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Contract Update 2008-9

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Damages

Direct loss is not the same as reasonably foreseeable loss - *The Achilles* reversed:

Transfield Shipping v. Mercator Shipping, HL [2008] 3 WLR 345

(see **2007-8 Contract Bulletin** for QB and CA rulings)

M chartered their bulk carrier to T for 5-7 months (at charterers' option) ending at the latest on 2 May 2004. T duly gave notice of redelivery between 30 April and 2 May. On 21 April the owners agreed a new charter, which was cancellable no later than 8 May. In fact T redelivered on 11 May, 9 days late. The owners had by then missed the cancellation date for their new fixture; more precisely, they had been allowed an extension of the cancellation date only in consideration of a reduction of \$8,000 in the daily hire rate, and they had accepted in order not to lose the entire contract. They claimed damages of \$1.365m, i.e. \$8,000 per day for the whole of the new fixture (192 days, less sums actually received in that period from T) - but equivalent to \$150,000 for each of the 9 days of the overrun period.

The arbitrators accepted that claim by a majority, and it was upheld in the Commercial Court and again in the Court of Appeal: the essential point was that, especially in the specialised shipping market, the type of damage in the event of late redelivery - i.e. loss of profit on a follow-on fixture - was capable of being contemplated as "not unlikely" within the meaning of *Koufos v. Czarnikow ("the Heron II")* even if its extent was not, and even though not one analogous authority had assessed damages at more than the lost differential for the overrun period.

The Lords have now ruled that this is too crude a test - NB per Baroness Hale “*This could be an examination question*” with “*no obviously right answer... We are looking here at the general principles which limit a contract-breaker’s liability when the contract itself does not do so.*” (She added that a comparison between contractual foreseeability per *Heron II* and the scope of liability for professional negligence per *South Australia Asset Management Company* [1997] AC 191, 211 might well make the difference between a congratulatory and an ordinary [sic] first-class degree.)

It was not simply a question of probability and foreseeability, but also of what the contracting parties had to be taken to have had in mind, given the nature and object of the commercial transaction in question. Per Lord Hoffmann: “*It must be in principle wrong to hold someone liable for risks which the people entering into such a contract in that particular market would not reasonably be considered to have undertaken.*”

This common basis was essential to the rule in *Hadley v. Baxendale*. Lord Reid had himself observed that the Court in that case “*did not intend that every type of damage which was reasonably foreseeable by the parties when the contract was made should either be considered as arising naturally, i.e. in the usual course of things, or be supposed to have been in the contemplation of the parties.*”

What mattered here was whether the common intention of reasonable parties to this kind of charterparty would have been that, in the event of a relatively short delay in redelivery, an extraordinary loss, measured by reference to the entire term of the new fixture, was (in Lord Reid’s formulation) sufficiently likely to result from the breach of contract to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within the defaulting party’s contemplation. Here, by contrast, it was contrary to that principle, and to the *Victoria Laundry*

principle (where the Defendant was ignorant of particularly lucrative dyeing contracts not fulfilled because of its late delivery) to envisage the parties contracting on the basis that T would be liable for any loss, however great, occasioned by a delay in redelivery in circumstances where it had neither knowledge of, nor control over, the next fixture – where, indeed, as the minority arbitrator had held, the risk in question was completely and inherently unquantifiable.

Moreover, the rules of liability for reasonably foreseeable consequences differ as between tort and contract - and with good reason, again per Lord Reid: “*In contract, if one party wishes to protect himself against a risk which to the other party would appear unusual, he can direct the other party’s attention to it before the contract is made.*”

It can safely be predicted that this authority will form part of the irreducible corpus of case-law known to every contract student for decades to come.

The burden of proof of lost sales:

Sony Computer Entertainment UK Ltd. v. Cinram Logistics UK Ltd., CA 8.8.08

C was contractually responsible for warehousing and distribution of S’s computer games and accessories. A consignment of 17,000 PlayStation memory cards was stolen on route (from Aylesbury to Basingstoke) in the course of delivery to one of S’s largest customers, Game Stores Group. The memory cards were ordered as a continuous product throughout the year, at a discounted price which was still over 3 times as much as cost price. C admitted liability but only for the cost price (c. £56,000), not their cost to the customer (c. £188,000). The Judge agreed with C that S had the burden of proving that it had lost sales - and thus the goods’ full wholesale

value - on the basis that the stolen delivery had not resulted in replacement orders; he went on to find that S had proved that loss on balance.

Held on appeal, the Judge was wrong but the result was right. There was no evidence here that the specific orders which had not been delivered had been replaced. The evidential burden of proving that there had in fact been substitute sales on which S had recouped its lost profit rested on the Defendant: if, as here, there were no difficulties about remoteness where goods were lost or converted by a bailee in breach of contract, the owner was prima facie entitled to the value of the goods. The Defendant could argue that the lost profit could have been earned in any event by some substitute or replacement sales, at mere manufacturing cost, but if so it was up to the Defendant to prove it.

Affirmation, Exclusion and Conditions Precedent

Breach of condition precedent: election to affirm distinguished from estoppel:

Kosmar Villa Holidays v. Trustees of Syndicate 1243, CA 29.2.08

K were held partially liable (though this was reversed on appeal on 23.10.07, leaving only the issue of costs) to a holiday-maker who had been paralysed in a shallow diving accident in Corfu. It was a condition precedent of the insurers' liability to indemnify K against accidental injury claims that K should give "immediate" notice of (a) any injury and (b) any claim. The accident happened in August 2002 but was not notified to S. The claim was made on 4 September 2003 and was notified to S the same day. 2 weeks later S proposed a joint strategy for dealing with the claim. It did not reserve its rights under the policy. The Claimant's solicitors were told of S's

interest and also contacted directly by S. 2 weeks after that S called for K's explanation for the delay in notification and reserved their rights. K simply asserted that it was impracticable to give notice of each and every injury that occurred, and its previous failure to do so – 16 times in as many months – had not been objected to. S's solicitors responded by repudiating all liability. K argued that (i) an estoppel by convention had arisen not to require notice of the accidents themselves (ii) K's non-compliance with the condition precedent gave rise to an election on S's part whether or not to exercise their right to avoid liability, and by openly dealing with the claim they had waived that right and affirmed the contract.

At first instance (see **2007-8 Contract Bulletin**) the Court rejected the first argument and accepted the second, holding that breach of a condition precedent, especially a procedural one, did not automatically discharge the insurer from liability.

The CA has disagreed. Breach of a procedural condition precedent remained purely in the area of estoppel. Election requires knowledge of the facts by one party and knowledge by the other of the election being made. Even if an insurer begins to deal with a claim, and even if he thereby represents that he views that claim provisionally as fit for indemnity, he is not required to maintain that position for all time. The exercise of his right to conduct or participate in a claim made against his insured is not an election, and certainly not an unequivocal election, to accept liability under the policy; and dealing with a claim is not necessarily inconsistent with subsequent repudiation of liability. In this instance the insurers had not expressly said they were waiving the need for immediate notification or that they were indeed accepting liability to indemnify K. The Judge had also been wrong to say that they had all the information they needed to repudiate earlier than they did.

Extending an insurance policy amounts to affirmation when non-disclosure is known...

Scottish Coal v. Royal & Sun Alliance and others, QB Comm 28.4.08

RSA (leading a consortium of 7 insurers) insured SC's mining operations, the policy being voidable at the insurers' option in the event of misrepresentation, material non-disclosure or material change in the original risk. RSA became concerned as to its risk exposure when SC undertook 'shortwall' mining (mining small pillars between larger mined panels) at the last underground mine in Scotland – Longannet, on the north side of the Forth - but it agreed to extend the policy for an increased premium payable pro rata for the month during which it undertook a review. After the review, and satisfactory action taken by SC to increase structural support, RSA withdrew a notice of cancellation provisionally endorsed on the policy. A collapse then occurred when SC tried to mine through a roadway bisecting the mined panels. Its claim for property and business interruption loss amounted to £6.5m. RSA avoided the policy and refused to indemnify on the grounds that the attempt to mine the cross-cut, and the manner in which it had been done, had given rise to a material change in risk and corresponding disclosure obligations.

Held, the avoidance had been unlawful. SC's plans to mine through the cross-cut had not been disclosed directly to the risk engineer but RSA's adjusters had nonetheless become aware of them before it had extended the policy and withdrawn the provisional cancellation notice. It had not indicated that subsequent extension depended on any reservation of rights and thus, being aware of the potential for avoidance, it had unequivocally elected to affirm the contract. RSA's argument that the insured risk was different from the risk underlying the claim was also rejected: the risk of collapse might well have been increased but its nature had not been changed.

... but affirmation must entail an election between mutually inconsistent rights:

Lexington Insurance v. Multinacional de Seguros SA, QB Comm 23.5.08

A Venezuelan aluminium company suffered a production shutdown and claimed on M for business interruption losses, of which L was the reinsurer. L thought the claim should be rejected after the adjusters changed their mind about liability, but M strongly disagreed and recommended the appointment of other adjusters. L then told M that its conduct breached the claims settlement provisions, since M's co-operation was a condition precedent of L's liability. L nonetheless continued to discuss settlement with M on a without prejudice basis.

L next decided that the claim was time-barred. Again M disagreed and, without consulting L, obtained a ruling from the *Superintendencia de Seguros* that the claim was not time-barred (on the basis that the normal 3 years had been extended by M's own failure to issue a refusal letter). M and L nonetheless agreed to argue that it was, as part of an agreed strategy. 6 months later, in an attempt to placate an important client, M wrote to its insured to say that it considered L's stance legally incorrect and incomprehensible.

It was accepted in retrospect that the claim had indeed become time-barred 3 years after the triggering event. L complained that M's actions had completely undermined the joint strategy as well as the condition precedent. In the ensuing litigation, M argued that L had prospectively waived any further breach of condition precedent, the clause simply ceasing to operate once L considered itself discharged from liability, that its letter to the insured had not expressly waived the time-bar, and that the writer (M's vice-president) did not have the authority to send it.

These arguments did not succeed. Affirmation requires a choice between mutually inconsistent rights. L had been presented with no such choice: if it was right to argue that M was in breach of condition precedent it had been automatically discharged from liability, and if it was wrong it had not been discharged from liability. Raising a defence, although it might involve a choice, did not amount to a contractual election. A reinsurer was entitled to argue that it had already been discharged from liability while actively co-operating in adjustment or settlement without prejudice to that contention. That was also in the interests of both parties, since the reinsurer might change its mind about denying liability, or else its defence might fail. Thus there had been no waiver by L. M had expressly waived the time-bar when writing to the insured and both the president and the vice-president had sufficient authority under Venezuelan law. By renouncing that time-bar, and in any event by its non-co-operation, M had been in breach of condition precedent.

Reasonableness under the UCTA

Regus (UK) v. Epcot Solutions, CA 15.4.08

R serviced office accommodation and E had rented space in its building at Heathrow. When this was closed down, E moved to another building a few miles away at Stockley Park and complained of (a) relocation expenses and (b) the inadequacy of the air-conditioning system, especially in the summer. It withheld fees due to R and counterclaimed when R sued for them. R's standard terms provided that it "*will not in any circumstances have any liability for loss of business, loss of profits, loss of anticipated savings, loss of or damage to data, third party claims or any consequential loss*". (Liability was also capped at the greater of 125% of the fees or £50,000.) The

Judge, finding the air-conditioning to be defective, held the exclusion clause to be unreasonable and unenforceable under the UCTA 1977 since it amounted to a total exclusion of any remedy at all.

Held, it wasn't and it didn't. The obvious and primary measure of loss for R's breach was diminution in the value of the services promised. That kind of loss was not excluded; nor, indeed, were fraud or wilful, reckless or malicious damage. The CA also rejected E's argument that "in any circumstances" covered deliberate infliction of loss by R such as failure to repair the air-conditioning. Such failure was deliberate only in the narrow sense that it depended on unwillingness to spend money but was not a deliberate attempt to cause damage to R's customers. It was negligent and nothing more. There was no inequality in bargaining power and E had rejected R's advice to its customers to take out business loss insurance. The capping provision was severable and was in any case reasonable when considered as a limitation clause, not an exemption clause.

Withholding payment for an alleged breach of condition precedent may be dangerous:

RAM Media v. Ministry of Culture of the Hellenic Republic (Secretariat General of Sport), QB 31.7.08

R had a contract to host a football awards ceremony to be held in November 2006 in Athens: the FIFPro World XI Awards. It was required to use its best endeavours to ensure that the awards were of the highest standard and attracted high-profile celebrities, including at least 6 of the 11 winning football-players. The Greek government was required to procure a venue and a broadcaster to film the event, and to pay a

hosting fee of €4m in 4 instalments. MoC paid the first two instalments but withheld the third on the grounds that R had not used its best endeavours – it did not help that most world-class players would be busy elsewhere in November, and that Greece was briefly suspended from FIFA in July. The parties negotiated possible variations but the ceremony was cancelled 5 days before its scheduled date. The Judge ruled that no variations had actually been agreed, despite agreements in principle. He also rejected MoC's argument that its obligation to pay each instalment was governed by a condition precedent that R should have performed those obligations it ought reasonably to have carried out by the date when each payment fell due. The obligations on one side, and payment on the other, reflected only part of the benefits and burdens of the contract; there had been no direct relationship between the instalments due from M and the services to be provided by R; there had been nothing particularly significant about the third due date; and in any case R's obligations were not set out with the certainty which a condition precedent would require. By refusing to pay the 3rd instalment unless R accepted a more onerous variation, MoC was simply in breach of the agreement and anticipatory breach as regarded the 4th. It had repudiated the agreement.

Fraudulent misrepresentation overrides an Entire Agreement clause:

Peart Stevenson Associates v. Brian Holland, QB 30.7.08

P terminated a 5-year franchise agreement after H, the franchisee of an inspection service for gas and electrical appliances, failed to pay management service fees due. H counterclaimed for misrepresentation inducing the agreement, whereby likely turnover and profitability had been grossly overstated, and the failure rate (in fact 60%) had been disguised. P also alleged breach of a covenant not to compete or

solicit custom in Staffordshire for 1 year after termination. They denied misrepresentation but relied in any event on a clause which declared that H had not relied on any pre-contractual representations (cmp. *Watford Electronics v. Sanderson* [2001] 1 All ER Comm 696).

The Judge agreed with P that failure to pay, when time was said to be of the essence, was a repudiatory breach, and P were entitled to damages based on the business turnover which H should have achieved until 2010 but for the unlawful termination. There had also been a breach of the post-termination competition clause, though no business had been solicited, there was no evidence of any potential replacement franchise and P had suffered no loss: nominal damages of £2 were awarded.

H's counterclaim also succeeded, however. The non-reliance clause was itself unreasonable and could not be relied upon since P's misrepresentations had been fraudulent. Accordingly it fell foul of both S.3 of the Misrepresentation Act 1967 and S.11 of the UCTA 1977. Damages reflecting the position in which H would have been, had he not been falsely induced to contract, exceeded his liability to P eightfold.

Express and Implied Terms

In any agency contract the implied 'effective cause' term may be displaced by an express term:

County Homesearch v. Cowham, CA [2008] 1 WLR 909

C agreed to find a suitable property for D to buy. He paid a registration fee of £500 and agreed to pay commission if he bought a property which C had introduced or

was deemed to have introduced – i.e. if he received those sale particulars from C or any of the estate agents with whom it dealt. D eventually purchased a property included on C’s list, which his planning consultant had drawn to his attention before introducing him to the vendors.

The CA agreed with the Recorder that the express terms of the contract, especially the deemed introduction clause, left no room for the implied term as to ‘effective cause’ which otherwise applied (see Bowstead 18th edn at art.57). There was no relevant distinction between a selling agent and a purchasing agent and the rationale of the implied term was no more than the need to avoid paying two sets of commission. Nor did the agreement fall foul of the Unfair Terms in Consumer Contracts Regulations 1999, art 7, since the meaning of the written terms themselves was not open to doubt.

‘Introducing a purchaser’ means introducing him to the purchase as well as the property:

Foxtons v. Bicknell, CA 23.4.08

B appointed F on a sole agency basis to sell her house in Twickenham. Its terms of business – a standard wording endorsed by the Estate Agents (Provision of Information) Regulations 1991 - entitled it to commission if at any time contracts were exchanged with a purchaser whom F, or any other agent, had introduced during the period of its sole agency or with whom B had negotiated within that period. F showed the house twice to a man who was looking for a property on behalf of his former wife and said he ‘loved it’. The wife then visited the house and did not – she did not even go above the ground floor - and nothing further was heard from either of them. This last visit was after the agency had been terminated (though F was still acting on a

multiple-agency basis). 3 months after that she visited again, under arrangements made by Hamptons, and without further encouragement or contact from F. She agreed to buy and paid the other agent but not F. F only found out what had happened when B, perhaps unwisely, asked it to find her somewhere to rent. When F sued for its commission, the Judge held that the words “at any time” negated any implication that F had to be the effective cause, but in any event it had been.

B’s appeal succeeded. There was no need to show effective cause (see **2007-8 Contract Bulletin, *Dashwood v. Fleurets***), but a purchaser introduced by F did not mean “a person who at some time in the future becomes a purchaser” but rather “a person who becomes a purchaser as a result of F’s introduction.” It was not apparent why an agent should be entitled to commission on a purchase for which he had no responsibility and which effectively originated after the sole agency had been terminated. Otherwise it was more likely, not less, that B would be liable for more than one commission. It was necessary to show that F had introduced the purchaser to the purchase and not merely to the property, and it had failed to do so.

Is the contractual duty of care under the Package Travel, Package Holidays and Package Tours Regulations 1992, r. 15 any higher than an occupier’s statutory duty?

Evans v. Kosmar Villa Holidays, CA [2008] 1 All ER 550

This was the shallow diving accident which led to the question of election and affirmation by an insurer (see 2(i) above). E was not quite 18 when he stayed in an apartment complex in Corfu, under independent Greek ownership and management, on a holiday arranged by the tour operator K. He was paralysed when diving at night

into a shallow pool which had two not very conspicuous “*no diving*” signs around it. These did not comply with the Federation of Tour Operators guidelines. He did not know its depth at the shallow end, though the deep end was only 1.5m, but often saw others diving in at both ends. K, which knew this practice perfectly well despite its denials, had been held 50% liable on the basis that it had failed to use reasonable skill and care in the provision of facilities and services, under a duty which was higher than an occupier’s duty to ensure the reasonable safety of its premises.

The CA ruled that the accident would have been entirely E’s fault even if K had been the occupier – see *Tomlinson v. Congleton BC* [2004] 1 AC 46; *Ratcliff v. McConnell* [1999] 1 WLR 670 – and that in any case there was no valid distinction to be made in E’s favour. There was no evidence that conditions at the apartment complex breached any relevant and local safety regulations. K’s contractual duty did not extend to guarding its clients against obvious risks or placing better or more prominent warning signs which, in any case, would probably not have stopped him from acting as he did in a moment of foolhardiness.

Retention of title does not in itself preclude freedom to sell:

Cl 6: “We shall open Letters of Credit on your suppliers in our name and sell the machines to you with reservation of title... You will invoice your customers with the debt assigned to us with the following assignment notice printed on them...”

Fairfax Gerrard Holdings v. Capital Bank Plc, CA [2008] 1 All ER 632

F provided finance for the buyer (D) of die-cutting machines from China which were to be sold to a customer financed by CB. The arrangement was that CB would buy

from D and lease to the end-customer. CB duly paid D, who took delivery but then went into liquidation before paying any more than the deposit. The end-customer had never signed the trust receipt sent to it.

The finance agreement between F and D contained an R.O.T. clause and also Clause 6 as set out above. The Judge held that D had had no express or implied authority to pass title and CB was thus (by purporting to lease the machinery) liable in conversion. He rejected the argument that D had had consent to pass title to the end-customer or to CB. He also found - thus disposing of the Factors Act 1889 / Sale of Goods Act 1979 defences – that CB was not a purchaser in good faith as it had failed to prove that it had no notice of any want of authority.

CB’s appeal succeeded. Clause 6, when considered on its own, recognised implicitly that before payment was effected title would lawfully be passed, at least to certain identified customers, and that upon sale the debt from the ultimate customer should be assigned. The only purpose in including a requirement that invoices to customers should bear notice in a particular form was that D should be entitled to pass title in the goods and hold the proceeds of sale effectively on trust. It was not a precondition of D’s authority to sell that it should have executed the assignment or signed a trust receipt, and there was no inconsistency between a retention of title clause and an implied or even express right to sell.

Avoidance of literal, but absurd, construction:

Croftcall v. Morgan Ch 11.7.08

C bought Ms’ shares in a property portfolio holding company, the properties appearing

in the company accounts as trading stock - and hence on the balance sheet as current assets at their historic cost (about £3m). On the basis that M estimated their present value to be about £16m gross or £10m net, a fixed share sale price was agreed at c. £14m, which was subject to adjustment “*having regard to the assets and liabilities*” as at the completion date.

M produced completion accounts showing the properties’ current value rather than historic book value, as well as other minor debts, with the result that the sale price was roughly trebled. C sued for a declaration that the true interpretation of ‘net current assets’ was not intended to include the stock of properties, since this would mean payment twice over for the same assets: the share purchase agreement was at a fixed price whereas the completion accounts mechanism was designed to update lesser reconciliations such as in rents and deposits.

The Court agreed. M’s interpretation, though literally correct, produced an absurd result that the parties could not have intended. Otherwise the share price would be adjusted by reference to the very assets that had already been taken into account in fixing the agreed price, before adjustment, at what was commonly believed to be open market value. The Court was required – see *Investors Compensation Scheme Ltd. v. West Bromwich Building Soc.* [1998] 1 WLR 896 HL – to interpret contractual language in a way that produced a sensible result in the light of the relevant background material. The implied limitation was essential to make commercial sense and the contract should in any case be rectified.

The Judge offered another pleasing example of a statement open to literal but absurd construction: the check-in warning at Gatwick “only one piece of hand luggage may be taken on board the aircraft”. [There used also to be large signs on the London Underground declaring: “Dogs must be carried.”]

What is meant by “liability”? Does it include an unenforceable liability?

Conister Trust v. (1) John Hardiman & Co. (2) MacClure Naismith, CA 21.7.08

C, a Manx Bank, devised a litigation funding arrangement, whereby panel solicitors such as JH would act for clients on a conditional fee basis, supported by ATE insurance. The scheme made the ATE premium, and all other disbursements, the subject of a loan from C to the client, the loan being subject in turn to the Consumer Credit Act 1974. These expenses of course had to be the client’s personal liability in order to be recoverable from the opponent under the indemnity principle.

C alleged mismanagement by JH with the result that nothing was recovered from defendants or proposed defendants and no insurance recoveries either because they were not pursued. C’s claim was for the sums outstanding on the loan agreements, JH having agreed by Cl. 4.5 of its contract with C to discharge any “*remaining liability*” of the borrower in such circumstances. JH’s defence was that the loan agreements between C and the clients were unenforceable for failure to comply with the CCA – specifically, failure to refer to rights of cancellation pursuant to S. 64 - and therefore that no “*remaining liability*” existed which JH were obliged to discharge instead.

C also alleged negligence against MN, solicitors specialising in consumer credit who had drafted the loan agreements. Unsurprisingly, they disputed JH’s contention. The skeleton arguments on this “*short but difficult point of construction*” ran to 130 pages.

Reversing the preliminary issue Judge, the CA rejected C’s argument that “*liability*” was apt to include an obligation that was unenforceable by virtue of the 1974 Act. The natural meaning of liability, in this context at least, referred to a person being liable in law. That was reinforced by the fact that Cl 4.5 referred not only to the

borrower's "remaining liability" but also to "any liability on a borrower under that borrower's Consumer Credit Act Agreement". The Judge had been wrong to hold that clause 4.5 should not be read so as to deprive C of recovery of any shortfall caused by JH's conduct, since the parties had to be taken to have foreseen the risk that a credit agreement either was or might become unenforceable. Cl. 4 ("repayment of the Advance") set out the necessary procedural steps for recovery, and the circumstances in which the solicitor might be responsible for unenforceability were remote. Equally, JH had not been undertaking some form of obligation to secure the carrying out of the clients' obligations.

The CA was unpersuaded by C's reliance on the general principle that an indemnity remains enforceable even where the primary obligation is not: the cases relied upon tended to show either that the person giving the indemnity was being treated as a principal, or that the agreement in question in fact imposed liability regardless of the validity of the primary obligation.

The Court also distinguished *R v. Modupe* [1991] CCLR 29, a case of fraudulent evasion of liability under a loan agreement which did not comply with regulations under the CCA but was thereby rendered enforceable only with the court's permission. Liability or potential liability existed to that extent, whereas by contrast failure to comply with S. 64 (cancellation rights) taints the agreement absolutely under S. 127.

Rights of assignment: Can a liquidator assign contractual claims if Statute says he can and the contract says he can't?

Ruttle Plant v. Secretary of State for Environment and Rural Affairs, TCC [2008] All ER Comm 264

In 2001 MAFF engaged Farm Assist Limited for emergency work after the foot-and-mouth outbreak. A dispute over its fees resulted but was eventually compromised at roughly half of FAL's invoices. The company then became insolvent and was wound up on the Revenue's application. Its liquidator assigned all rights of action to R, in exchange for 33% of any sums recovered, and R sued for breach of contract and rescission of the settlement agreement, which it alleged was procured by the Ministry's economic duress.

But the contract with the government prohibited FAL (without consent) from assigning or sub-contracting "any portion of the contract". This clause was held to prevail over, or rather to qualify, the Liquidator's statutory rights under Schedule 4 of the Insolvency Act 1986. The latter conferred extensive powers to the liquidator to sell property, including power to dispose of a cause of action in exchange for part of the proceeds, but that did not mean that such a right existed where the Parties had expressly agreed that there should be no assignment.

There was nothing in the argument that Cl. 21 had been intended to terminate upon liquidation. However, although a contractual prohibition might in principle be a circumscription of statutory powers which was contrary to public policy, the existence of the right to assign by virtue of the Act alone did not suffice.

Covenants in Restraint of Trade

Restraint is likely to be too wide if preventing contact with customers with whom there have been no personal dealings:

WRN v. Ayris, QB 21.5.08

A resigned from the satellite broadcasting company where he worked for 8½ years, first as Rebroadcasting Manger and later as Head of Sales and Marketing, and went to work for a competitor. W sued for an injunction, claiming that the new employer shared a number of its customers with whom A was likely to have contact. His previous contract had prohibited him, for 6 months after termination in any capacity whatsoever (albeit for certain products and services only) from seeking or accepting any business, orders or custom from any customer of W's. After his resignation he also signed an agreement shortening his notice period but extending the period of restraint to 12 months. A argued that the restraint was unnecessarily wide and the termination agreement unenforceable for want of consideration.

The Court agreed on both points. The leaving contract brought forward the date after which no salary was payable, and thus the only arguable consideration passing from W was a promise to perform an existing contractual obligation. The restrictive covenants were unreasonable since they went beyond preventing contact with customers A had previously dealt with personally. Reasonableness had to be adjudged at the time when the agreement was made, regardless of the prospect of promotion, and an important part of A's role had been to foster contacts with actual or potential customers, especially at senior level. 6 months was reasonable but the general restraint was not.

12 months' restraint is *prima facie* too long unless justified by evidence of its necessity in the specific circumstances:

Basic Solutions v. Sands, QB 23.6.08

BS made chemical products including a 'track grip' solution for railway tracks. It sought injunctions when S prepared a tender for the same contract with Network Rail within days of leaving the company. It was alleged that this breached a 12-month restrictive covenant. But while refusing relief on the grounds that the mere provision of samples for testing did not amount to "supply", Eady J also held that BS had failed to put forward any evidence of the particular factors relied upon as justifying what was *prima facie* an excessively long period of restraint.

"I cannot see, as a matter of general principle, how the fact that there may sometimes be long lead times in tendering for and obtaining contracts should, in itself, have a bearing upon the period for which restrictive covenants should be effective."

This is a salutary warning: claims are often brought to enforce 12-month (and sometimes longer) restraint clauses without sufficient thought being given to evidential justification for the length of restraint.

Restraint of competing business is unreasonable if there is no business with which to compete: - but this includes potential as well as actual business.

Chipsaway International v. Kerr, QB 30.7.08.

C operated a bodywork-repair system for franchisees using its name and products but did not itself run a repair service. K was a former franchisee in Banbury who set

up a body-shop but whose contract prevented him, for 12 months after termination, from being engaged in any capacity in any business which competed with C's business within the territory. At the date of termination C did not have another franchisee within the same territory – i.e. 6 postcodes in Oxfordshire - and was not specifically looking for one.

C's claim for injunctive relief failed at first instance. The crucial words in the covenant were: "*which competes with the Business*". That referred to facts as they were at the date of termination and not to the possibility of future competition. K's business did not in fact compete with C's because C had no such business within the designated area. The position would change if it did grant another local franchise within 12 months of termination but unless and until that happened there was no breach.

The CA reversed this decision on 11.3.09. The fact that C did not look for a new franchisee was irrelevant: the meaning of the covenant was not dependent on there actually being a new franchisee in the territory. Its purpose was also to provide breathing space for 12 months to allow C to find one. It was there to protect C's goodwill, and there was no sense in denying protection during the period when it was really needed. The commercial purpose of the restrictive covenant was partly to stop K from carrying on business which would hinder C in finding a new franchisee.

Compromise Agreements

Waiver of future claims: clear and express words are required for a settlement agreement to apply to fraud:

Satyam Computer Services v. Upaid Systems, CA [2008] 2 All ER Comm 465

S developed a computer program for PIN-operated telephone accounts that U intended to patent, assigning the relevant intellectual property rights and negotiating a separate services agreement. The relationship broke down and ended in various proceedings and applications. These were eventually settled by agreement under English law and jurisdiction. U subsequently alleged (in Texan proceedings) patent infringement involving forgery by S of employees' signatures on its provisional patent application.

S maintained the action was a breach of the settlement agreement, Cl 21 of which barred any future claim "*arising out of or relating in any way to the Services Agreement including claims relating to representations, warranties, intellectual property rights, quality of services performed...*"

The Judge and CA disagreed. Express words are required for a settlement agreement to apply to fraud. In the absence of clear language the Court would be very slow to infer that a party had intended to surrender rights and claims of which he was unaware, and could not have been aware. In any case the claim in Texas had been brought in relation to the assignment agreement, whereas the settlement related overtly to the Services Agreement. Although these overlapped to some degree, they had different operative dates and the latter had not superseded the former.

Are unapproved ancillary settlements binding? Do agreements in a will survive its revocation?

Soulsbury v. Soulsbury, CA, Times 14.11.07

After their (amicable) divorce H was ordered to make periodical payments. There was no lump sum or property adjustment order. 3 years later, on his 50th birthday, H suggested to W that in lieu of maintenance he should leave her £100,000 in his will. W eventually agreed, in a telephone conversation, and H made a will to that effect. H then remarried. He died later the same day. His widow refused to honour the £100,000 legacy under a will which the act of remarriage had automatically revoked (Wills Act 1837, s.18). She also argued that ordinary contractual principles did not determine the issue of accord since an agreement to compromise ancillary relief gave rise to no enforceable promise unless and until approved by the Court.

Held and upheld, where the promisee had honoured her bargain the deceased would remain bound to honour his own. If he failed to provide payment for W upon his death a breach of contract claim would lie against his estate. The question was whether it made any difference that a bargain to forgo maintenance payments had not been sanctioned by the Court. This depended on the nature of the agreement. If it were an agreement to oust the jurisdiction of the court it would be void and a wife could not contract herself out of her statutory right to maintenance, *Hyman v Hyman* (1929) AC 601 HL. But here the agreement was to pay £100,000 subject to conditions subsequent, namely the death of H, and W not having enforced any arrears or applied for further matrimonial relief – as she had been free to do. Those events had been fulfilled and the obligation crystallised on H's death. W had not bartered away her right to future maintenance nor prevented any consideration by the court of her

claims. In those circumstances the jurisdiction of the court had not been ousted. Dicta which appeared to suggest the contrary in *Xydhias* [1999] 2 All ER 386 were too wide. This particular agreement was not a compromise of an application for ancillary relief, there was no pending application to compromise and neither party envisaged going back to court to approve the agreement. It was a perfectly valid agreement. His estate was in breach of an agreement binding upon it and S was entitled to her damages.

Warranty as condition or condition precedent?

Collidge v. Freeport Plc, CA 5.3.08

“Subject to and conditional upon the terms set out below the company will... [pay you]

.... You warrant as a strict condition of this agreement that....”

C was the founder and chief executive of F, which created “retail outlet villages”, but was accused of financial impropriety and was bought out. F's obligation to pay was (see above) subject to terms, including a warranty by C that he knew (actually or constructively) of no circumstances that might constitute a repudiatory breach of his contract of employment such as would have entitled F to terminate his employment without notice. Before paying C, F told him that matters had come to light which (in the absence of explanation) were a breach of his warranty – in brief, systematically fiddling his expenses. C's response was to sue.

The Judge rejected C's argument that (i) the term in question was not a condition precedent but (ii) even if it were, it had been met by C simply giving the warranty, and

that F had not been entitled to terminate the agreement before its obligation to pay had accrued.

The CA agreed. Although the condition was not expressed to be a condition precedent, the structure and wording of the agreement as a whole made it clear that the payment of compensation to C by F was conditional on the terms that were contained therein. It was a *sine qua non* of those terms that the facts were as warranted before F became liable to make any payment at all; indeed, the warranty itself had the same force as in an insurance contract. F had properly and sufficiently protected itself against the possibility that C's promise and guarantee of conduct were untrue, as they were.

Guarantees and Indemnities

What is the difference?

Pitts v. Jones, CA [2008] 1 All ER Comm 548

P were employees and minority shareholders in a shopfitting company of which J was the MD and majority shareholder. J wanted to sell his shares and told P they would need to raise £500,000 to exercise their rights of pre-emption. He also said he had found a corporate purchaser who was willing to buy their shares, too, at the same price though in instalments. P were willing to waive their pre-emptive rights but were worried that they would have no security, and their options would be worthless if the purchaser became insolvent before buying their shares. To persuade them to sign the option agreements, J orally undertook that if the named buyer did not pay for their shares he would. On legal

advice he declined to put this in writing. The option agreements were duly signed and the waiver of pre-emption rights was approved at an EGM, convened at short notice with P's consent, along with a loan by the company to the buyer. The sale of J's shares went through but the buyer became insolvent and P received nothing.

The issue in their action for the shares' value (£714.29 per share) was whether J's oral undertaking was a guarantee or a contractual indemnity. If the latter, it was enforceable; if the former, it fell foul of the Statute of Frauds 1677 S.4.

The CA reversed the initial finding that there had been no consideration for J's promise - there had been, even if P had not consciously worked out exactly what it was - but nevertheless agreed that it was in the nature of a guarantee. A guarantee is a special type of contractual indemnity whereby one person promises to answer for the debt or default of another. Generally speaking, this applies to promises which are separate and distinct from a primary contractual obligation. The test proposed by Lord Esher MR in *Sutton v. Grey* [1894] 1 QB 285 was whether the Defendant had an interest in the transaction or was totally unconnected with it. Later authorities looked rather at the object of the contract seen as a whole and whether the promise could be said to be incidental to that central object. If so, it was an indemnity. They stressed that liability, under an indemnity, is independent of the question whether a third party makes default or not, whereas "*the Statute applies only to promises made to the person to whom another is already or is to become answerable*" (*Harburg India Rubber Comb Co. v. Martin* [1902] 1 KB 778).

J's undertaking to P was not part and parcel of the transaction whereby he sold his own shares with the company's approval and financial backing. He had involved himself in the transaction with P only as a means of persuading them to co-operate

in the main transaction. The only connecting thread was thus motive, not contractual object. There was no larger transaction which subsumed all these steps and events. The oral promise was unenforceable.

“Payment on demand”: must there always be proof of the guaranteed debt?

IIG Capital Plc v. Van der Merwe, Ch [2008] 1 All ER Comm 435

“all monies and liabilities (whether actual or contingent) which are now or may at any time hereafter be due, owing, payable or expressed to be due, owing or payable to the Lender from or by the Borrower ... ”

V’s fruit and vegetable importing company had a loan facility of \$23m, governed by New York law, and V signed a document described as a Guarantee, governed by English law, which recorded the facility, the condition precedent that V guaranteed its obligations thereunder and a condition that Guaranteed Monies (defined as above) were payable “immediately upon demand unconditionally”. The company failed to pay some \$30m demanded of it (including interest and charges), and so did V when IIG certified that amount as due under the loan agreement. IIG sought summary judgment. V argued that apart from mere demand there had also to be proof of liability under the underlying loan agreement, and accordingly that they were entitled to raise defences that their company could have raised.

The Court accepted, on appeal from the Master, that with private individuals rather than banks there was a strong presumption against giving the words “*on demand*” the effect of creating an independent primary obligation – in contrast for example to a performance bond. But here the definition of “Guaranteed Monies” included not

only moneys that the company actually owed but also moneys “expressed” to be due, owing and payable. This sufficed to displace the usual presumption. V’s liability was not necessarily co-extensive with that of their company. They had agreed that a certificate in the prescribed form would be conclusive and binding on them save in the case of manifest error, of which there was none.

[appeal dismissed 22.5.08]

Mistake

Rectification cannot be made if the mistake is not as to the contractual terms but as to their legal consequences:

Oun v. Ahmad, CH 19.3.08

O agreed to buy A’s lease of an off-licence and the flat above it in Bolton. The agreement (said to be a deed but not under seal and therefore not a deed) stipulated a payment in advance and the balance on completion but did not apportion consideration as between property, fixtures, and goodwill, nor what was to be done with trading stock. A second document was therefore drawn up, 2 hours later, to deal with these matters. When the parties fell out over completion, an adjudicator found that the agreement - comprising as it did 2 documents - fell foul of s. 2 of the Law of Property (Miscellaneous Provisions) 1989, and also that rectification of the original document was impossible since it had reflected the parties’ common intentions relevant to that document. Accordingly O did not have the benefit of a binding contract and had not been entitled to register a unilateral notice against A’s title.

O's appeal was dismissed. By S 2(1) such a contract had to be in writing and all the material terms had to be incorporated in one document. Once the agreed terms were established it was necessary to see whether they were all incorporated or not. If not, there was no valid contract. This might in principle be subject to rectification, but rectification was not available where the parties had executed the agreement they intended to execute and the mistake (of one or both of them) was as to its legal consequences. On the evidence accepted here, although the agreed terms had not all been recorded in the first document, this was because the parties had expressly agreed not to include the terms as to apportionment. An express agreement to omit terms meant there was no mistake in the written expression of the arrangement, and rectification could not extend to a term which the parties had expressly agreed should not be recorded.

Footnote: *Statoil v. Louis Dreyfus Energy Services* 29.9.08 – there is no equitable jurisdiction to order rescission when one party has made a unilateral mistake of fact as to the basis of a contract but his assumption does not become a term of the contract.

Penalty Clauses

Are minimum payment requirements penal? Curiously, although such provisions have been commercially commonplace from time immemorial, there is no previous authority:

M & J Polymers v. Imerys Minerals, QB [2008] 1 All ER (Comm) 893

C supplied chemical dispersants under a supply contract lasting at least 3 years. The

contract, noting that the buyers wanted a “regular and reliable supply”, required D to order minimum quantities and also to pay for minimum quantities even if they had not ordered them. When C alleged repudiation and claimed damages for unlawful termination, D protested that this ‘take or pay’ provision was a penalty clause, not a mere claim in debt for the agreed price.

The Court accepted that it would be simplistic to say that the law on penalties had no application where the claim was for an agreed sum due from the defendant in return for the claimant's contractual performance. A minimum payment clause in a hire purchase contract, though expressed as a debt, could readily be penal in nature. It was the substance of the arrangement that mattered. A clause would not be penal where it provided for payment upon the happening of a specified event other than breach of a contractual duty owed to the intended payee; but in this situation the obligation to pay was triggered by breach - because it arose where D had failed to order the minimum quantities stipulated in the agreement. The rule against penalties therefore applied in principle. Nonetheless the clause was commercially justifiable, was not oppressive and had been freely negotiated and agreed between parties of equal bargaining power. Nor was it a deterrent provision applied in terrorem. C was entitled to damages.

Liquidated damages clauses triggered by failure to turn up for work – here, too, there is no previous English authority:

Tullett Prebon Group Ltd. v. El-Hajjali, QB 31.7.08

T wanted to hire a specialist derivatives broker for their global foreign exchange, commodities and equities business and E, an expert in Variance Swaps, was head-

hunted. Both parties took legal advice during negotiations. One clause specifically drawn to his attention - his solicitors even advised him that T would probably sue upon it - provided that if E failed to take up the job he would have to pay T a sum equal to 50% of his basic salary and 50% of any payment due on signing (which on the evidence totalled £294,000). E signed the contract but 5 days later he changed his mind about the job. T was unable to find a replacement and sued. E argued that this was a penalty clause and that his breach had caused no loss.

The Clause was upheld. It was not extravagant or unconscionable in comparison with the greatest range of loss (running into millions) that could conceivably flow from breach. E's presence was critical to the particular project and function his employers had in mind, and there was no reason in principle why a liquidated damages clause could not form part of an employment contract provided it was not penal in substance. E had taken legal advice and was well aware of what he was agreeing to, and in circumstances of equal bargaining power the court should be slow to allow a party to resile from his agreement. T would probably be able to establish loss resulting from E's breach which was actually in excess of the sum provided for. It did not matter that the parties had not discussed or agreed what that loss might be. Nor did the deterrent aspect make a clause penal in itself unless that were its predominant purpose. Damages here could not be for the cost of a replacement - since T had been unable to find one - but rather for consequential loss, and that had been fixed in advance in a liquidated sum.

Adrian Salter

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Adrian Salter specialises in all aspects of contract litigation, commercial disputes, fraud and professional negligence. His forensic strengths are in advocacy, rapid assimilation of facts and immediate identification of the critical issues of a dispute. Adrian's fluency in French, Italian and German is often usefully deployed in multi-national and cross-border business disputes. He acts extensively for SIF, Zurich Professional, St. Paul's and other insurers, particularly in relation to solicitors' negligence, and has arbitrated several apportionments of liability. He is an avid amateur pianist and singer (baritone). His dream case materialised when acting for the Fire Brigade after its appliance collided with an opera singer outside Harrods. She tore her vocal cords as she screamed, claimed galactic damages for the loss of her career, and after musicological cross-examination recovered £3,000.



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