COMMERCIAL CONTRACT LAW: RECENT DEVELOPMENTS

Ewan McKendrick QC (Hon)
Registrar and Professor of English Private Law, University of Oxford
3 Verulam Buildings, Gray's Inn

SECTION A: FORMATION OF CONTRACTS

TRIGGER EVENT HELD TO BE AN ESSENTIAL TERM

In *Wells v Devani* [2016] EWCA Civ 1106, [2017] QB 959 the appellant property developer was having some difficulty in selling a development of 14 flats. The appellant was put in contact with the respondent estate agent. During a conversation between the parties in January 2008 the respondent stated that his standard fees were 2% plus VAT but no mention was made of the circumstance which would trigger the obligation to pay the fee. More or less immediately after the conversation the respondent contacted a housing association who agreed, subject to contract, to buy the remaining flats. The respondent sought to recover commission of £42,000 plus VAT from the appellant. On the day following the agreement by the housing association to purchase the flats the respondent sent to the appellant an email which referred to his standard terms of business which provided for the payment of a fee of 2% plus VAT which commission was stated to be 'due on exchange of contracts with a purchaser, but payable from the proceeds of sale by your conveyance, with your written authority.'

At first instance it was held that the parties had entered into a legally binding contract in the course of their telephone conversation on 29 January. In relation to the event which triggered the obligation to pay commission, the minimum term necessary to give business efficacy to the parties' intentions was implied into the contract, namely that payment was 'due on the introduction of a buyer who actually completes the purchase.' The appellant appealed to the Court of Appeal who, by a majority, allowed the appeal.

The majority of the Court of Appeal held that it was incorrect to seek to imply a term into a contract without first establishing that the parties had indeed entered into a contract. As Lewison LJ pointed out, the implication of a term into a contract 'assumes that there is a concluded contract into which terms can be implied' and it was not legitimate for the court, under the guise of implying a term, to make the contract for the parties (see *Scancarriers A/S v Aotearoa International Ltd* [1985] 2 Lloyd's Rep 419). It was wrong in principle for a court to turn an incomplete bargain into a legally binding contract by adding expressly agreed terms and implied terms together.

The question to be answered, therefore, was whether or not the parties had entered into a legally binding contract. On this issue the majority concluded that they had not. Lewison LJ stated that the 'trigger event' upon which the commission became payable was something

which the law required as essential for the formation of legally binding relations. Thus the failure of the parties to reach agreement on the time at which the commission was to be paid was held to be fatal to the existence of a contract between the parties.

The Supreme Court has granted leave to appeal from the decision of the Court of Appeal.

DELIVERY DATE HELD TO BE AN ESSENTIAL TERM

In *Teekay Tankers Ltd v STX Offshore & Shipbuilding Co Ltd* [2017] EWHC 253 (Comm), [2017] 1 Lloyd's Rep 387 the parties entered into an option agreement which enabled buyers to purchase optional additional vessels to the 4 vessels it had already agreed to purchase. Clause 4 of the option agreement provided as follows:

> The Delivery Dates for each [of the] Optional Vessels shall be mutually agreed upon at the time of [TT's] declaration of the relevant option, but [STX] will make best efforts to have a delivery within 2016 for each [of the] First Optional Vessels, within 2017 for each [of the] Second Optional Vessels and within 2017 for each [of the] Third Optional Vessels.

No delivery date was agreed at the time of the declaration of the relevant option. It was held that the agreement was void for uncertainty. Walker J accepted (at [187]) that this was a case 'where the court should strive to give effect to the bargain made by the parties if it is possible to do so.' In an attempt to render the clause sufficiently certain the claimants sought to imply two terms into clause 4 (see [117] – [120]). The first was that the delivery date in respect of each option vessel was such date as STX offered, having used its best efforts to provide a delivery date in 2016 for the first optional vessel and 2017 for the other two and, in the event that STX was not able to offer a date within the relevant year despite using its best efforts, the earliest date thereafter which STX was able to offer using its best efforts. The second was that the delivery date in respect of each optional vessel was to be an objectively reasonable date having regard to STX's obligation to use its best efforts to provide delivery dates within 2016 or 2017 as appropriate, to be determined by the court if not agreed.

One of the difficulties faced by the claimants was that it was not disputed that the identification of delivery dates for the relevant vessels was an 'essential matter' ([116]) and the terms which the claimants sought to imply into the option agreement did not merely involve a reading down of the words 'shall be mutually agreed upon' in clause 4 but amounted to the creation of a 'wholly different' scheme. Walker J was not convinced that any of the implied terms satisfied the strict tests laid down for the implication of a term into a contract (on which see Section C below). The first implied term was rejected because a unilateral offer of a delivery date would not be equated with one to be mutually agreed and it had the appearance of a term fashioned with the benefit of hindsight. In relation to the second implied term, given that both parties intended that either would remain free to agree or disagree about a proposed delivery date as its own perceived interest might dictate, there was held to be no room for an implied term that in the absence of agreement the matter would

be determined by reference to an objective criterion of reasonableness. As Walker J noted, there is a crucial distinction between agreeing to use best efforts or best endeavours to achieve a particular result and agreeing to use best endeavours to reach agreement on an essential term. This was a case in the latter category and there was no sufficient basis for the implication of a term of the type advocated by the cliamants. In the absence of an implied term, it was held that there was no way that the agreement could be saved given that it contained express provisions for future agreement on an essential term.

BINDING CONTRACT OR A JOKE?

The case of *Blue v Ashley* [2017] EWHC 1928 (Comm) arose out of a jocular conversation between three investment bankers in a pub on the evening of 24 January 2013 during the course of which the defendant, Mr Ashley, said that he would pay Mr Blue, the claimant, £15 million if Mr Blue could get the price of Sports Direct shares (then trading at around £4 per share) to £8. Mr Blue expressed his agreement to that proposal and everyone laughed. Thirteen months later the Sports Direct share price did reach £8. In these circumstances the claimant alleged that he was entitled to the promised £15 million. The defendant paid him £1 million but declined to make any further payment. The claimant brought an action to recover the balance of the promised payment. His claim failed.

Leggatt J held that no reasonable person present in the pub on 24 January would have thought that the offer to pay the claimant £15 million was serious and was intended to create a contract, and no one who was actually present in the pub that evening, including the defendant, did in fact think so at the time. They all thought it was a joke. The fact that the claimant had since convinced himself that the offer was a serious one, and that a legally binding agreement had been made, was not sufficient to turn the alleged promise into a legally binding contract.

Leggatt J stated that the 'key issue' was whether, when the defendant said that he would pay the claimant £15 million if he could get the Sports Direct share price to £8 per share, this would reasonably have been understood as a serious offer capable of creating a legally binding contract. He decided that it was not an offer capable of creating a legally binding contract for the following reasons: (i) the setting for the meeting. Leggatt J stated that 'an evening of drinking in a pub with three investment bankers is an unlikely setting in which to negotiate a contractual bonus arrangement with a consultant'; (ii) the purpose of the meeting was not to discuss the position of the claimant but to meet with third parties; (iii) the jocular nature of the conversation at the pub; (iv) the defendant had no commercial reason to offer to pay the claimant £15 million as an incentive to do work aimed at increasing the Sports Direct share price; (v) the idea that the claimant could somehow, through his skills and contacts in corporate finance, get the share price to double its then level seemed plainly fanciful; (vi) the "offer" was far too vague to have been seriously meant; (vii) none of the witnesses who took part in the conversation thought the defendant was being serious; and (viii) the claimant

himself did not understand there to be such an intention at the time when the conversation in the pub took place or in the period immediately afterwards.

The agreement was also missing an essential term, namely the period of time within which the share price had to reach £8. There was no objective standard which the court could invoke to identify a period within which the claimant would need to get the share price to £8 in order to be paid £15 million. That was a matter which could only be decided by express agreement between the parties themselves. The claimant's failure to prove that a specific period was agreed was a further reason to conclude that the parties had not entered into a binding contract given that their agreement lacked an essential term.

REASONABLE ENDEAVOURS AND GOOD FAITH

In *Astor Management AG v Atalaya Mining plc* [2017] EWHC 425 (Comm) the claimants sought to recover payment of deferred consideration on the ground that the defendants' obligation to make the payment had been triggered or, if it had not been triggered, this was because of the defendants' breach of contract. The defendants denied that they had breached the terms of the agreement and their case was that their obligation to make payment had not been triggered. Clause 6(f) of the Master Agreement at the centre of the dispute between the parties provided as follows:

> Each of EMED, EMED Holdings and EMED TARTESSUS undertakes to use all reasonable endeavours to obtain the Senior Debt Facility with EMED Tartessus as borrower and to procure the restart of mining activities in the Project on or before 31 December 2010 and shall provide [Astor], upon request, with such written updates as to the status of the Project as [Astor] may reasonably require.

Two principal issues arose in relation to this clause. The first was whether it created legally enforceable obligations. The second was, on the assumption that it did, whether the defendants were in breach of its terms as a result of their decision to restart mining at the project by issuing shares in EMED rather than by raising those funds in the form of senior debt finance. Leggatt J held that the clause was enforceable but that the claimants had failed to show that the defendants had breached the obligation to use all reasonable endeavours to obtain the senior debt facility.

In relation to the enforceability of the clause, Leggatt J adopted a robust approach. He held that the role of the court in commercial disputes 'is to give legal effect to what the parties have agreed, not to throw its hands in the air and refuse to do so because the parties have not made its task easy.' But it is important not to take these observations too far. Leggatt J has taken a more robust line on this issue than some other judges and it is therefore necessary to continue to draft such clauses with care because they do remain vulnerable to legal challenge if criteria cannot be identified by which to evaluate the reasonableness of the endeavours taken.

It is established law that an obligation to use reasonable endeavours will be enforceable if the object of the endeavours is sufficiently certain and there are sufficient objective criteria by which to evaluate the reasonableness of the endeavours. One of the difficulties in the case law relates to the situation in which the obligation to use reasonable endeavours relates to a transaction to be concluded with a third party. On this issue Leggatt J expressed his disagreement with the observations of Andrews J in *Dany Lions Ltd v Bristol Cars Ltd* [2014] EWHC 817 (QB) in so far as they created the impression that the requirements of certainty of object and sufficient objective criteria are difficult to satisfy and will not usually be satisfied where the object of an undertaking to use reasonable endeavours is an agreement with a third party. In his judgment it should almost always be possible to give sensible content to an undertaking to use reasonable endeavours (or 'all reasonable endeavours' or 'best endeavours') to enter into an agreement with a third party. Whether such endeavours have been taken is a question of fact which a court can perfectly well decide. It may on occasion be difficult for a court to decide whether or not the obligation has been discharged but that is not a reason to conclude that the obligation itself is too uncertain to be enforceable. If necessary, a court will make a value judgment in deciding whether or not 'reasonable' endeavours have been taken.

Leggatt J did not accept that there were no objective criteria by which the reasonableness of endeavours to obtain a senior debt facility could be judged. But he did accept that a court will be very slow to second-guess a commercial party on matters of commercial judgment. For that reason, it may in many circumstances be extremely difficult or impossible to show that a party ought reasonably to have pursued a negotiation with a particular lender, or accepted a given offer, or proposed a lower rate of interest. But it is important to remember that the burden of proof is on the party alleging failure to comply with the obligation. Where the criticism involves a matter of fine judgment, it may be impossible to establish a breach. In other cases, however, the absence of reasonable endeavours may be obvious. It does not follow from the fact that there may often be difficulty in proof that there is no obligation at all or that the obligation has no sensible content. On the present facts it was held that the clause did not require the EMED companies to obtain a senior debt facility unless there was a reasonable expectation that the copper produced from the mine when mining restarted would generate enough revenue to maintain the EMED group as a going concern. The claimants were unable to make good their claim that the sum which EMED raised from its shareholders could and would if all reasonable endeavours had been used have been obtained from a senior debt facility provided by one or more of the shareholders. Accordingly, there was no breach of the clause.

The claimants also alleged that the Master Agreement contained an implied obligation to perform it in good faith. Leggatt J held that any such implied term was a 'modest' requirement because it did no more than reflect the expectation that a contracting party will act honestly towards the other party and will not conduct itself in a way which is calculated to frustrate the purpose of the contract or which would be regarded as commercially unacceptable by reasonable and honest people. This is a lesser duty than the positive

obligation to use all reasonable endeavours to achieve a specified result which the contract in this case imposed. Thus, even if an obligation to act in good faith was implied, there was no basis for saying that the defendants did not act in good faith in circumstances where the claimants had failed to establish a breach of the reasonable endeavours obligation. In this connection it should also be noted that the courts remain generally reluctant to imply into a contract a term requiring the parties to act in good faith in the performance of the contract (*General Nutrition Investment Co v Holland And Barrett International Ltd* [2017] EWHC 746 (Ch), [321], *Property Alliance Group Ltd v Royal Bank of Scotland plc* [2016] EWHC 3342 (Ch), [276]).

A BINDING OBLIGATION TO REFER A DISPUTE TO ARBITRATION?

In *Associated British Ports v Tata Steel UK Ltd* [2017] EWHC 694 (Ch) Rose J held that clause 22 of the contract between the parties created a binding obligation to refer a dispute to arbitration. It provided:

> It is hereby agreed between the parties that in the event of any major physical or financial change in circumstances affecting the operation of [Tata's] Works at Llanwern or Port Talbot or ABP's operation of the Tidal Harbour on or at any time after the 15th day of September 2007 either party may serve notice on the other requiring the terms of this Licence to be re-negotiated with effect from the date on which such notice shall be served. The parties shall immediately seek to agree amended terms reflecting such change in circumstances and if agreement is not reached within a period of six months from the date of the notice the matter shall be referred to an Arbitrator (whose decision shall be binding on both parties and who shall so far as possible be an expert in the area of dispute between the parties) to be agreed by the parties or (if the parties shall fail to agree) to be appointed on the joint application of the parties or (if either shall neglect forthwith to join in such application then on the sole application of the other of them) by the President for the time being of the Law Society.

In reaching this conclusion, Rose J stated that the authorities all stress that each case in which a clause is challenged as being void for uncertainty is to be decided on its own facts. She also noted that many of the cases also stress that the courts should strive to give some meaning to contractual clauses agreed by the parties if it is at all possible to do so. The courts are particularly reluctant to find a clause too uncertain to create an obligation in cases where the contract of which the clause forms part has already been performed by one or both parties over a period of time.

The courts have also drawn a distinction between those cases where the court is considering whether a contract has been agreed at all between the parties and those where the court is considering whether a particular clause in an otherwise binding agreement is valid. In the

latter category of case, a court is 'particularly reluctant to find that a clause is void for uncertainty' (see also *Kitcatt v MMS UK Holdings Ltd* [2017] EWHC 675 (Comm), [212]).

On the facts of this case, Rose J stated that it was not difficult to see the commercial sense behind a clause such as clause 22. The parties were in 'a relationship of mutual interdependence', the contract was stated to last for 25 years and clause 22 came into effect almost half way through that period and gave them an opportunity to reassess their relationship. Rose J accepted the submission that the parties had not intended that either party would bear the risk of the licence terms being immutable for 25 years.

Turning to the specifics of the clause, Rose J held that clause 22 was sufficiently certain to create a binding obligation to refer a dispute to arbitration. The phrase 'any major physical or financial change in circumstances' was not too uncertain or vague to be enforceable. The wording and context of the clause pointed to the kind of changes that could trigger the right to seek a revision of the contract. In relation to the criteria to be applied by the arbitrator when deciding how to amend the terms of the licence, the clause was not as open-ended as the claimants asserted. This was so for a number of reasons. First, the arbitrator was not faced with the task of setting new terms in a vacuum but could take account of the existing terms. Second, a limit would be placed on the task of the arbitrator by the nature and effect of the major physical or financial change in circumstances that triggered the arbitration. Third, the arbitrator would be working within the parameters set by the submissions of the parties. The clause was held to be more than an agreement to negotiate. The parties intended that if they failed to agree, an independent third party would be appointed to impose a fair solution on them. Accordingly it was held that clause 22 amounted to a binding obligation to refer a dispute to arbitration. The trigger was not too uncertain although it would be for the arbitrator to decide whether the matters set out in the defendant's letters amounted to a 'major physical or financial change in circumstances' entitling the defendant to a revision of the licence terms.

SECTION B: INTERPRETATION OF CONTRACTS

Wood v Capita Insurance Services Ltd [2017] UKSC 24, [2017] 2 WLR 1095 concerned the construction of a sale and purchase agreement for the sale of shares in an insurance company. The sellers agreed to provide an indemnity to the buyers in respect of losses arising out of mis-selling or suspected mis-selling of insurance products or services in the period before the sale of the shares. The indemnity was in the following terms:

> 'The sellers undertake to pay to the Buyer an amount equal to the amount which would be required to indemnify the Buyer and each member of the Buyer's Group against all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and all fines, compensation or remedial action or payments imposed on or required to be made to the Company following and arising out of claims or complaints registered with the FSA, the Financial Services Ombudsman or any other Authority against the Company, the Sellers or any Relevant Person and which relate to the period prior to the Completion Date pertaining to any mis-selling or suspected mis-selling of any insurance or insurance related product or service.'

Shortly after the buyer acquired the shares in the company, some employees raised concerns about the way in which the company had sold policies to its customers. A review was carried out which demonstrated that higher arrangement fees had been levied on a number of customers than might have been expected and these findings were reported to the FSA. The company subsequently agreed with the FSA to conduct a customer remediation exercise for those customers identified as potentially affected by the mis-selling. It was alleged that the liabilities and costs of this exercise amounted to some £2.4 million.

One of the issues in the litigation (and the issue before the Supreme Court) was whether the buyer was entitled to bring a claim against the sellers under the indemnity in these circumstances. The difficulty which they faced was that the requirement to pay compensation was said to have arisen not from a legal claim raised by clients, nor from a complaint made by clients to the FSA or any other regulatory authority but as a result of the referral by the buyers and the company of the findings of the review to the FSA. It was held that these events did not fall within the scope of the indemnity.

In reaching this conclusion the Supreme Court first considered the relationship between *Arnold v Britton* and *Rainy Sky SA v Kookmin Bank*. Here Lord Hodge affirmed that *Arnold* had not 'rowed back' from *Rainy Sky* and confirmed that *Arnold* had not 'altered the guidance' given in *Rainy Sky* nor had it involved a 'recalibration' of the approach summarised in *Rainy Sky*.

Lord Hodge affirmed that, when seeking to interpret a contract, the court's task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. He noted that this is not 'a literalist exercise focused solely on a parsing of the wording of the particular clause but that the court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning.'

The Supreme Court confirmed that the approach to the interpretation of contracts adopted by the courts is both 'unitary' and 'iterative'. Where there are rival meanings, the court 'can give weight to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense.' In striking a balance between the indications given by the language and the implications of the competing constructions the court must consider 'the quality of drafting of the clause' and 'it must also be alive to the possibility that one side may have agreed to something which with hindsight did not serve his interest.' Similarly, the court must not lose sight 'of the possibility that a provision may be a negotiated compromise or that the negotiators were not able to agree more precise terms.' This exercise 'involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated.'

Finally, Lord Hodge observed that:

> 'Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation. Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements. Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance. But negotiators of complex formal contracts may often not achieve a logical and coherent text because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement. There may often therefore be provisions in a detailed professionally drawn contract which lack clarity and the lawyer or judge in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type.'

From this review of the underlying principles, Lord Hodge concluded that 'the recent history of the common law of contractual interpretation is one of continuity rather than change' and that one of 'the attractions of English law as a legal system of choice in commercial matters is its stability and continuity, particularly in contractual interpretation.'

In identifying the true meaning of the words used by the parties the Supreme Court did not find the answer in the natural and ordinary meaning of the words used by the parties. The disputed indemnity clause had not been drafted with precision and its meaning was held to be 'avoidably opaque'. Similarly Lord Hodge did not place much by way of emphasis on the location of the commas given that there are no set rules for the use of commas and, in any event, the draftsman's use of commas was erratic. Nor was it possible for the court to have regard to the negotiations which led to the conclusion of the share purchase agreement given that they are inadmissible. Further, business common sense had a relatively limited role to play in deciding how to strike a balance between the competing commercial goals of buyers and sellers (which were to increase and restrict the scope of the indemnity respectively).

More positively, Lord Hodge held that the 'contractual context' of the indemnity was 'significant' and he attached particular importance to the relationship between the indemnity clause and the range of two year warranties given by the sellers in the share purchase agreement. Had the indemnity clause stood alone, the interpretation advanced by the buyers might well have had greater substance. But the indemnity clause had to be seen in the context of the contract as a whole and, in particular, alongside the wide-ranging warranties given by the sellers. As has been noted, these warranties were time-limited. They gave the buyers a two year time period in which to examine the practices of the business they had bought and to deal with any regulatory matters. As Lord Hodge observed, it was 'not contrary to business common sense for the parties to agree wide-ranging warranties, which are subject to a time limit, and in addition to agree a further indemnity, which is not subject to any such limit but is triggered only in limited circumstances.' This was held to be the true construction of the contract with the consequence that the events which occurred did not fall within the scope of the indemnity (but probably fell within the scope of one of the warranties, albeit that these warranties had apparently expired as a result of the buyers failure to notify the sellers of a warranty claim within the two year period). Thus construed, the bargain may have turned out to be a poor one for the buyers but, as Lord Hodge observed, it was not 'the function of the court to improve their bargain.'

APPLICATIONS OF THE PRINCIPLES BY WHICH CONTRACTS ARE INTERPRETED

A number of issues can be identified arising out of the recent case-law, albeit the cases do not merit individual analysis.

(i) In a number of recent cases, both parties to the litigation have agreed on the general principles to be applied to the interpretation of the contract and the

difference between them has been one that relates to the application of these principles to the facts of the case: see, for example, *Systems Pipework Ltd v Rotary Building Services Ltd* [2017] EWHC 3235 (TCC), [16], *Ziggurat (Claremont Place) LLP v HCC International Insurance Company plc* [2017] EWHC 3286 (TCC), [22], *Gard Shipping AS v Clearlake Shipping Pte Ltd* [2017] EWHC 1091 (Comm), [14] and *Astex Therapeutics Ltd v Astrazeneca AB* [2017] EWHC 1442 (Ch), [87].

(ii) At a general level it can be said that the aim of the court is to determine what a reasonable person who had all the background knowledge which would reasonably have been available to the parties when they contracted would have understood the parties to have meant (*Systems Pipework Ltd v Rotary Building Services Ltd* [2017] EWHC 3235 (TCC), [16]). The court will have regard to the background knowledge reasonably available to the person or the class of persons to whom the document is addressed. The background knowledge that the neutral, reasonable person employs when understanding a commercial document can include knowledge of the relevant law. The court will also seek to place the word or phrase in dispute in its context and in particular the context of the contract as a whole. But a judge should not allow himself or herself to be over-influenced by surrounding circumstances at the expense of the contractual language used by the parties: *TJH and Sons Consultancy Ltd v CPP Group plc* [2017] EWCA Civ 46, [23].

(iii) An emphasis on the meaning of the words used by the parties (and on giving the words their ordinary and natural meaning) is not be equated with an over-literal interpretation of one provision without regard to the whole of the document, particularly in the case of complex documents which have been put into circulation in the market (*Metlife Seguros de Retiro SA v JP Morgan Chase Bank, National Association* [2016] EWCA Civ 1248, *Re Sigma Finance Corp* [2009] UKSC 2, [2010] 1 All ER 571). The normal or dictionary meaning of the words used may yield to their context (*Savills (UK) Ltd v Blacker* [2017] EWCA Civ 68, [33]), although the balance to be struck between the natural and ordinary meaning of the words and their context is not always an easy one to strike.

(iv) The *contra proferentem* rule would now seem to be a rule or principle of last resort. In *Multiplex Construction Europe Ltd v Dunne* [2017] EWHC 3073 (TCC), [2018] BLR 36, [28] Fraser J observed that the rule 'has far less application in modern times than it did before' (see *K/S Victoria Street v House of Fraser (Stores Management) Ltd* [2011] EWCA Civ 904, [2012] Ch 497, [68] and *Persimmon Homes Ltd v Ove Arup Partners Ltd* [2017] EWCA Civ 373, [2017] BLR 417, [52]). He also noted that there 'are in any event better ways of resolving problems of construction, not least construing the actual words used' (see *Arnold v Britton* and *Wood v Capita Insurance Services Ltd*). The *contra*

proferentem rule is of particularly limited application to contracts entered into in a commercial context (even in the case where one of the contracting parties has failed to take legal advice). Fraser J concluded that the *contra proferentem* rule had little if any application to the facts.

(v) In *Carillion Construction Ltd v Emcor Engineering Services Ltd* [2017] EWCA Civ 65 Jackson LJ stated that it is 'only in exceptional cases' that commercial common sense can 'drive the court to depart from the natural meaning of contractual provisions' (see *Arnold v Britton* [2015] UKSC 36, [2015] AC 1619, *Grove Developments Ltd v Balfour Beatty Regional Construction Ltd* [2016] EWCA Civ 990, [2017] 1 WLR 1893 and *National Health Service Commissioning Board v Silovsky* [2017] EWCA Civ 1389). The Court of Appeal did not consider the case to be such an exceptional case. Although the natural meaning of the words produced some 'anomalies' and 'oddities' and, in certain circumstances, the wording taken from the standard form sub-contract could result in one or other party making a bad bargain that did not amount to a justification for the court to depart from 'the natural meaning of the words which they had used or adopted.' On the other hand, in *Sutton Housing Partnership Ltd v Rydon Maintenance Ltd* [2017] EWCA 359 the Court of Appeal rejected the defendant's construction of the contract on the ground that it would have rendered inoperable important parts of the contract (relating to the right to obtain a bonus and the right to terminate the contract in the event that the parties failed to achieve a minimum acceptable performance level). These consequences were held to be 'extraordinary' and to amount to 'an absurdity, which no-one could have intended.' The claimant's interpretation was accepted on the basis that it was 'the only rational interpretation of the curious provisions into which the parties have entered.' However, it may be going too far to say that, in a case where there is no ambiguity in the disputed contract term, considerations of commercial common sense do not need to be considered (*Liontrust Investment Partners LLP v Flanagan* [2017] EWCA Civ 985, [39])

(vi) The relationship between the recitals to a contract and its substantive terms was considered by Coulson J in *Russell v Stone (trading as PSP Consultants)* [2017] EWHC 1555 (TCC). The traditional approach set out in *Re Moon* (1886) 17 QBD 275 consists of three rules. The first is that in the case where the recitals are clear and the operative part is ambiguous, the recital prevails. The second is that where the recitals are ambiguous but the operative parts are clear, it is the operative part that will prevail. The third is the case where both parts are clear but are inconsistent with each other in which case the operative part is to be preferred. In the present case Coulson J noted that modern methods of interpretation, in which background plays a far larger part than used to be the case, may have 'tempered' the traditional approach, such that recitals in a deed can be looked at as part of the surrounding circumstances of the contract without a need to find ambiguity in the operative provisions of the contract.

(vii) It is permissible to take account of conduct subsequent to the making of the contract to identify whether agreement was reached and if so what the terms of the agreement probably were where the contract between the parties has been made by conduct: *Vivienne Westwood Ltd v Conduit Street Development Ltd* [2017] EWHC 350 (Ch), [28]. But it is not possible to have regard to subsequent conduct where the agreement between the parties is made in writing and the issue before the court is one that relates to the meaning of that written term.

(viii) When considering whether to incorporate the terms of one contract document into another contract, the first rule of interpretation is to construe the incorporating clause in order to decide on the width of the incorporation and the second is that the court must read the incorporated wording into the host document to see if, in that setting, some parts of the incorporated wording nevertheless have to be rejected as inconsistent or insensible when read in their new context: *TJH and Sons Consultancy Ltd v CPP Group plc* [2017] EWCA Civ 46, [13].

(ix) Where a contract contains terms which require an item (i) which is to be produced in accordance with a prescribed design, and (ii) which, when provided, will comply with prescribed criteria, and literal conformity with the prescribed design will inevitably result in the product falling short of one or more of the prescribed criteria, 'it by no means follows that the two terms are mutually inconsistent'. While this is a possible conclusion in some cases, 'in many contracts, the proper analysis may well be that the contractor has to improve on any aspects of the prescribed design which would otherwise lead to the product falling short of the prescribed criteria'. In other cases the correct result may be that the requirements of the prescribed criteria only apply to aspects of the design which are not prescribed. The most likely result, however, is that 'the courts are generally inclined to give full effect to the requirement that the item as produced complies with the prescribed criteria, on the basis that, even if the customer or employer has specified or approved the design, it is the contractor who can be expected to take the risk if he agreed to work to a design which would render the item incapable of meeting the criteria to which he has agreed': *MT Højgaard A/S v E.ON Climate & Renewables UK Robin Rigg East Ltd* [2017] UKSC 59, [2017] BLR 477.

(x) In *Burrows Investments Ltd v Ward Homes Ltd* [2017] EWCA Civ 1577 Henderson LJ was careful not to elevate the *ejusdem generis* principle beyond its proper limits, emphasising that it was no more than a 'guide' to be applied by the court when seeking to interpret a contract

FAILURE TO NOTIFY CLAIM IN ACCORDANCE WITH THE SHARE PURCHASE AGREEMENT

In *Teoco UK Ltd v Aircom Jersey 4 Ltd* [2018] EWCA Civ 23 the Court of Appeal held that a purchaser had failed to give a seller notice of a claim in accordance with the terms of a share purchase agreement ('SPA') entered into between the parties. Paragraph 4 of the SPA provided:

> 'No Seller shall be liable for any Claim unless the Purchaser has given notice to the Seller of such Claim setting out reasonable details of the Claim (including the grounds on which it is based and the Purchaser's good faith estimate of the amount of the Claim (detailing the Purchaser's calculation of the loss, liability or damage alleged to have been suffered or incurred)).

The principal issue before the court was whether the purchaser had given the seller notification such as to trigger the operation of the clause entitling the purchaser to bring a claim. The Court of Appeal, upholding the decision of the Deputy High Court Judge, held that the purchaser had not given notice in the required form.

While Newey LJ recognised that 'every notification clause turns on its own individual wording' (*RWE Nukem Ltd v AEA Technology plc* [2005] EWHC 78 (Comm), [10]) he also stated that 'reference to previous decisions can still…be of some assistance' In *RWE Nukem* Gloster J stated that she would 'expect that a compliant notice would identify the particular warranty that was alleged to have been breached.' In *Senate Electrical Wholesalers Ltd v Alcatel Submarine Networks Ltd* [1999] 2 Lloyd's Rep 423 Stuart-Smith LJ stated that 'certainty is only achieved when the vendor is left in no reasonable doubt not only that a claim may be brought but of the particulars of the ground on which the claim is to be based.' Applying these principles to the facts of the present case, Newey LJ concluded that the letters sent by the purchaser had failed to satisfy the requirements of paragraph 4 because they did not identify the particular warranties and provisions of the Tax Covenant on which the claims were based. The 'setting out' of the 'grounds' of a claim required explicit reference to particular warranties or other provisions. The omnibus references in the letters to 'Warranty Claims or Tax Claims' were held to be insufficient because there was 'real scope for doubt' about which provisions were thought by the purchaser to be relevant. Thus in failing to identify the particular warranties and other provisions on which the claims were based, the letters did not comply with the requirements of paragraph 4 of the SPA so that the Deputy High Court Judge had been correct to strike out the purchaser's claim.

INDEMNITY OR GUARANTEE?

In *Multiplex Construction Europe Ltd v Dunne* [2017] EWHC 3073 (TCC) the claimant brought an action for summary judgment for £4 million against the defendant, Mr Dunne. The claim arose out of two contracts entered into between the claimant, Mr Dunne personally

and two of his companies, namely Dunne Building and Civil Engineering Ltd ('DBCE') and its parent company Dunne Group Ltd ('DGL'). The backdrop to these transactions was that DBCE was in significant need of an injection of funds in order to be able to continue its business without interruption. The claimant's case was that the parties had entered into a contract of indemnity under which Mr Dunne was personally liable to pay it the sum of £4 million. Mr Dunne denied that he was liable to pay and submitted that the contract between the parties was one of guarantee that only imposed secondary obligations upon him, with the primary obligations resting with DBCE. Fraser J held that the liability of Mr Dunne was as a primary obligor and that he was therefore liable to make the payment of £4 million to the claimant.

The distinction between a guarantee and an indemnity has proved to be a problematic one in the law of contract. In theory, the distinction is an easy one to draw. An indemnity is a primary obligation undertaken by one party to pay to another on the occurrence of a certain event, whereas a guarantee is a secondary obligation which arises upon the default by the debtor of a primary obligation. Although relatively straightforward to describe, the distinction has proved to be much more difficult to apply in practice (see, for example, *Actionstrength Ltd v International Glass Engineering IN.GL.EN SpA* [2003] UKHL 17, [2003] 2 AC 541) and it depends on the wording of the clause in dispute.

Clause 3 of the agreement between the parties was headed Guarantee and clause 3.1A provided as follows:

> The Guarantor irrevocably and unconditionally guarantees, warrants and undertakes jointly and severally to the Contractor [the claimant] that should the Sub-Contractor [DCBE] suffer an event of insolvency (including but not limited to administration, administrative receivership, liquidation, ceasing or threatening to ceasing carrying on its business in the normal course or otherwise) or otherwise not be able to pay back the Advance Payment to the Contractor immediately upon receipt of a written demand from the Contractor, the Guarantor shall immediately be liable to the Contractor for the payment of the Advance Payment and shall indemnify and hold harmless the Contractor against any loss, damage, demands, charges, payments, liability, proceedings, claims, costs and expenses suffered or incurred by the Contractor arising therefrom or in connection therewith.

Fraser J noted on the basis of this clause that Mr Dunne had 'irrevocably and unconditionally' guaranteed, warranted and undertaken jointly and severally to the claimant that, should an event of insolvency occur, he would 'immediately' be liable to the claimant for payment of the advance payment. Fraser J attached particular importance to the word 'immediately'. This was not a case in which the parties had anticipated that there would be any kind of accounting done with DBCE. Rather, they anticipated an immediate payment to the claimant by Mr Dunne.

In so far as counsel for the defendant submitted that the primary obligation was owed by DBCE rather than Mr Dunne, Fraser J concluded that it made no commercial sense to impose

an obligation upon DBCE to repay the advanced payment on the occurrence of its own insolvency. The commercial purpose of the contract was held to be that the parties had agreed that the claimant, in return for providing substantial cash flow assistance, was to be given the assurance that the sum advanced would be repaid immediately by Mr Dunne and DGL on a joint and several liability basis if DBCE, to whom the sum was advanced, had become insolvent.

The obligation upon Mr Dunne to repay the advance payment to the claimant in the event of the insolvency of DBCE was therefore held to be a primary obligation upon him and that the contract was one of indemnity. This conclusion was reinforced by the use of the word 'indemnify' in the latter part of the clause.

SECTION C: IMPLIED TERMS

THE TEST TO BE APPLIED FOR THE IMPLICATION OF A TERM AS A MATTER OF FACT

The general effect of recent case law (following the decision of the Supreme Court in *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742) has been to emphasise the strict requirements which must be satisfied before a term will be implied into a contract, particularly a written contract of some length which has been negotiated with the benefit of legal advice (see, for example, *Impact Funding Solutions Ltd v Barrington Support Services Ltd (AIG Europe Ltd, Third Party)* [2016] UKSC 57, [2016] 3 WLR 1422; *BP Gas Marketing Ltd v La Societe Sonatrach* [2016] EWHC 2461 (Comm), [320], *Teekay Tankers Ltd v STX Offshore & Shipbuilding Co Ltd* [2017] EWHC 253 (Comm), [2017] 1 Lloyd's Rep 387 and *Co-operative Bank plc v Hayes Freehold Ltd (in liquidation)* [2017] EWHC 1820 (Ch), [99]).

IMPLIED TERMS AND CONTRACTUAL DISCRETIONS

In *Watson v Watchfinder.co.uk.Ltd* [2017] EWHC 1275 (Comm) the claimants brought an action in which they sought specific performance of a written share option agreement. It was common ground that all the formal steps required for the exercise of the option by the claimants had been fulfilled. However, the defendants relied by way of defence on clause 3.1 of the agreement between the parties which provided that

> The Option may only be exercised with the consent of a majority of the board of directors of the Company.

Clause 3.2 further provided that

> If the consent specified in Clause 3.1 has not been obtained by the Investors before the Options Expiry Date the Option shall lapse and neither party to this agreement shall have any claim against the other under this agreement except in relation to any breach occurring before that date."

No such consent had been given and so the defendants submitted that the option could not be exercised. While the claimants accepted that no such consent had been given, they contended that on the facts of the case the lack of such consent should be disregarded.

The first issue to be considered was the interpretation of Clause 3.1. Judge Waksman rejected the submission made by the defendants that the clause gave them an unconditional right of veto. Such a construction would render the option meaningless and defied common sense and so was rejected.

The second issue concerned the scope of the defendants' right of veto. Judge Waksman held that it was subject to the implied term that the defendants' discretion was to be exercised in a way that was not arbitrary, capricious or irrational in the public law sense (*Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 1 WLR 1661). The implication of such a term was held to be necessary to give business efficacy to the contract between the parties. The implied term does not entitle the court to substitute what it thinks would have been a reasonable decision for the decision made by the party entrusted with the discretion and it was also noted that it may not be appropriate to apply to contractual decision-makers the same high standards of decision-making as are expected of the modern state.

A particular difficulty arose on the facts of the present case in that it was not entirely clear what the defendants were meant to be considering when deciding whether or not to give their consent. The claimants submitted that the test was entirely forward-looking and involved asking whether they would be suitable shareholders in the defendant company. Judge Waksman rejected this submission and held that the test to be applied was whether the claimants had made a real or significant contribution to the progress or growth of Watchfinder as a business. Applied to the facts of the case, Judge Waksman held that there was barely any considered exercise of the discretion at all, there was no evidence from the directors themselves and they appeared to be operating on the assumption that they had an absolute veto. There was held to be hardly any real exercise of the discretion at all here but in any event in no way could it be described as in compliance with the implied term. There was no real discussion, it did not focus on the correct matters, it proceeded on a mistaken view of what it was about and it was arbitrary, taking account of the fact that this was a decision of a private company and not a public authority.

Given the failure to comply with the implied term, the court had to proceed as if consent had been given and accordingly the claimants were held to be entitled to succeed on their claim for specific performance of the Option Agreement.

But not every case in which a decision has to be made is a contractual discretion case. In *Brogden v Investec Bank plc* [2016] EWCA Civ 1031 the claimants brought an action against the defendants in order to recover bonuses to which they alleged they were entitled. The relevant provision of the contract between the parties provided as follows:

> **3. Bonus**
>
> You will be entitled to a guaranteed bonus of £6,200,000 . . . payable in your first year of starting employment . . .
>
> In your second financial year of operation starting on 1 April 2008, the bonus calculation will be based on an EVA formula calculated as 40% of EVA generated by the Equity Derivative business. . . .
>
> In the third financial year starting on 1 April 2009 and thereafter the bonus calculation will be normalised based on a formula calculated as 30% of EVA generated by the Equity Derivative business. . . .

At first instance the judge, Leggatt J, held that the bank had a discretion in relation to the manner in which it assessed EVA and that its decision could not be challenged unless it could be shown that it had acted irrationally or in bad faith. The Court of Appeal held that Leggatt J was not correct to hold that the contracts gave the bank a discretion in relation to the manner in which EVA was calculated ([18]). Having been told that the bank used the term 'EVA' to mean revenue, minus costs, minus cost of capital, all calculated before tax, and that EVA for the new desk would be calculated in the same way as that for other business units, it was held that the appellants had a right to have the EVA calculated in that way and that the bank's obligation was correspondingly limited.

SECTION D: TERMINATION

ACCEPTANCE OF REPUDIATORY BREACH MUST BE CLEAR AND UNEQUIVOCAL

In *Vitol SA v Beta Renowable Group SA* [2017] EWHC 1734 (Comm) the claimant agreed to buy 4,500 metric tonnes of biofuel from the defendant. The defendant subsequently stated that it was unable to provide the biofuel in accordance with its obligations. The defendant accepted that in so acting it had a committed a repudiatory or renunciatory breach of its contractual obligations. The claimant's case was that on 27 June 2016 it accepted that breach by failing to nominate a vessel for the carriage of the biofuel by midnight on that date. The defendant denied that there had been any such acceptance and it maintained that the claimant's failure to nominate a vessel had the consequence of relieving the defendant of its obligation to deliver the biofuel. In the alternative the claimant sought to rely on a notice of contractual termination sent by email to the defendant on 7 July 2016.

The law relating to the acceptance of a repudiation is clear. The acceptance requires no particular form but the communication or conduct of the accepting party must clearly and unequivocally convey to the repudiating party that it is treating the contract as at an end (*Vitol SA v Norelf Ltd (The Santa Clara)* [1996] AC 800). Whether or not an act or omission amounts to an acceptance of a repudiatory breach is always a fact-specific question. On the facts of this case, Carr J held, not without 'some hesitation', that there was no such clear and unequivocal conduct by the claimant. The principal difficulty faced by the claimant was that it was relying upon an omission to establish its acceptance. This difficulty was compounded by the fact that the parties had previously agreed to a variation of their contractual arrangements when the defendant had been unable to perform its obligations and the parties were at the time in 'ongoing negotiations'. The fatal obstacle was created by an email sent by the claimant to the defendant at 15.43 on 27 June which read as follows:

> ‘To date you have delivered 0 MT relating to Contract 5289640 and have indicated that you will be unable to do so within the lifting period.
>
> As you should be well aware, you have a contractual obligation to deliver the full 4500 MT specified under the Contracts and failure to comply with your obligations will be in breach of contract entitling us to terminate and/or claim damages against you. Please be advised accordingly.
>
> We continue to reserve all of our rights, under the contract and at law.’

The latter email was held to be inconsistent with an intention on the part of the claimant to terminate the contracts within a few hours by failing to make a nomination. In these circumstances the claimant’s silent failure to nominate a vessel was held to be not a sufficiently clear and unequivocal act to amount to an acceptance of the repudiatory breach. The moral of the story is clear. A party who intends to accept a repudiatory breach should do so clearly and unequivocally, preferably by a written notice, so that there can be no dispute of the type that occurred on the facts of the present case.

Having thus concluded, it was unnecessary for Carr J to decide whether a party who purports to have accepted a renunciation as terminating the contract must also demonstrate that it subjectively believed that the relevant words or conduct were evincing an intention not to perform and that, at the time of acceptance, it actually accepted the same as terminating the contract. The law of contract is traditionally concerned with the objective intention of the parties but there is some authority, which remains in need of authoritative consideration, that acceptance here requires a subjective belief that a repudiatory breach has been committed.

However, Carr J held that the failure to nominate a vessel did not discharge the defendant from the obligation to perform its remaining obligations under the contract. The obligation to nominate a vessel was held not to be a condition precedent to the obligation to deliver the biofuel. The contract between the parties was therefore terminated by the claimant on 7 July 2016 when it sent its contractual notice of termination to the defendant.

INNOMINATE TERMS AND EXPRESS RIGHTS TO TERMINATE

In *Phones 4U Ltd (in administration) v EE Ltd* [2018] EWHC 49 (Comm) the claimant applied for summary judgment to dismiss the defendant’s primary counterclaim. The principal relationship between the parties was to be found in a Trading Agreement which was set to run until 30 September 2015. There was also a set of Pay As You Go Terms which were set to run until 31 December 2014. From 2012 onwards the claimant’s business was under financial pressure and on Friday 12 September 2014 the defendant notified the claimant that it would not renew or replace the Trading Agreement on its expiry. This led the board of the claimant to meet later the same day and to seek the appointment of administrators. The claimant continued to trade over the weekend but on Monday morning (15 September) it did not open its retail outlets and shops and online trading was suspended. The cessation of business turned out to be permanent. On 17 September the defendant sent

the administrators a letter in which it stated that 'in accordance with clause 14.1.2 of the Agreement, we hereby terminate the Agreement [the Trading Agreement] with immediate effect' but adding that 'nothing in this notice shall be construed as a waiver of any rights EE may have with respect to the Agreement.'

In the present claim the claimant sought to recover from the defendant the revenue generated from EE contracts sold by the claimant (which sums would fall due through until 2021). But, as has been noted, the focus of the litigation before Andrew Baker J was on the defendant's counterclaim for loss of bargain damages.

Andrew Baker J held that the defendant had a real prospect of establishing that the claimant had breached the terms of the Trading Agreement. More difficult was the question whether the breach was a repudiatory breach. It was not alleged that the breach was a breach of a condition. So in order to establish that the breach was repudiatory the defendant had to show either that there had been a breach of an innominate term and the consequences of the breach were sufficiently serious or that there had been a renunciation of the contract by the claimant.

When considering whether or not the breach was sufficiently serious the court had to focus attention on the period between 15 and 17 September given that the contract had been terminated on 17 September by the letter sent by the defendant to the administrators. Andrew Baker J held that the loss of business between 15 and 17 September had not deprived the defendant of substantially the whole benefit of the contract (indeed he characterised such a claim as 'fanciful'). The defendant's case that there had been a repudiatory breach therefore turned to a large extent on the likelihood of the claimant's cessation of trading continuing for substantially the whole of the remaining term of the contract. As Andrew Baker J noted 'the question whether a breach of contract was or was liable to become sufficiently serious in its consequences as to go to the root of a contract is inherently a fact-sensitive evaluation.' He concluded that the question of the probable longevity of the cessation of trading by the claimant was not apt for determination by summary judgment. On this basis he was not satisfied that the defendant did not have a realistic prospect of establishing the existence at the time of its termination letter of a repudiatory breach by the claimant of the terms of the Trading Agreement. In this respect he therefore declined to make a summary judgment order.

Given his conclusion on breach of an innominate term, it was not necessary for Andrew Baker J to give extensive consideration to the claim that the claimant had also renounced the contract. He did not grant the claimant summary judgment in respect of this part of the claim either given that the innominate term claim was, subject to the next point, to go through to trial. But the evidence to establish a renunciation seemed much weaker as the claimant did not appear to have indicated that it did not intend to resume trading.

The final issue concerned the impact of the termination letter of 15 September and whether its effect had been to deprive the defendant of its entitlement to bring a claim for loss of bargain damages in respect of any repudiatory breach committed by the claimant. In this connection it is important to note that clause 14.1.2 of the Trading Agreement entitled one

party to terminate the Trading Agreement 'with immediate effect…if the other party…appoints an administrator.'

The characteristic features of the case where held to be that: (i) the defendant had a contractual right to terminate which was triggered otherwise than by breach, actual or anticipatory (namely the appointment of an administrator), (ii) that right was expressly exercised by the defendant and (iii) at the time of termination on 17 September no mention was made by the defendant of any breach, actual or anticipatory, but a repudiatory breach and/or renunciation in fact existed. After an extensive review of the authorities, Andrew Baker J concluded that the 'key question' was whether it was necessary for the defendant's entitlement to bring a claim for loss of bargain damages that the defendant had terminated the contract for breach, actual or anticipatory, by the claimant. He concluded, as a matter of 'first principle', that this was what the defendant was required to do and that, if a letter of termination communicated clearly a decision to terminate only under an express contractual right to terminate that had arisen irrespective of any breach, then it could not be said that the contract was terminated for breach and so a claim for loss of bargain damages could not be brought.

It was therefore necessary to consider whether the defendant's termination letter was an attempt to exercise a common law right to terminate for repudiatory breach and/or renunciation. Andrew Baker J found the termination letter sent by the defendant to be entirely clear, namely that the defendant was exercising its right to terminate under clause 14.1.2, which was a right independent of breach. While it was true that the defendant had stated that it was not waiving its rights, a right reserved is not a right that has been exercised. The defendant retained its right to sue upon any breach of contract committed by the claimant prior to termination of the Trading Agreement but it was not permitted to 're-characterise the events after the fact and claim that it terminated for breach when that is simply not what it did.' It followed from this that the defendant had no real prospect of success on its primary counterclaim and so summary judgment was granted in favour of the claimant.

CONDITIONS PRECEDENT AND THE CONTRACTUAL RIGHT TO TERMINATE

In *Interserve Construction Ltd v Hitachi Zosen Inova AG* [2017] EWHC 2633 (TCC) the defendant contractor entered into a design and build sub-contract with the claimant/ The contract was terminated by the defendant on 6 July 2015 when the claimant was removed from the site. The defendant based its entitlement to terminate the contract on its claim that the claimant had failed to 'proceed regularly and diligently with the Works' and/or had committed 'a material breach' of the contract. These were grounds of termination set out in clause 43(1)(h) and (q) of the contract between the parties. The clause concluded by stating that if any of the grounds of termination set out in the various limbs of the clause had been satisfied

> ‘then, subject to Sub-Clause 43.1A and without prejudice to any other rights or remedies which the Purchaser may possess, the Purchaser may forthwith by notice terminate the employment of the Contractor under the Contract.’

Sub-clause 43.1A of the contract provided that in the case of a default by the contractor the purchaser

> ‘may (at its absolute discretion) notify the Contractor of the default and if the Contractor fails to commence and diligently pursue the rectification of the default within a period of seven (7) days after receipt of notification, the Purchaser may by notice terminate the employment of the Contractor under the Contract.’

When the defendant delivered to the claimant its letter dated 6 July 2015, it stated that it was terminating the contract forthwith pursuant to clause 43(1)(h) and/or (q) and concluded by stating that ‘for the avoidance of doubt, HZI does not exercise its discretion to provide a 7 day period for rectification under Clause 43.1A of the Conditions.’ The claimant disputed the defendant’s entitlement on the ground that it was a condition precedent to the defendant’s entitlement to terminate the contract on the grounds it had put forward that it first issue a notice pursuant to sub-clause 43.1A and give to the claimant a seven day period in which to commence and diligently pursue the rectification. For the defendant it was submitted that, since the giving of notice under sub-clause 43.1A was ‘at its absolute discretion’, the giving of notice could not be a condition precedent to the giving of notice to terminate the contract.

Jefford J held that the claimant’s construction of the contract was the correct one. The natural meaning of the words ‘subject to Sub-Clause 43.1A’ was that the right to terminate was ‘subject to’ or conditioned on sub-clause 43.1A in the sense that, in the instances covered by sub-clause 43.1A, the right to terminate only arose if sub-clause 43.1A had been operated. This being the case, if the defendant had wished to terminate the contract on the grounds it had alleged, it had to first give notice to the claimant and give to it the opportunity to rectify its default.

The defendant sought to refute the claimant’s construction of the contract by relying on the words ‘at its absolute discretion’ in clause 43.1A and maintaining that the claimant’s construction of the clause deprived these words of any effect. Jefford J rejected this submission. She held that the function of these words was to emphasise that the question whether or not to give notice and commence the termination process was a matter for the defendant and that a failure on its part to do so could not have adverse consequences (for example, leaving it vulnerable to the submission that the absence of a notice evidenced the absence of default or the waiver of its right to rely on the default). She also pointed out that the words ‘at its absolute discretion’ were used elsewhere in the contract and that in these contexts it had the meaning that the question whether or not do something was the choice, but not the obligation, of the purchaser and that, in some cases, it expressly provided that the purchaser’s acts did not have any adverse consequences such as the waiver of rights.

SECTION E: VITIATING FACTORS

ECONOMIC DURESS

In *Times Travel (UK) Ltd v Pakistan International Airlines Corporation* [2017] EWHC 1367 (Ch) the claimant travel agents sought to set aside an agreement into which they had entered with the defendant airline. They alleged that they had been pressurised by the defendant to enter into an agreement not to participate as claimants in proceedings brought against the defendant by other travel agents in the Association of Pakistani Travel Agents and instead to enter into a fresh agreement with the defendant. Under this new agreement one of the claimants agreed to give up all accrued claims for commission under previous contractual arrangements between the parties. One of the grounds on which the claimants sought to set aside the agreement was economic duress.

Warren J stated that the necessary ingredients for a successful economic duress claim are (i) pressure which is illegitimate, (ii) the pressure must be a significant cause inducing the claimant to enter into the contract and (iii) the practical effect of the pressure must be that there is compulsion on, or a lack of practical choice for, the victim.

In relation to the first of these points, the word 'illegitimate' is important. Illegitimate pressure is not the same thing as unlawful pressure. Thus lawful conduct can in some cases amount to duress, at least in the case where the threat is coupled by a demand which goes substantially beyond what is normal or legitimate in commercial arrangements. The second point is also important. Warren J interpreted this to mean that the applicable test is a 'but for'

test, albeit that it is not necessary for the claimant to prove that the threat was the overwhelming or predominant cause of the relevant conduct by the claimant. In relation to remedy, Warren J noted that the primary remedy is rescission of the contract. He observed that there was an issue, which it was not necessary for him to resolve, as to whether damages are available in addition to, or in lieu of, rescission. It was not necessary for him to resolve the point on the facts of the case before him but it is suggested that the better view is that damages are not available unless the claimant can establish that the defendant has committed a tort.

Applying these principles to the facts of the present case, Warren J held that the pressure applied by the defendant in relation to one of the claimants had been illegitimate (although whether the defendant had acted in good faith or bad faith in depriving the claimant of its accrued rights to commission was moot) and that the pressure applied was a significant cause of the claimant entering into the new agreement. The claimant had no practical alternative but to submit to the pressure and take what was on offer, albeit that it had protested that this was unfair. One of the claimants was therefore entitled to set aside the new agreement but in the case of the other claimant it remained entitled to recover its accrued commission under a collateral agreement with the defendant and this was held to eliminate the illegitimacy required to establish economic duress.

SECTION F: DAMAGES

MITIGATION, CAUSATION AND BENEFITS RECEIVED BY THE INNOCENT PARTY

In *Globalia Business Travel SAU of Spain v Fulton Shipping Inc of Panama* [2017] UKSC 43, [2017] 1 WLR 2581 a charterer of a vessel refused to accept that it had agreed to extend the hire of a vessel for a period of just over two years. Its refusal to accept the extension amounted to a repudiation of the contract. The extension would have expired on 2 November 2009 and the charterers returned the vessel on 28 October 2007. The owners thereupon sold the vessel for over US$23 million. Had they sold the vessel in November 2009, after the financial downturn, it would have realised only US$7 million. The owners brought their claim for damages calculated by reference to the net loss of profits which they alleged they would have earned during the additional two-year extension. In making this claim the owners identified the revenue which would have been earned under the charterparty in this period while giving credit for the costs and expenses which would have been incurred in operating the vessel for this period but which had been saved as a result of the sale of the vessel. The claim amounted to some US$7.5 million. On behalf of the charterers it was submitted that the owners should give credit for the US$16 million benefit it had received as a result of being able to sell the vessel in 2007 rather than 2009. The Supreme Court rejected the latter submission.

Lord Clarke held that the fall in value of the vessel was irrelevant because the owners' interest in the capital value of the vessel had nothing to do with the interest injured by the charterers' repudiation of the charterparty. There was no sufficient causal link between the benefit sought to be brought into account and the breach of the charterparty. The charterers' repudiation resulted in a prospective loss of income for a period of approximately two years. But there was nothing about the premature termination of the charterparty which made it necessary to sell the vessel. The decision to sell the vessel was a commercial decision made by the owners which could have been taken at any time and was not connected to the breach. At most it could be said that the termination of the charterparty was the occasion for selling the vessel, but it was not the legal cause of it. The decision of the owners to sell the vessel was therefore their own decision which they made for their own commercial reasons at their own risk and which was no part of the subject matter of the charterparty and had nothing to do with the charterers.

Nor could the sale of the vessel be said to be an act of successful mitigation which should have been taken into account in the assessment of damages. The loss in respect of which the claim was brought was the loss of income during the two year period of the charterparty. Relevant mitigation in that context would be the acquisition of an alternative income stream. But the sale of the vessel was not itself an act of mitigation because it was not capable of mitigating the loss of the income stream and so it was not appropriate to bring it into account in the assessment of damages.

NEGOTIATING DAMAGES

In *Burrows Investments Ltd v Ward Homes Ltd* [2017] EWCA Civ 1577 the Court of Appeal held that the defendant had breached the terms of its contract with the claimant in disposing of 5 properties without first obtaining the consent of the claimant. The claimant's claim for damages encountered the difficulty that it had not suffered any loss as a result of the breach. It therefore sought to recover damages on a 'negotiating basis', that is to say, based on the sum of money that the claimant might reasonably have demanded from the defendant in return for releasing it from the restrictions in the sale agreement which prevented the disposal of the properties to the social landlord.

Clause 4.9 of the sale agreement provided that

> 'The Buyer covenants with the Seller not to make any Disposal of the Property or part of it other than a Permitted Disposal at any time during the Overage Period without: -
>
> 4.9.1 first procuring that the person to whom the Disposal is being made has executed a Deed of Covenant and that Deed of Covenant is delivered to the Seller.'

The trial judge declined to award damages on a negotiating basis because he concluded that the contractual restriction in clause 4.9 was not in the nature of a property right but was merely 'a personal covenant' given by the defendant to protect the overage payment obligation. He was unwilling to permit the claimant 'to extract a profit by way of ransom'

and so concluded that damages were not to be assessed on a negotiating basis. The Court of Appeal reversed this finding. The defendant had transferred the properties in breach of clause 4.9 and the claimant was held to have a legitimate interest and expectation that the defendant would not breach its terms. The latter conclusion was reinforced by the fact that the defendant had negotiated with the claimant for three months on the basis that the proposed transfer was not a permitted disposal but had then effected the sale behind the claimant's back and without its consent. It was not the case that the claimant was seeking to extract a ransom from the defendant. Rather, it was simply seeking to be compensated for the loss of the opportunity to negotiate a reasonable price for releasing the defendant from its contractual obligations. The benefit of that contractual restriction was a potentially valuable piece of property in its own right and the claimant had been deprived of the opportunity to exploit it for what it was worth by the defendant's unilateral action.

On this basis the Court of Appeal held that the claimant was in principle entitled to recover damages from the defendant on a negotiating basis in accordance with the principles laid down in cases such as *Pell Frischmann Engineering Ltd v Bow Valley Ltd* [2009] UKPC 45, [2010] BLR 73 and *Wrotham Park Estate Co Ltd v Parkside Homes Ltd* [1974] 1 WLR 798. However, it was not necessary for the Court of Appeal to assess the damages payable to the claimant on this basis. Its only task was to decide whether in principle the claimant was entitled to recover damages on a negotiating basis. Having concluded that the claimant was so entitled, the case was then remitted to the trial judge to determine the issue of quantum if the parties were unable to agree on that matter themselves.

THE SCOPE OF THE PENALTY CLAUSE RULE

The Supreme Court in *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Ltd v Beavis* [2015] UKSC 67, [2016] AC 1172 reformulated the penalty clause rule as it operates in English law and held that the correct test for the identification of a penalty clause is whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's legitimate interest in the performance of the contract.

The scope of the rule was further considered in *Vivienne Westwood Ltd v Conduit Street Development Ltd* [2017] EWHC 350 (Ch) in the context of a side letter between a landlord and tenant. The side letter conferred on the tenant the benefit of a lower rent (£90,000) than that reserved by the lease (£110,000), for the first 5 and possibly the first 10 years of the term. The side letter also contained a cap of £125,000 for the following 5 years if a higher open market was determined on the first rent review in 2014. The lower rent was, however, conditional on various matters, and was also terminable by the landlord in specified circumstances. The right to terminate arose with immediate effect in the event of breach by the tenant of any of the terms and conditions in the side letter, any term of the lease or any term of a document supplemental to the lease. In the event of termination, the side letter provided that 'the rents will be immediately payable in the manner set out in the Lease as if this agreement had never existed.' The first rent review in 2014 produced an agreed rent of

£232,500 but the defendant maintained that it was entitled to the benefit of the cap in the side letter. The claimant disputed this on the ground that it had terminated the side letter following the failure by the tenant to pay one quarter's rent. The defendant claimed that the termination provisions in the side letter were unenforceable as a penalty.

Mr Timothy Fancourt QC, sitting as a Deputy Judge of the High Court, first considered the scope of the decision of the Supreme Court in *Cavendish* before applying it to the facts of the case. In relation to the scope of the decision in *Cavendish*, he derived the following propositions from the case (the references are to the paragraph numbers in *Cavendish*):

> i) Whether or not a contractual provision is a penalty is a question of interpretation of the contract, and the real question is whether it is penal or punitive in nature (paras 9, 31, 243).
>
> ii) In English law, a penalty clause can only exist where a secondary obligation is imposed upon a breach of a primary obligation owed by one party to the other. It is to be distinguished from a conditional primary obligation, which depends on events that are not breaches of contract (paras 14, 32, 258).
>
> iii) Whether a clause imposes a secondary liability upon a breach of contract is a question of substance and not of form (para 15)
>
> iv) A provision that in substance imposes a secondary liability for breach of a primary obligation is penal if it imposes on the party in default a detriment out of all proportion to any legitimate interest of the innocent party in the performance of the primary obligation (para 32), or (using traditional language) which is exorbitant, extravagant or unconscionable in comparison with the value of that legitimate interest (paras 152,255).
>
> v) The onus lies on the party alleging that a clause is a penalty to show that the secondary liability is exorbitant, extravagant or unconscionable (para 143)
>
> vi) Since the penalty rule is an interference with freedom of contract, it is not lightly to be concluded that a term in a contract negotiated by properly advised parties of comparable bargaining power is a penalty (paras 33, 35).

Taking account of these factors, Mr Fancourt QC held that, when considering whether a contractual stipulation is or is not a penalty, a court must address first the threshold issue - is the stipulation in substance a secondary obligation engaged upon breach of a primary contractual obligation; then identify the extent and nature of the legitimate interest of the promisee in having the primary obligation performed, and then determine whether or not, having regard to that legitimate interest, the secondary obligation is exorbitant or unconscionable in amount or in its effect. To the extent that the side letter purported to

permit the lessor to impose a greater obligation upon the happening of any breach of any obligation of the lease, that secondary obligation was capable of being a penalty.

Turning to the legitimate interest sought to be protected by the side letter, Mr Fancourt QC held that the defendant landlord was not able to argue that it had a legitimate interest as such in seeing the rent revert to what it called the market rental level. That would be a legitimate interest in non-performance of the claimant's obligations, not a legitimate interest in their performance. The defendant was therefore required to establish that it had a greater interest in seeing the claimant perform all its obligations promptly than would be compensated by interest, damages and costs otherwise recoverable for a breach of covenant.

When considering whether the secondary liability was exorbitant or not, the first issue considered by the judge was the circumstances in which the defendant was entitled to terminate the side letter. It was held that the right arose on any non-trivial breach of the side letter and that it did not arise only on a material breach. Secondly, it was necessary to consider whether termination of the side letter had retrospective effect. It was held, as a matter of construction, that it did, so that termination at any time during the period of reduced rent had the consequence that the claimant would have to pay additional rent for all the preceding years of the term that had passed, as well as paying it for the future. On this basis it was held that, notwithstanding the fact that the contract was freely negotiated between two advised parties of equal bargaining power, the obligation to pay rent at a higher rate as from the rent commencement date of the lease, regardless of the nature and consequences of the breach and when it occurs, was penal in nature.

SECTION G: EXCLUSION, LIMITATION AND INDEMNITY CLAUSES

THE MEANING OF 'EXCLUDING FRAUD'

In *Interactive E-Solutions JLT v O3B Africa Ltd* [2018] EWCA Civ 62 the issue before the Court of Appeal was whether Interactive E-Solutions JLT could establish an arguable cause of action against O3B which was not barred by an exclusion clause contained in a Master Services Agreements ('MSA') in the following terms:

> THE PARTIES AGREE THAT O3B'S SOLE OBLIGATION AND CUSTOMER'S EXCLUSIVE REMEDIES FOR ANY CAUSE WHATSOEVER (EXCLUDING FRAUD BUT INCLUDING LIABILITY ARISING FROM NEGLIGENCE), ARISING OUT OF OR RELATING TO THIS MSA, ANY SERVICE ORDER, OR ANY OTHER AGREEMENT BETWEEN CUSTOMER AND O3B ARISING OUT OF OR RELATED TO THIS MSA OR ANY SERVICE ORDER, UNDER ANY THEORY OF LAW OR EQUITY ARE LIMITED TO THOSE SET FORTH IN SECTION 6 AND SECTION 8 OF THIS MSA, AND ALL OTHER RIGHTS AND REMEDIES OF CUSTOMER OF ANY KIND ARE EXPRESSLY EXCLUDED

> AND WAIVED. Nothing in this MSA limits the liability of either Party arising from fraud…

The Deputy High Court Judge held that there was no such arguable cause of action because the only claims that fell outside the scope of the clause were claims where fraud or dishonesty formed part of the gist of the claim. Although Interactive claimed that a certificate had been obtained as a result of untrue statements made to the entity which granted the licence, there was no suggestion that Interactive had been misled by anything said or done on behalf of O3B, nor was it alleged that the entity issuing the licence had been misled by the letter containing the allegedly untrue statements. Interactive appealed against that finding but its appeal was dismissed.

Before turning to the specifics of the clause in dispute Lewison LJ made some general comments in relation to the approach adopted by the courts to the interpretation of exclusion clauses. First, he noted that the traditional approach was one of 'hostility'. Second, he noted that that attitude 'began to change with the passing of the Unfair Contract Terms Act 1977.' In particular, he stated that 'since then the courts have become more accepting of such clauses, recognising (at least in commercial contracts made between parties of equal bargaining power) that exclusion and limitation clauses are an integral part of pricing and risk allocation.'

Turning to the specifics of the clause, Lewison LJ noted the legal background to what has been called the fraud 'carve-out', namely the conclusion in *Thomas Witter Ltd v TBP Industries* [1996] 2 All ER 573, 598 that it would inevitably be unreasonable to exclude liability for fraudulent misrepresentation. In an attempt to avoid this conclusion contracting parties have adopted the practice in many cases of stating in express terms that the exclusion or limitation clause does not attempt to exclude liability for fraud. The reference to fraud in this context was held to be a reference to a legal liability. This conclusion was supported by the use of the words 'liability', 'obligation' 'remedies' and 'right of recovery' in clause 10(c). While the word 'cause' could in some circumstances be construed to mean 'reason', in the present context it was held to mean 'cause of action.' The Court of Appeal was not impressed by the submission that this construction rendered much of the detailed wording of clause 10(c) redundant. Lewison LJ noted the 'repetitive' nature of the clause and observed that 'the argument from redundancy seldom carries much weight because…drafters frequently employ linguistic overkill and try to obliterate the conceptual target by using a number of phrases expressing more or less the same idea.'

LIMITING LIABILITY FOR DELAY AND DISRUPTION

In *McGee Group Ltd v Galliford Try Building Ltd* [2017] EWHC 87 (TCC) the issue before the court concerned a term, clause 2.21B, which capped the sub-contractor's liability 'for direct loss and/or expense and/or damages' at 10% of the value of the sub-contract price. It was held that this clause capped liability in respect of all of the claims brought in respect of

delay and disruption (although it did not extend to claims in respect of defective works). In reaching this conclusion Coulson J stated:

> In summary, a clause which seeks to limit the liability of one party to a commercial contract, for some or all of the claims which may be made by the other party, should generally be treated as an element of the parties' wider allocation of benefit, risk and responsibility. No special rules apply to the construction or interpretation of such a clause although, in order to have the effect contended for by the party relying upon it, a clause limiting liability must be clear and unambiguous.

Coulson J held that clause 2.21B was a 'straightforward provision' and that such percentage caps are 'a common way in which parties to a commercial agreement seek to reduce risk and promote certainty.' The cap was not referable to claims made under particular clauses of the sub-contract so the fact that the defendant's claim was not made under clause 2.21 did not mean that the cap was not applicable.

The inclusion of the words 'and/or damages' did not extend the scope of the clause to claims for defective work. Clause 2.21B only placed a limit on claims for damages for delay and disruption. The words 'direct loss and/or expense' were well understood and encompassed claims for financial loss which flowed directly from delay and disruption caused to a main contractor (or a sub-contractor) and which were recoverable under the first limb of the rule laid down in *Hadley v Baxendale* (1854) 9 Exch 341. The defendant's submission that the cap did not apply to claims brought under another clause of the sub-contract, such as clause 4.21, was held to be an 'artificial and uncommercial interpretation' which had no basis in practical reality. Coulson J therefore held that the cap applied to all of the defendant's claims for loss and/or expense and/or damages for delay and disruption.

EXCLUDING LIABILITY FOR NEGLIGENCE AND THE CONTRA PROFERENTEM RULE

In *Persimmon Homes Ltd v Ove Arup & Partners Ltd* [2017] EWCA 373, [2017] BLR 417 the claimants brought an action for breach of contract and negligence against the defendants following the discovery of significant amounts of asbestos contamination site at a development site. The claimants' case was that the defendants should have warned the claimants about the existence of the contamination. The defendants relied by way of defence on clause 6.3 of the contract between the parties which provided that

> 'The Consultant's aggregate liability under this Agreement whether in contract, tort (including negligence), for breach of statutory duty or otherwise (other than for death or personal injury caused by the Consultant's negligence) shall be limited to £12,000,000 (twelve million pounds) with the liability for pollution and contamination limited to £5,000,000 (five million pounds) in the aggregate. Liability for any claim in relation to asbestos is excluded.'

The claimants' case was that the clause did not provide the defendant with protection against the claims which they had brought. They relied upon three principal submissions. First, they submitted that the words 'liability for pollution and contamination' in the first sentence of clause 6.3 meant liability for causing pollution and contamination and not liability in connection with pollution and contamination. The Court of Appeal rejected this submission and held that clause 6.3 was not limited to claims for causing the spread of contamination or asbestos but applied to claims in relation to contamination and pollution and in relation to asbestos (that is, it covered the presence and not simply the movement of asbestos).

Second, the claimants sought to invoke the contra proferentem rule. The attempt to invoke the rule was rejected by the Court of Appeal. Jackson LJ stated that the rule now has 'a very limited role' in commercial contracts negotiated between parties of equal bargaining power (see *K/S Victoria Street v House of Fraser (Stores Management) Ltd* [2011] EWCA Civ 904, [2012] Ch 497, [68] and *Transocean Drilling UK Ltd v Providence Resources plc* [2016] EWCA Civ 372, [2016] 2 Lloyd's Rep 51, [20]). The meaning of the clause was held to be clear, namely that liability for any claim in relation to asbestos had been excluded, and there was no ambiguity to which the rule could apply

Third, the claimants submitted that the defendants had not satisfied the tests laid down by the Privy Council in *Canada Steamship Lines Ltd v The King* [1952] AC 192 for excluding liability in negligence. As is well known, three guidelines were laid down in *Canada Steamship*. First, if the clause expressly exempts a party from the consequences of its negligence then the clause is effective, as a matter of construction, to exclude such liability. Second, in the absence of an express reference to negligence, it must be considered whether the clause is wide enough in its ordinary meaning to encompass negligence. The third principle only comes into play when the second principle has been satisfied. In such a case, the court must consider whether the clause could provide a defence to a claim which is not based on negligence, in which case the clause will generally be confined in its application to that other, non-negligent source of liability.

Jackson LJ noted the controversy in relation to the status of the *Canada Steamship* guidelines and stated that, with the benefit of hindsight, it can be seen that 'it is not satisfactory to deal with exemption clauses and indemnity clauses in one single compendious passage.' Thus he observed that 'it is one thing to agree that A is not liable to B for the consequences of A's negligence. It is quite another thing to agree that B must compensate A for the consequences of A's own negligence.'

Jackson LJ also noted that, in recent years and especially since the enactment of the Unfair Contract Terms Act 1977, the courts have 'softened their approach to both indemnity clauses and exemption clauses' (see, for example, *Lictor Anstalt v MIR Steel UK* [2012] EWCA Civ 1397, [2013] 2 All ER (Comm) 54 at [31] – [34]) and stated that, in his view, the *Canada Steamship* guidelines were now 'more relevant' to indemnity clauses than to exclusion clauses (at least in relation to commercial contracts). He therefore concluded that the guidelines were of 'very little assistance' in the present case (although had it been necessary

for him to do so he would have found that the guidelines were satisfied on the facts of the case).

Finally, in relation to the role of exclusion and limitation clauses in the allocation of risk, Jackson LJ noted that in major construction contracts the parties 'commonly agree how they will allocate the risks between themselves and who will insure against what.' He stated that exemption clauses are 'part of the contractual apparatus for distributing risk' and that there is 'no need to approach such clauses with horror or with a mindset determined to cut them down.'

The Court of Appeal therefore concluded that the meaning of clause 6.3 was clear and that neither the *contra proferentem* rule nor the case law on the exclusion of liability for negligence could come to the rescue of the claimants. The defendants had effectively excluded liability for all of the claimants' pleaded claims in respect of asbestos and contamination.

THE EXCLUSION OF CONSEQUENTIAL LOSS

There is an established line of authority which holds that a clause which attempts to exclude liability for 'consequential losses' is effective only to exclude liability for damages falling under the second limb of the rule in *Hadley v Baxendale*: that is to say, it is effective only to exclude special losses which are recoverable by virtue of the fact that they were in the contemplation of both parties at the time of entry into the contract. Such a clause is not effective to exclude direct losses, including loss of profit, which flows naturally from the breach (see, for example, *Hotel Services v Hilton International* [2000] BLR 235). However, a different conclusion was reached by Sir Jeremy Cooke in *Star Polaris LLC v HHIC-PHIL Inc* [2016] EWHC 2941 (Comm), [2017] 1 Lloyd's Rep 203 where he held that arbitrators had been entitled to conclude that the word 'consequential' was used by the parties in its cause-and-effect sense, as meaning following as a result or a consequence.

The clause in dispute was to be found in Article IX of the contract between the parties and in particular in Article IX 4 (a) which provided

> Except as expressly provided in this Paragraph, in no circumstances and on no ground whatsoever shall the BUILDER have any responsibility or liability whatsoever or howsoever arising in respect of or in connection with the VESSEL or this CONTRACT after the delivery of the VESSEL. Further, but without in any way limiting the generality of the foregoing, the BUILDER shall have no liability or responsibility whatsoever or howsoever arising for or in connection with any consequential or special losses, damages or expenses unless otherwise stated herein.

Sir Jeremy Cooke held that the words 'consequential or special losses, damages or expenses' did not mean such losses, damages or expenses as fell within the second limb of *Hadley v Baxendale* but had the wider meaning of financial losses caused by guaranteed defects, above and beyond the cost of replacement and repair of physical damage.

A number of factors contributed to this conclusion. First, the Article was a 'complete code' which meant that, in order to succeed, the buyer had to bring its claims within its terms. Second, Article IX 4 (d) concluded with the words:

> The guarantees contained as hereinabove in this Article replace and exclude any other liability, guarantee, warranty and/or condition imposed or implied by statute, common law, custom or otherwise on the part of the BUILDER by reason of the construction and sale of the VESSEL for and to the BUYER.

Third, the obligations undertaken by the builder were only to repair or replace defective items of the kind described in the Article and the physical damage caused thereby, with all other financial consequences falling on the buyer. Fourth, given that the only positive obligations assumed by the builder under the contract were the repair or replacement of defects and physical damage caused by such defects, the term consequential or special losses had a wider meaning than the second limb of *Hadley v Baxendale* and instead meant those losses which followed as a result or consequence of physical damage.

The case should not be understood as a case which casts doubt on the authorities which hold that the usual meaning of consequential loss is confined to the second limb of *Hadley v Baxendale*. It was not open to Sir Jeremy Cooke, as a judge sitting in the Commercial Court, to cast doubt on decisions of the Court of Appeal. But the case does demonstrate that the equation of consequential losses with the second limb of *Hadley v Baxendale* is not an inevitable one and that the court can depart from it where it is established on the evidence that the parties did not intend to use the phrase in this sense and they can point to terms in the contract which can only be consistent with the term being given a wider meaning.

THE SCOPE OF SECTION 3 OF THE UNFAIR CONTRACT TERMS ACT 1977

Section 3(1) of the Act provides that 'this section applies as between contracting parties where one of them deals on the other's written standard terms of business.' The meaning of this subsection was considered by the Court of Appeal in *African Export-Import Bank v Shebah Exploration & Production Co Ltd* [2017] EWCA Civ 845, [2017] BLR 469. The context was a claim by the claimant banks for repayment of an advance of $150 million made by the claimants to the defendants pursuant to a facility agreement. The defendants sought to set off counterclaims amounting to $1 billion but the claimants relied upon clause 32.6 of the Facility Agreement which provided that

> 'All payments to be made by an Obligor under the Finance Documents shall be calculated and be made without (and free and clear of any deduction for) set-off or counterclaim.'

The defendants sought to challenge the validity of clause 32.6 under section 3 of the Act. The claimants maintained that the section was not in play because the requirements of section 3(1) had not been satisfied. The Facility Agreement was based on the form of syndicated facility agreement recommended by the London Market Association as 'a starting point for

negotiation.' On the facts of the present case the final form of the agreement was produced following negotiations which took place between the parties and their respective solicitors (which included some heavily marked up redrafts).

The Court of Appeal held that there are four elements which must be satisfied before a claim can be brought under section 3(1). First, the term must be written and, second, the term must be a term of business. Both of these elements were satisfied on the facts of the present case. More difficult are the other two requirements. Third, the term must be part of the other party's standard terms of business. This requires a demonstration that the party putting forward the terms 'habitually uses these terms of business.' It does not suffice for this purpose to show that the terms are sometimes used; it is necessary to go further and demonstrate that they are invariably or usually used (see *British Fermentation Products Ltd v Compare Reavell Ltd* [1999] 2 All ER (Comm) 389).

The fourth requirement is that the parties must deal on those written standard terms. As Longmore LJ recognised, this raises the question of whether the section is applicable where there has been negotiation between the parties the result of which is that some but not all the standard terms are applicable to the deal. For this purpose Longmore LJ held that it was relevant to ask whether there 'have been more than insubstantial variations to the terms which may otherwise have been habitually used by the other party to the transaction.' If there have been substantial variations it is unlikely to be the case that the party attempting to invoke section 3 will have discharged the burden on it to show that the contract has been made on the other's written standard terms of business. He held that there was no requirement that the negotiations relate to the exclusion clause in the contract; it suffices that the negotiations relate to some part of the standard terms of business.

It is important in this case to note the location of the burden of proof. The onus of proof is upon the party alleging that the requirements of section 3 have been satisfied so that it is incumbent on the party alleging that the deal has been done on the other's written standard terms of business to show that this is so. This may require that party to make 'anonymised requests about prospective terms of business.'

Applying the above to the facts of the case, the Court of Appeal held that the defendants had filed no evidence in support of their claim that the deal had been done on the claimants' standard terms of business. Given that there were three different claimants, based in two different countries, there was held to be no basis for the belief that the terms were standard and, in any event, the negotiations between the parties (as evidenced by the drafts which had passed between the parties) were such that the requirements of the section had not been satisfied.

EXCLUSION CLAUSES: INCORPORATION, INTERPRETATION AND REASONABLENESS

In *Goodlife Foods Ltd v Hall Fire Protection Ltd* [2017] EWHC 767 (TCC), [2017] BLR 389 the defendant sought to rely on the following clause (clause 11) by way of defence to the claims brought against it by the claimant.

> We exclude all liability, loss, damage or expense consequential or otherwise caused to your property, goods, persons or the like, directly or indirectly resulting from our negligence or delay or failure or malfunction of the systems or components provided by HFS for whatever reason. In the case of faulty components, we include only for the replacement, free of charge, of those defective parts. As an alternative to our basic tender, we can provide insurance to cover the above risks. Please ask for the extra cost of the provision of this cover if required.

The claim arose from a fire in which the claimant alleged it had suffered property damage and business interruption losses in excess of £6 million. The claimant alleged that these losses had been caused by a failure of a fire suppression system supplied and installed by the defendant. The effect and validity of clause 11 was tried as a preliminary issue.

The first issue was whether the defendant's standard terms, including clause 11, had been incorporated into the contract. HHJ Stephen Davies held that they had been so incorporated. The quotation stated on its face that the defendant's standard terms and conditions would apply and by attaching a copy of these conditions to the quotation the defendant had done enough to incorporate the standard terms and conditions as a whole into the contract concluded with the claimant. The submission that clause 11 was an onerous or unusual clause was also rejected.

The second issue concerned the interpretation of the clause. Here Judge Davies held that the words 'damage…caused to your…persons' amounted, contrary to the submission of the defendant, to an attempt to exclude liability for death or personal injury caused by negligence (contrary to s 2(1) of UCTA) but that it did not attempt to exclude liability for civil fraud (the words 'for whatever reason' being linked back to the earlier words in the sentence and were not to be understood as a free-standing attempt to exclude liability for all forms of liability).

The third issue concerned the reasonableness of the clause. On this point the fact that clause 11 on its proper construction sought to exclude liability for death or personal injury caused by negligence was problematic because s 2(1) of UCTA declares such clauses to be ineffective. The claimant relied on this to submit that the whole of clause 11 was invalid because the court had no power to sever the ineffective part and give effect to the remainder (see *Stewart Gill Ltd v Horatio Myer & Co Ltd* [1992] QB 600). Judge Davies rejected this submission and held, following the decision of the Court of Appeal in *Trolex Products Ltd v Merrol Fire Protection Engineers Ltd*, Unreported, Court of Appeal, 20 November 1991, that the words 'damage…caused to your…persons' had no effect and the question to be asked was one that related to the reasonableness of the remaining parts of the clause (or the clause with the word 'persons' removed).

On the latter issue Judge Davies held that the defendant had discharged the burden of proving that clause 11 was reasonable. The factors upon which he relied in reaching this conclusion

were that the parties were of broadly equal size and bargaining power, the defendant had taken reasonable steps to draw the attention of the clause to the claimant and the loss in respect of which the claimant had brought the claim (damage to its premises caused by fire) was a loss in respect of which the claimant could and should have been covered by insurance (and the defendant also in clause 11 had stated its willingness, if asked, to provide insurance to cover the risks which had materialised).