to reach a consensus before going forward. Better now than later. For emphasis let us assume that the contract is simply drafted without a Heads of Agreement meeting. In such a case the clause on repayment (depending on the lawyer) could have simply been couched as follows: “the parties agree that the loans made to the business by the Financier shall be repaid in a way and manner to be agreed”. With a clause like this the dispute is only postponed for a later date. However with the use of the Heads of Agreement mode it is discussed, consensus is reached and it is incorporated into the contract. Both parties know from the onset and sign with their eyes (and other senses) wide open.

Decision Making

A typical joint venture or any partnership would have to be administered. Both parties having contributed some resources to the business (assume 50-50 contributions) would expect to have a say in the business. How will decisions be taken? What happens where both parties are unable to agree on a decision point? In one particular company a core investor had committed funds to the company based on a one page MOU. Thereafter the other party produced a "concise" draft MOU with a clause excluding the core investor from the management of the company. It is usual that Core Investor either manages or employs the major players in the Management Team. This was therefore a fundamental error which would never have been if preliminary discussions (heads of agreement style) had taken place. At least the question would have been asked: How will decisions be taken? Or who will manage the company?

To put this in perspective I recall a book I read that talked about a merger in the US that went on to be a great success. The CEO'S that piloted this merger were later asked: What was the secret of their success? They chorused: "we spent months talking to one another with no lawyers. We went through the details over and over again". They said by the time they were instructing the Solicitors they were all so sure in their minds what they wanted and their instructions were unambiguous. It so happened that whenever the different lawyers handling the merger required clarification on any issue the response was exactly the same even when each of them was asked independently. Talk of consensus! It follows that the time they spent just talking was time well spent. Many clients may not have the tenacity and data to go it this way, hence the solicitor who midwives the transaction has to help them push until the baby comes – the heads of agreement method is what induces the labour and reduces the risk of a still birth in future.

Perhaps one can safely say that the next time you are about to castigate a party to a contract for not keeping to the bargain, you would take a closer look to see if he got what he actually bargained for. Again it just might be another case of a consensus failure.

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