

Some recent developments in English contract law

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Introduction

The aim of these notes is to provide a brief survey of the main developments in contract law over the past couple of years.

The notes will be updated from time to time.

Construction and implied terms

There has been much recent authority on the interpretation of contracts and implied terms, refining with ever increasing sophistication the principles stated by Lord Hoffmann in Investors Compensation¹ and Belize². Many decisions emphasise business sense, or commercial sense, or common sense, but often what makes sense for one judge is nonsense to another.³ Ascertaining the meaning of a contract can be a complex business. Recent cases deal with a number of overlapping topics, including how to approach interpretation, whether “something has gone wrong with the language” so as to justify “constructive rectification”, implied terms, old-fashioned “full blown”⁴ rectification, and issues about the admissibility of evidence.

For anyone who needs a more comprehensive review, there are articles by Lord Grabiner Q.C. in the Law Quarterly Review on the interpretation of contracts⁵, and by Mr. John McCaughran Q.C. in the Cambridge Law Journal on implied terms.⁶

The first recent authority to mention is, inevitably, Rainy Sky⁷. This is often seen as a case which, in the eternal battle between literal and contextual interpretation, favours the

¹ Investors Compensation Ltd. v. West Bromwich Building Society [1998] 1 W.L.R. 896 at 912-3.

² A-G of Belize v. Belize Telecom Ltd. [2009] 1 W.L.R. 1988.

³ For example, in Investors Compensation the appellants lost in a unanimous Court of Appeal, which was overruled by a majority in the House of Lords.

⁴ So called by Arden L.J. in Cherry Tree, below at [25].

⁵ [2012] L.Q.R. 41.

⁶ [2011] C.L.J. 607.

latter, by applying “business common sense” to issues about interpretation. But this may not be entirely justified. 4 points are worth noting:-

(1) The Supreme Court clearly approved the literal principle as stated by Sir Simon Tuckey in his minority judgment in the Court of Appeal:-

“The court must first look at the words which the parties have used ... if the language ... leads clearly to a conclusion that one or other of the constructions contended for is the correct one, the court must give effect to it, however surprising or unreasonable the result must be ...”

Or, as Lord Clarke put it, “where the parties have used unambiguous language, the court must apply it” [16, 23].

(2) It is therefore only if there are two possible constructions that “the court is entitled to prefer the construction which is consistent with business commonsense and to reject the other” [21]. There are many earlier authorities which say the same - that the starting point is to look at the language, and that, if it is unambiguous, the court has no power to improve it so as to make it more reasonable or less apparently one-sided.⁸

(3) What the Supreme Court decided, in overruling the majority judgment of the Court of Appeal, was that, where there are two possible constructions, the court is not bound to prefer the one which more naturally accords with the language: in such a case, the court is entitled (not bound) to prefer the more commercial construction, even if the language favours the other one [25, 29-30, 43].

(4) However, Rainy Sky was a case in which the bank had been unable to think of a credible reason for its interpretation [44], according to which an advance payment bond would not respond to the shipbuilders’ insolvency, which was its main *raison d’être*.

⁷ Rainy Sky S.A. v. Kookmin Bank [2012] 1 All E.R. (Comm) 1.

⁸ See for example Re Sigma Finance Corp. [2008] EWCA Civ. 1303 at [98] per Lord Neuberger M.R.; Multi-link Leisure Developments Ltd. v. North Lanarkshire Council [2011] 1 All E.R. 175 at [11] per Lord Hope; Belize (supra) at [16-7].

Therefore, it is not surprising that in that case the court preferred the far more commercial construction to the one which better fitted the language.

In other cases, one may find a more even balance between the linguistic and the commercial arguments, and in such a case the court may well place as much weight on the language as on the commercial considerations or more. Such cases are the difficult ones.

As Briggs J. put it in Jackson v. Dear, in a passage approved by the Court of Appeal⁹:-

“The dictates of common sense may enable the court to choose between the alternative interpretations (with or without implied terms), not merely where one would “flout” it, but where one makes more common sense than the other. But this does not elevate commercial common sense into an overriding criterion, still less does it subject the parties to the individual judge’s own notion of what might have been the most sensible solution to the parties’ conundrum.”

The principle stated above - that where the language is unambiguous, the court must apply it - is of course subject to the well-known fifth principle in the Investors Compensation case, namely that, if it is clear to the court (1) that something has gone wrong with the language and (2) what the parties did intend to agree, then it can correct the agreement. The court is not obliged to attribute to the parties an intention they plainly did not have.

But as Lord Hoffmann said in Investors Compensation, and also in Chartbrook¹⁰, a court will not easily conclude that something has gone wrong with the language, and there are very few reported cases in which a court has so concluded, usually where read literally the contract makes no sense.

⁹ [2013] EWCA Civ 89 at [15] to [18].

¹⁰ Chartbrook Ltd v. Persimmon Homes Ltd. [2009] 1 A.C. 1101 at [14].

There are 3 recent Court of Appeal cases in which the fifth principle - now usually referred to as “corrective interpretation” or “rectification by construction” - has been considered, but found not to be justified.

The first is the decision of the Court of Appeal in Cherry Tree Investments Limited v. Landmain Limited¹¹.

In that case, a bridging loan had been granted to the defendant, the registered proprietor of a property, under a facility agreement which provided that the defendant’s obligations should be secured by a first legal charge over the property, and which also varied the statutory power of sale by providing that the money secured by the charge should become immediately due on the execution of the agreement.

However, on the same day, the parties executed a legal charge, which did not include this provision and only the charge, not the facility agreement, was registered pursuant to the Land Registration Act 2002. So anyone inspecting the register would not be aware of the variation, and would assume that the money would be due on default.

The lenders served notice on the defendant that the money was immediately due and payable, which the defendant disputed on the basis that he was not in default, but the lender went ahead and sold the property at auction to the claimant.

The result was a dispute between the claimant, the purchaser at the auction, and the defendant as to whether the variation of the statutory power of sale in the facility agreement should also be read into the registered charge, on the basis that this was - in the light of the facility agreement - the obvious intention of the parties to the registered charge.

¹¹ [2013] 2 W.L.R. 481.

The case raised several interesting issues, but the main ones for present purposes are whether the facility agreement constituted admissible extrinsic evidence for the purpose of interpreting the legal charge and if so whether it led to a different interpretation.

The claimant's argument was simple. The parties must have intended the provision in the facility agreement making the sum lent immediately due and payable to be included in the legal charge as well. They cannot have intended the provisions to be different, and the omission from the legal charge was clearly a mistake which fell within the fifth principle.

Arden L.J. accepted this argument [72-5]. She held that there were three conditions necessary for corrective interpretation, namely (i) it must be clear from the document interpreted with the admissible background (not including evidence of the negotiations) that the parties had made a mistake, (ii) that it must be similarly clear what the parties intended to agree and (iii) the mistake must be one of language or syntax. She held that all these conditions were met and that the legal charge could be corrected by interpretation, without any need for what she called a full-blown rectification claim, pleaded and proved by evidence, including evidence of the negotiations.

The majority, consisting of Lewison and Longmore L.JJ. disagreed. Lewison L.J. held [141-6] that the language of the charge made perfect sense as it stood, and that it was not permissible to use the process of corrective interpretation to insert whole clauses that the parties had mistakenly failed to include. For that to be done required a properly pleaded and proved claim for rectification, which would not have assisted the defendant, as it would only have taken effect when upheld by the court. Longmore L.J. held [144, 148, 150] that the charge was a public document which could not be rectified in this way [144, 148, 150].

Two aspects of this may be seen as surprising. First, Lord Hoffmann did not say, either in Investors Compensation or in Chartbrook that the mistake had to be one of language or syntax, as both Arden L.J. and Lewison L.J. suggest.

Secondly, it is hard to see why the omission of a term can only be cured by a rectification claim. Belize is all about the implication of terms which, it is clear, are part of the agreement, but are not expressed in it. This point is discussed in relation to Spencer v. Secretary of State for Defence, below, and in relation to the Aberdeen case, under the Implied Terms heading.

The other issue discussed in Cherry Tree was whether extrinsic evidence of background was admissible at all. The courts have on a number of occasions decided that, where a contract or other document was intended to be relied upon by third parties who had not been involved in the negotiations, it was to be interpreted by reference only to the written provisions, and such part of the background as would be available to the third parties. It would be wrong for them to be affected by background of which they were unaware. That applies, for example, to the articles of a company, which are intended to constitute a contract to which subsequent shareholders will become a party.¹² But this is not so in all cases in which third parties may rely on the contract; for example, assignees must take their chance.¹³

In Cherry Tree, the Court considered whether this applied to the legal charge, which was registered pursuant to the Land Registration Act, but decided that it did not. Arden L.J. reviewed the issue at great length, and held that the facility agreement was admissible background evidence in interpreting the legal charge. This led directly to her decision that the variation must be read into the charge.

Lewison L.J. also held that it was admissible, but went on to hold that it was of little or no weight, and did not support corrective interpretation. The reasonable observer would conclude that, for one reason or the other, the parties intended to keep the provision in the facility agreement private, and not to include it in the legal charge [123-130].

¹² Bratton Seymour Service Co. Ltd. v. Oxborough [1992] B.C.L.C. 693.

¹³ See Chartbrook at [40].

If an issue arises as to whether normally admissible background should be excluded, because it was not known to third parties to whom the contract or other document was addressed, the judgments in this case are a good place to look for a comprehensive review of all the authorities, including what Lord Hoffmann said about the issue in Chartbrook.

The second Court of Appeal decision on corrective interpretation is Scottish Widows v. BGC International¹⁴, which concerned the interpretation of a rent review clause in commercial lease which, the judge held, contained an obvious linguistic mistake.

In the Court of Appeal, the leading judgment was given by Arden L.J., who set out the conditions for corrective interpretation in the same terms as she did a few days later in Cherry Tree, to which I have already referred [21].

She said that, in Investors Compensation and Chartbrook, the conclusion that something must have gone wrong with the language was reached because the effect of the literal construction would be to render the instrument ineffective in law or irrational and arbitrary, but that the principle was of wider application and might be invoked for different reasons.¹⁵ However, she was not persuaded that there was an obvious mistake in the language of the lease, and the other members of the Court agreed: the appeal was dismissed.

The main interest of the case lies in the discussion about the extent to which the pre-contractual negotiations were admissible [32-35]. Pre-contractual negotiations are generally inadmissible for most purposes but, as Lord Hoffmann makes clear in Investors Compensation¹⁶, the boundaries are not entirely clear.

¹⁴ [2012] EWCA Civ. 607.

¹⁵ The example she gives - inconsistency with another term - is not compelling: in such a case the agreement read as a whole would be ambiguous.

¹⁶ [1998] 1 W.L.R. 898 at 912-3, principle (3).

In Scottish Widows, the respondents sought to rely on the pre-contractual negotiations as evidence establishing what the common object of the transaction was. Arden L.J. accepted that the objective fact of the common aim of the parties would be part of the background admissible on interpretation, but held that considerable caution should be exercised before treating communications in the course of pre-contractual negotiations as admissible evidence to establish what it was, and she held that in the instant case they did not support the respondent's case [32-5].

The other recent Court of Appeal decision in which a submission that something had gone wrong with the language was rejected is Ing Bank NV v. Ros Roca¹⁷. The Court of Appeal strongly disagreed with the judge's view that the appellants' construction was "commercial nonsense"; there was no mistake in the language, but rather a mistake in failing to anticipate its consequences [29, 81], and Rix L.J. said [110]:-

"Judges should not see in Chartbrook an open sesame for reconstructing the parties' contract, but an opportunity to remedy by construction a clear error of language which could not have been intended".

Yet another recent decision involving the "something has gone wrong with the language" principle is the decision of Vos J. in Spencer v. Secretary of State for Defence.¹⁸ This case is notable for an issue as to what constitutes the background known or reasonably available to the parties to the contract.

The claimants, who were farmers, held an annual tenancy from the Secretary of State of some 256 acres, to which it was agreed in 1998 there should be added an extra acre, recorded in a written memorandum increasing the rent slightly to £16,333 p.a..

¹⁷ [2012] 1 W.L.R. 572.

¹⁸ [2012] 2 All E.R. (Comm) 480.

The parties commenced arbitration proceedings to determine the rent payable under the original tenancy with effect from September 1999, not appreciating that the effect in law of the memorandum increasing the area and the rent was to terminate the old tenancy (in respect of which there was the pending arbitration) and to create a new tenancy.

The arbitrator determined that the annual rent under the original tenancy (which by then had terminated) was to be £27,700 p.a.

It was common ground between the parties that they had no idea that the effect of the memorandum would be to create a new tenancy, and that both assumed and expected that the rent determined in the arbitration would be payable under the original tenancy.

The Secretary of State contended that it would be unreasonable and absurd if there were no legal mechanism to correct an obvious mistake in the memorandum, and that the new tenancy must be on terms that the rent was to be £16,333 or such sum as might be determined in the rent arbitration. The tenant submitted that the court could not improve their contract, since the law must give effect to what the parties meant by the words they used, and not what they would have meant if they had known something which in fact they did not know.

The case therefore directly raised as an issue whether, in interpreting an agreement, the court must include in the relevant background knowledge of something that was reasonably available to the parties, even if it was proved that it was actually unknown to both. It is clear¹⁹ that the reasonable observer is to be taken to know facts which were actually known to both parties, but unclear what the position is where both are ignorant of a reasonably available fact. Also in issue was whether knowledge of the automatic termination of the contract was, on the facts, reasonably available to the contracting parties in this case.

¹⁹ Chartbrook at [24].

Vos J. reviewed extensively the recent authorities on construction and implied terms and concluded [62-3] that:

“... the entire construction exercise is about determining what a reasonable person would take the contract to mean, not about determining the subjective intentions of the parties ... the audience that is supposed to be construing the contract ... is not the parties themselves, but a third party or reasonably observer having all the background knowledge which would reasonably have been available to the parties.”

However, having correctly stated the principle, he misapplied it by holding [71-74] that what had to be considered was the knowledge available not to the parties, but to the reasonable third party observer. He said that, having regard to the objective nature of the exercise, there might be considerable room for argument in any particular case as to what knowledge was reasonably available to such a person, and in particular what legal knowledge might be so available; but such a person could not be assumed to be in ignorance of clear and well-known legal principles, such as the principle involved in the instant case:

“The fact that the parties and their lawyers were unaware of this is unfortunate, but cannot mean that the reasonable person, with whom the construing court is concerned, should be assumed to be labouring under the same misapprehension.”

On this basis, Vos J. held that the outcome was simple, and that the meaning of the agreement was that the rent would be £16,333 until the end of September 1999, and would thereafter be whatever was determined in the arbitration; he reached this conclusion both on the basis that something had gone wrong with the language [85] and on the basis that there was an implied term to this effect [88].

Whilst the result of the case may be right, the reasoning is wrong:-

First, as was said in Investors Compensation, the law is not forced to attribute to the parties an intention which they plainly did not have, but that is precisely what has been done: the parties, who were ignorant of the law, had no idea that its operation had resulted

in the need for the new term to govern the rent after September 1999, and cannot have intended one.

Secondly, again according to Investors Compensation, the reasonable observer is equipped with all the knowledge reasonably available to the parties²⁰ in the situation in which they are at the time of the contract, not with all the knowledge reasonably available to himself, the criterion used by Vos J.²¹; such a criterion would be impossible to operate, since there would be no way of assessing what knowledge would be available to a hypothetical and disembodied reasonable observer.²²

Thirdly, using the correct test, whilst there is no reason why knowledge of the legal position should not in principle be a relevant part of the background, it is difficult to see how knowledge of relevant law could be reasonably available, and therefore attributed, to the parties to a contract, unless it would be unreasonable of them not to have consulted lawyers on the point. This could not be the case here; all the parties were doing was slightly increasing the area and the rent; they could not have anticipated the legal pitfall which this opened up.

Since the relevant law was neither known nor reasonably available to the parties, it is very difficult on the most recent statements of the principles to construe the agreement or imply a term so as to achieve what might be seen as the right result. There was no mistake in the language, and no omission of something that had been agreed. The parties did not intend the new term; they were unaware of the consequence of not having it.

Possibly resort to the now unfashionable officious bystander might help: “Excuse me, but do you realise that your original agreement has automatically terminated. Do you want

²⁰ See also Rainy Sky at [21].

²¹ Vos J. may have been misled by the way Lord Hoffmann expressed the point in Belize at paragraph 16 (“... a reasonable person having all the background knowledge, which would be reasonably available to the audience to whom the instrument is addressed”), but clearly Lord Hoffmann was referring to what he had said in Investors Compensation, and was not intending to introduce a different test: possibly something went wrong with his language!

²² Compare Phoenix Life Assurance Society v. FSA [2013] EWHC 60 (Comm) at [41-2] per Andrew Smith J.

the rent fixed by the arbitrator to apply to the new agreement? A. Of course.” But is the officious bystander allowed to give information before asking his question?

A different issue arose in Lloyds TSB Foundation for Scotland v. Lloyds Banking Group plc²³, namely how to apply a term of an agreement to circumstances which the parties cannot possibly have foreseen at the time of the agreement. The case concerned the proper construction of a deed executed in 1997, by which the banking group covenanted to make charitable payments of 0.1946% of pre-tax profits as shown in the audited accounts.

The 2009 accounts included an unrealised gain of £11 billion, described as a “gain on acquisition”, arising from the difference between the amount paid for HBOS and the supposed fair value of its assets.

At the time of the deed, in 1997, it would have been illegal to include an unrealised gain of this kind in pre-tax profits; after 2005 however a change in EU law made it lawful.

Applying the terms of the deed in accordance with their plain meaning, the £11 billion was included in the pre-tax profits. Since the situation was unforeseeable, there could be no question of an implied term, and it was not a case in which anything had gone wrong with the language. However, the parties to the deed could not have had it in mind that a charitable payment would be made on the basis of an unrealised gain.

The Supreme Court held²⁴ that the parties to the deed in 1997 could only have been concerned with realised profits or losses, and that the change was wholly outside their original contemplation, and not something that they would have accepted had they foreseen it. The question was therefore how the language best operated in the

²³ [2013] 2 All E.R. 103.

²⁴ See especially [20-5, 33-5, 49-50].

fundamentally changed and entirely unforeseen circumstances in the light of the parties' original intentions and purposes. Using the accounts in the sense intended by the Deed, the wholly novel unrealised profits were to be excluded. It was unthinkable in 1997 that the accounting rules would be changed to allow unrealised profits to be treated as part of the group's pre-tax profits.

Similar reasoning might provide a better basis for the decision in Spencer, above, in that the parties clearly intended the new rent to apply from September 1999, and could not have anticipated that it would not do so under their original agreement, which had unknown, to them, been terminated.

Before leaving the interpretation of contractual terms, it is worth referring to dicta in two cases on the iterative approach to contractual interpretation.

First Cooke J. in Gemini (Eclipse 2006-3) plc v. Danske Bank A/S²⁵ briefly summarises the process of interpretation where two meanings are possible as –

“... an iterative process involving the checking of each of the rival meanings with the other provisions and investigating its commercial consequences ...”²⁶

and so arriving at the meaning which makes better commercial sense.

Secondly, Lewison L.J. in his dissenting judgment in Jet2.com Ltd v. Blackpool Airport Ltd,²⁷ making essentially the same point, said that it is wrong in principle to focus only on the particular factual situation which has given rise to the dispute in construing the contract. It is necessary to test each of the rival constructions by considering what their result would be in other factual situations. The whole potential range of the application of the provision must be taken into account, in an iterative, or repetitive, process.

²⁵ [2012] EWHC 3103 (Comm).

²⁶ See also [2012] L.Q.R. 41.

²⁷ [2012] EWCA Civ 417 at [50-1].

Phoenix Life Assurance Society v. F.S.A., mentioned in fn. 18, is a good example of the process.

Implied terms

Turning to implied terms, 4 years have now elapsed since the Privy Council decision in Belize, containing Lord Hoffmann's analysis, demonstrating that the implication of a term into a contract is part of the process of construction, and stating that the old officious bystander, business efficacy, and it goes without saying tests were just different ways of expressing this. It is now possible to assess what impact his decision has had.

In the fairly numerous later authorities, Lord Hoffman's analysis has been for the most part enthusiastically adopted. But it is doubtful whether any case has been differently decided as a result of it.

The most important of the recent authorities are the decisions in the Court of Appeal in The Reborn [2010] 1 All E.R. (Comm) 1 and Jackson v. Dear, above (fn.9), and dicta of Cooke J. in SNCB Holding v. UBS AG [2012] EWHC 2044 (Comm) at [57-65] and Aikens L.J. in Crema v. Cenkos Securities plc [2011] 2 All E.R. (Comm) 676 at [37-43].

The main points to come out of these authorities are the following:-

(1) The Court of Appeal in The Reborn made it clear that the test was still one of necessity; there is to be no relaxation of the test in the direction of the implication of a term on grounds of reasonableness alone.²⁸

(2) There is continued reliance on the business efficacy test: in most cases, the term must be necessary in order to make the contract work. That was held in The Reborn to be the appropriate test, and it was also referred to recently by Lady Hale as the appropriate

²⁸ [2010] 1 All E.R. (Comm) 1 at [15-8].

test in Société Générale v. Geys²⁹. See also the Aberdeen case, below, at [33] per Lord Clarke; he also referred to the officious bystander test.

(3) There is also continued reliance in the recent cases on what was said by Sir Thomas Bingham M.R. in the Philips Electronique³⁰ case, that, in comparison with the interpretation of express language:

“... the implication of contract terms involves a different and altogether more ambitious undertaking: the interpolation of terms to deal with matters for which, ex hypothesi, the parties themselves have made no provision. It is because the implication of terms is potentially so intrusive that the law imposes strict constraints on the exercise of this extraordinary power.”

So it seems that, as regards implied terms, it is business as usual. However, there remains the possibility, as Lord Hoffmann indicated in Belize, that it may sometimes be necessary to imply a term, not in order to make the agreement work, when it can work perfectly well as it stands, but to give effect to the intention of the parties.³¹

Reverting briefly to Cherry Tree and Scottish Widows, in both these cases, in the context of her discussion on corrective interpretation, Arden L.J. said³²:

“... it is not enough that the parties have mistakenly failed to provide for a particular circumstance. For the court to correct that error would be to re-write the parties’ contract and to step beyond the permissible limits of interpretation.”

However, whilst as Lord Hoffmann says in Belize³³, if the contract makes no express provision for what is to happen when some event occurs the usual inference is that

²⁹ [2012] UKSC 63 at [55].

³⁰ [1995] EMLR 472; see Socimer International Bank Ltd (in liq.) v. Standard Bank London Ltd. [1008] EWCA Civ. 116 at [105] per Rix L.J.; The Reborn at [16] per Lord Clarke M.R..

³¹ Belize at [22-3]; Jackson at [15, 18].

³² See at [65] and [22] respectively.

nothing is to happen, sometimes the court concludes that a provision should be implied because that is what the contract, reasonably understood, must mean. This is part of the process of construction or interpretation.

Once it is accepted that the implication of a term is part of the process of interpretation, there seems to be little difference between this - adding the words which the parties have omitted - and corrective interpretation. In both cases, the question is what the reasonable observer with all the relevant background knowledge reasonably available to both parties would conclude that the parties had agreed.

This was the position in Aberdeen City Council v. Stewart Milne Group Ltd³⁴, another case, like Rainy Sky, in which counsel was unable to find any logical commercial reason for his construction of the contract [32], in this case for the application of a contractual definition in certain circumstances. Lord Hope held “that the wording of the contract could be interpreted to achieve a sensible result” [20]. Lord Clarke said that he would “... prefer to resolve this appeal by holding that such a term should be implied rather than by a process of interpretation. The result is of course the same [33].” The other 3 members of the Supreme Court agreed with both.

So it appears that corrective interpretation and the implication of a term are closely related. It may be a matter of judicial preference whether to call the process interpretation or implication.

Rectification of contracts for mistake

As is clear from the above, there are two ways of correcting mistakes in a contract. The first is “corrective interpretation”, where the court is satisfied that something has gone wrong with the language. Then there is the “full-blown” claim for rectification, which has

³³ [2009] 1 W.L.R. 1988 at [17].

³⁴ [2011] UKSC 56.

to be pleaded and proved and, in relation to which, evidence of the negotiations is admissible.

Some commentators³⁵ have suggested that corrective interpretation has more or less replaced, and rendered obsolete, the traditional claim for rectification. That cannot be right, and it was rejected by Lewison L.J. in his judgment in the Cherry Tree case [120]. There will always be cases - such as the Daventry, below - in which a mistake has been made, but not one which is clear to the court without an analysis of the negotiations between the parties.

The decision of the Court of Appeal in Daventry District Council v. Daventry and District Housing Limited³⁶ is a difficult one. Permission to appeal was refused by the Court of Appeal: I do not know whether there is an outstanding application to the Supreme Court.

Following the decision of the Court of Appeal is Joscelyne v. Nissen³⁷, the law on rectification for common mistake seemed to be clear. There were four requirements. First, the common subjective intention of both parties with respect to a particular matter in the contract, which was clear and unambiguous. Second, an outward expression of accord with respect to that matter. Third, that the intention continued up to the time when the contract was completed. Fourth, a mistake in the execution of the contract, resulting in it not giving effect to the common intention.³⁸

The law relating to rectification for unilateral mistake was also clear. This was possible only where there was a mistake by one party as to the terms of the contract which was known to the other party, who dishonestly failed to correct it.³⁹

³⁵ These are referred to in the judgment of Lewison L.J. in Cherry Tree at [90-1].

³⁶ [2012] 1 W.L.R. 1333; see also Davies, Rectifying the Course of Rectification: [2012] M.L.R. 412; the Jonathan Brock lecture delivered by Sir Paul Morgan on 3rd December 2012.

³⁷ [1970] 2 Q.B. 86.

³⁸ See per Peter Gibson L.J. in Swainland Builders Ltd. v. Freehold Properties Ltd. [2002] 1 EGLR 71 at [33].

³⁹ Smith v. Hughes (1870) L.R. 6 Q.B. 597.

The result, however, of Chartbrook and Daventry is that the law is in a state of considerable uncertainty. In Chartbrook, the House of Lords held, obiter, that the existence of the common intention was to be established objectively; it is what the reasonable observer would have thought the parties intended, not what they actually intended. Although obiter, this was accepted as the law in Daventry.

Daventry concerned the sale by the District Council to a specially formed company, limited by guarantee, of its entire housing stock, together with the transfer of the relevant staff. The issue which arose related to that inevitable element of any such deal these days, namely who was responsible for the gaping hole in the pension fund.

The parties agreed in principle on Version 1 of the proposed contract, which provided that the purchase, Housing, would be responsible for the deficit. But Housing's negotiator, knowing that the Council believed that the agreement provided that Housing was responsible, nevertheless thought that there was an ambiguity. He told his Board that the Council would be responsible for the deficit, while allowing the Council to think otherwise.

Later, Housing's bankers caused its solicitors to propose a term which clearly provided that the Council would have to pay for the shortfall. This was seen by the Council's negotiator, but he simply failed to understand the new term, and continued to believe that Housing would pay for it. But the contract it signed included the new terms which made the Council liable.

For the trial judge, Vos J. and the dissenting member of the Court of Appeal, Etherton L.J., the important point was that the parties had agreed to the final, altered, terms of the contract. The Council's negotiator had been negligent, but he had seen and apparently approved the new term, and had not caused the Council's solicitors to question it. There was no common mistake, since the new term was exactly what Housing intended, and there was no dishonesty justifying rectification for the Council's unilateral mistake, once the new term had been drawn to the Council's attention.

Nor was there any relevant dishonesty to justify rectification for the Council's unilateral mistake because, once the new term was included in the draft agreement by Housing's solicitors to the Council's solicitors, it could no longer be said that Housing had failed to correct the Council's mistake. Any dishonesty lay in the past.

For the majority in the Court of Appeal, Lord Neuberger M.R. and Toulson L.J., the main features of the case were the reprehensible conduct of Housing's negotiator, and the fact that the new term had not been negotiated or even drawn attention to in any correspondence between the parties or their solicitors, without which it made no commercial sense.

The majority, applying the objective test, decided that there was a common mistake. A reasonable observer would conclude that, since there had been no renegotiation between the commercial negotiators, the new term proposed by Housing's solicitors must be a mistake, and that the parties had not intended to alter the terms of the original deal, which made Housing liable. This was despite the deliberate inclusion of the new term in the contract by the solicitors acting for one party without objection by the solicitors acting for the other.

Therefore, the majority held, on an objective view of the facts, that the term had been altered by mistake, and should be rectified by restoring the old term.

Alternatively, the majority would have been prepared to decide the case on the basis that there was a unilateral mistake by the Council, caused by the reprehensible conduct of Housing's negotiator.

All three members of the Court expressed varying degrees of doubt about the workability of the principle approved in Chartbrook, requiring an objective test for the question whether the parties had been mistaken: would a reasonable observer with knowledge of all the facts conclude that they were mistaken? There are indeed difficulties.

The present position appears to be as follows:

(1) Rectification is a discretionary remedy, and it is essential that a claimant who seeks it must establish that he was, subjectively, actually mistaken [82, 198].

(2) According to the House of Lords in Chartbrook, the claimant must also establish that, on an objective view of the evidence, there was a common mistake. But, since the decision in Chartbrook concerned the proper construction of the agreement, its views on rectification were obiter.

(3) The Court of Appeal in Daventry proceeded on the basis that the test was objective, but the main reasons for this were that the case had been argued on the basis that what was said obiter in Chartbrook was correct, and that the same result would have been arrived at on either basis. It would be open to a court in a later case to disregard Chartbrook, although this would be a bold course to take, since the obiter view of the House of Lords was unanimous, and the point had been fully argued. Toulson L.J. in particular however had grave doubts as to its correctness [78, 152, 179-183, 196].

(4) The Court of Appeal was divided on the facts, but agreed on the formulation of the requirements for rectification, set out in Etherton L.J.'s judgment [80, 179, 228]:

“I suggest that Peter Gibson LJ’s statement of the requirements for rectification for mutual mistake [in Swainland Builders - see fn. 38] can be rephrased as: (1) the parties had a common continuing intention, whether or not amounting to an agreement, in respect of a particular matter in the instrument to be rectified; (2) which existed at the time of execution of the instrument sought to be rectified; (3) such common continuing intention to be established objectively, that is to say by reference to what an objective observer would have thought the intentions of the parties to be; and (4) by mistake the instrument did not reflect that common intention.”

(5) Evidence of subjective intention is still admissible notwithstanding the need to prove the common continuing intention objectively, because (a) as to the claimant, he

must prove that he was actively mistaken in order to qualify for equitable relief (see (1) above), (b) as to the defendant, his subjective understanding that the agreement was correct may lead to the court refusing equitable relief (see (7) below), and (c) the subjective intention of both parties may shed some light on the prior accord, especially if this was oral, or partly oral.⁴⁰

(6) If the objective approach indicated in Chartbrook is followed, the court may conclude that there has been a common mistake between the parties when (a) actually they had different beliefs as to what the terms of the contract were and/or (b) the defendant to the claim for rectification had made no actual mistake, and would not have agreed to the terms of the contract as rectified: indeed that was the situation in Daventry.

(7) Even if the claimant establishes that he was subjectively mistaken, and that objectively assessed there was a common mistake, rectification is a discretionary remedy and may be refused on equitable grounds, for example if to grant it would be unfair to the other party, or to a third party; indeed this might well have been the result in Daventry, but for its negotiator's conduct [182, 209-224].

(8) Both Toulson L.J. and Lord Neuberger envisaged that it might be necessary to relax the requirements for rectification for unilateral mistake, and would probably have been prepared to decide Daventry on this basis, despite the finding of Vos J. that there was no operative dishonesty by the time the contract was concluded [183-4, 226].

The law is in a state of some uncertainty. All one can say with confidence is that changing an important term in a proposed contract, which has already been agreed in negotiations, while not drawing explicit attention to the change, may be dangerous; it may be seen as sharp practice, and lead to protracted litigation as to what, objectively, has been agreed.

Intention to create legal relations and uncertainty

⁴⁰ See Chartbrook [65] and Daventry [82, 198].

There are 4 recent cases on this topic, involving related issues on all of which a claimant needs to succeed, namely whether there was an intention to create legal decisions, whether the agreement was enforceable and whether the agreement was sufficiently certain.

First, the decision of Teare J. in Shaker v. Vista Jet Group Holding S.A.⁴¹, relating to a letter of intent for a transaction concerning the purchase, operation and repurchase of an aircraft.

The terms of the letter of intent required the buyer to proceed in good faith and to use reasonable endeavours to agree a number of transaction documents by a cut-off date. It also provided for a deposit, which was returnable if the transaction documents had not been agreed by the cut-off date despite the exercise of good faith and reasonable endeavours.

Teare J. held that the obligation to use reasonable endeavours to agree the transaction documents was void for uncertainty, because there were no objective criteria by reference to which the obligation could be policed by the court. Therefore, the condition precedent to the return of the deposit was unenforceable in law.

There is nothing surprising about this. There is a considerable body of case law to the effect that obligations to negotiate are, almost without exception, unenforceable for that reason.

Similar points arose in two cases in which the issue was whether the parties intended to enter into legal relations.

⁴¹ [2012] 2 All E.R. (Comm.) 1010.

Dhanani v. Crasnianski⁴², an earlier decision of Teare J., concerned a letter and term sheet under which the claimant was to set up a €50 million private equity fund, the capital to be provided by the defendant.

The issues were whether, in view of what was left outstanding to be agreed between the parties, (a) they had intended the contract to be binding and (b) the terms were sufficiently certain to be binding, if that was the intention.

The judge said that there were two questions [75]. First, looked at objectively, did the parties intend a legally binding obligation? Secondly, was there anything more than an unenforceable agreement to agree? The questions overlapped:-

“... the circumstance that an agreement is no more than agreement to negotiate and agree may show objectively that the parties to it cannot objectively have intended it to be legally binding, notwithstanding that it had certain characteristics which otherwise might have evinced an intention to agree, for example, that it was signed by each party.”

He went on to give different answers to the two questions. The parties had intended to contract, but due to uncertainty had failed to do so. There remained too much to agree, and there was no objective criterion to apply to enable the court to supply what was missing. Scammell v. Ouston⁴³ and Walford v. Miles⁴⁴ continue to rule.

Barbudev v. Eurocom Cable Management Bulgari EOOD⁴⁵ is a decision of Blair J., upheld by the Court of Appeal. It was quite a similar case relating to an investment agreement for a project in Bulgaria. The facts are complex, but what matters is the court's approach. The Court of Appeal identified the three separate issues:-

⁴² [2011] 2 All E.R. (Comm.) 799.

⁴³ [1941] A.C.251.

⁴⁴ [1992] 1 A.C. 128

⁴⁵ [2011] 2 All E.R. (Comm.) 951; [2012] 2 All E.R. (Comm.) 963; Chitty vol.1 at [2-187].

(1) Did the parties intend to create legal relations? That was to be decided on an objective basis, on an assessment of the conduct of the parties as to a whole.⁴⁶ In a commercial context, the onus of demonstrating that there was no such intention is a heavy one.

(2) Was the agreement an enforceable one, or was it an agreement to agree, or an agreement to negotiate: if the latter, Walford v. Miles.

(3) If there was an agreement, and not an unenforceable agreement to agree, were the terms sufficiently certain.

On the facts, the Court of Appeal disagreed with Blair J., and held that there was an intention to create legal relations, but agreed with him on the second and third questions. Therefore, there was no enforceable contract because essential terms governing the relationship between the investors had not been agreed.

Finally, there is a recent decision in a case called MRI Trading AG v. Erdenet Mining Corporation Ltd.⁴⁷ The facts are again complex, but the decision of the judge, Eder J., stresses two familiar points, and the Court of Appeal upheld his decision.

First, the relationship between intention and uncertainty: if it is clear from the terms of the contract – as it was - that the parties intend a binding contract even though some matters remain to be agreed, the court will do its best to achieve the necessary certainty, unless what remains to be agreed makes the contract “truly unworkable”.

Secondly, the importance of part performance; where the party seeking to say the agreement is unenforceable has obtained a significant benefit under it, again the court will

⁴⁶ See RTS Flexible Systems v. Moerkerei Alois Macher GmbH & Co. KG [2010] 1 W.L.R. 753.

⁴⁷ [2013] 1 All E.R. (Comm) 1, especially [23-34]; [2013] EWCA Civ. 156.

do its best to uphold the agreement. In MRI the agreement was part of a settlement of a previous dispute, and the effect of holding the agreement to be unenforceable would have been to leave the other benefits of the settlement, of which the agreement was one part, in place.

In the Court of Appeal, Tomlinson L.J. stressed the importance of part performance, and of parties experienced in the trade having added on the basis that there was a concluded agreement. He also held that the matters which had been left for further agreement were incidental, and that provision for arbitration gave the parties a means of resolving the issues.

Eder J.'s judgment helpfully cites at [23] the applicable principles, as set out in the judgment of Rix L.J. in Mamidoil-Jetoil Greek Petroleum Company S.A. v. Okta Crude Oil Refinery AD⁴⁸, the first port of call in cases of this kind.

Contracts to use best endeavours

Next, another topic, linked to the issue of uncertainty, agreements with obligations to use best endeavours, or all reasonable endeavours, or just reasonable endeavours. These have been considered recently in a decision of the Court of Appeal in Jet2.com Limited v. Blackpool Airport Limited.⁴⁹ This case will not be going to the Supreme Court.

The case concerned a 15 year contract between an airport operator and a low cost airline which contained a provision that they would co-operate together and use their best endeavours to promote the airline's low cost services from the airport.

An argument that "promote" in this provision meant no more than advertising and marketing was rejected. Both the trial judge and the Court of Appeal held that it meant co-operate to advance the interests of Jet2's airline.

⁴⁸ [2001] 2 Lloyd's Reports 76.

⁴⁹ [2012] 2 All E.R. (Comm.) 1053.

The issue which arose between the parties related to flights outside the airport's normal opening hours. For the first 4 years of the contract, Blackpool allowed Jet2 to operate flights in accordance with schedules which included regular arrivals and departures outside the airport's normal opening hours. However, these were uneconomic from the airport's point of view, because the support services they had to provide cost more than the additional income. 4 years into the contract period, Blackpool gave Jet2 a week's notice that no such flights would be permitted in the future.

Both the trial judge and the majority in the Court of Appeal held that Blackpool was obliged to allow out of hours flights, and that its withdrawal of them was a breach of contract.

But they declined to grant a declaration that Blackpool was obliged to allow such flights for the remainder of the contract term, on the ground that whether the obligation to use best endeavours required this depended on the circumstances prevailing at any given time.

Circumstances might change, for example, if it became clear that Jet2 could not operate low cost services from Blackpool profitably whatever flights were permitted. Then it might be that the best endeavours obligation would not require flights outside normal hours.

Blackpool advanced two main arguments. The first was that the obligation to use best endeavours was too uncertain to be enforced. There was no criterion by reference to which any particular requirement, whether opening out of hours, or the provision of check-in staff, or the provision of enhanced passenger lounges, did or did not fall within the scope of the obligation.

On this, the Court of Appeal broadly agreed on the principle, which was that an obligation to use best endeavours was enforceable unless either (a) the object intended to

be procured by the endeavours was too vague or uncertain to be the subject of a legal obligation or (b) the parties had provided no criteria on the basis of which it was possible to assess whether best endeavours had been used.

The members of the Court however disagreed as to the application of the principle. The majority, that is Moore-Bick and Longmore L.JJ., held that “use best endeavours to promote” (i.e. advance the interests of) the airline services was sufficiently certain. It meant that Blackpool had to do all that it reasonably could to enable Jet2’s business to succeed and grow.

They hold that the obligation to use all reasonable endeavours to provide a cost base to facilitate low-cost pricing was too uncertain to be enforced; otherwise the inability to define the precise limits of the obligation in advance, and the difficulty of determining in any given case whether a particular step was within or outside the scope of best endeavours, did not make the provisions void for uncertainty.

Lewison L.J. dissented in strong terms, precisely because in his view the impossibility of defining the content of best endeavours made it too uncertain to be enforced. How for example could a court judge whether a best endeavours obligation required say additional passenger lounge facilities.

The second point, strongly argued by Blackpool, was that an obligation to use best endeavours could not require a party to act against its own commercial interests. This was roundly rejected by the two judges in the majority: the very nature of an obligation to use best endeavours might indeed require a party to act against its own commercial interests, for example by spending money on endeavours which would not benefit it. They held that the extent to which the party under the obligation could take into account his own commercial interests depends on the nature and terms of the contract.⁵⁰

The judgments are illuminating for a number of reasons.

⁵⁰ See [32] (Moore-Bick L.J.) and 70 (Longmore L.J.).

First, they contain a thorough review of all or most of the previous authorities on such provisions.

Second, as to different forms of wording, the members of the court seemed to see little if any difference between “best endeavours” and “all reasonable endeavours”, but I do not think that this was part of the ratio of the case.

However, there may be a difference. “Best endeavours” means what it says - not second best endeavours.⁵¹ “All reasonable endeavours” and “reasonable endeavours” may leave more room for an argument that the suggested endeavours are unreasonable, because of the commercial burden on the party who, it is suggested, has an obligation to use them.

Third, there is some emphasis in the majority judgments on the familiar point that, once a court is convinced that the parties intend an obligation to be legally binding, it will seek to avoid holding it to be void for uncertainty where possible. So, best endeavours to advance the interests of Jet2’s airline provides a sufficiently clear criterion against which to measure any particular suggested step.

Fourth, such an obligation is a flexible one: what an obligation to use best endeavours may require can vary from time to time in accordance with the prevailing circumstances. The court can determine what, at any particular time, the airport was obliged to do. The majority disagreed with Lewison L.J.’s view that, in the absence of a more specific criterion than reasonableness, the obligation to use best endeavours was too uncertain to be enforced.

Fifth, where business has been carried on in a certain way for some time, the onus is on the party seeking to say that the obligation to use best endeavours now requires more, or

⁵¹ Sheffield District Railway Co. v. Great Central Railway Co. (1911) 27 T.L.R. 451 per A.T. Lawrence J., cited with approval by Longmore L.J..

less, to justify this - in this case to justify the withdrawal of the flights outside normal hours.

Good faith

There is a detailed analysis of the circumstances in which a duty of good faith will be implied in the decision of Leggatt J. in Yam Seng Pte. Ltd. v. International Trade Corporation Limited.⁵²

The contract he was considering was a distribution agreement, not drafted by lawyers and described by him as “skeletal”, relating to the distribution of various fragrances with the brand name “Manchester United” in specified territories, mostly but not entirely limited to duty free sales.

The distributor complained of various breaches of the express terms of the contract and also of what it saw as conduct by the defendant which undermined its ability to achieve duty free sales, consisting in part of providing false information as to what was happening in the domestic market and in part of setting prices which undercut the duty free retail price.

Leggatt J., having referred in some detail to the provision in other jurisdictions, starts with a paragraph⁵³ which, at first sight, seems to contain two somewhat conflicting sentences:-

“I doubt that English law has reached the stage ... where it is ready to recognise a requirement of good faith as a duty implied by law ... into all commercial contracts. Nevertheless, there seems to me to be no difficulty, following the established methodology of English law for the implication of terms in fact, in implying such a duty in any ordinary commercial contract based on the presumed intention of the parties.” (my emphasis)

⁵² [2013] EWHC 111 (QB) at [131-154].

⁵³ Paragraph 131. The distinction is drawn between a term implied by law and a term implied on the facts – but the distinction is a very fine one, if the term is to be conventionally implied into all commercial contracts.

He goes on to say that shared values and norms of behaviour, including but not limited to honesty, derived from general social acceptance or from the specifics of a particular trade or commercial activity, are taken for granted by the parties without being set out explicitly in their written agreements.

Gathering pace, he suggests that a requirement that the parties performed their contract honestly is so obvious that it goes without saying, as are lesser forms of bad faith conduct which one might described as improper or commercially unacceptable rather than dishonest.

Further, dishonesty would not only consist of making untrue statements, but might include a failure to correct a statement, true when made but which has become untrue, or giving an evasive answer, or deliberately avoiding an answer, in response to a request for information.

He concludes that the existence and extent of an implied term depends on the contractual context, but may well be part of contracts involving a long-term relationship between the parties to which they make a substantial commitment, and which require

“a high degree of communication, co-operation and predicable performance based on mutual trust and confidence and involving expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties’ understanding and necessary to give business efficacy to the arrangements”.

The suggested test is what the parties are presumed to have intended, on the basis of attributing to them “the purposes and values which reasonable people in their situation would have had”.

He describes an implied term of this kind as being one “of good faith and fair dealing”, and suggests that the traditional English hostility towards a doctrine of good faith in the performance of contracts, to the extent that it still persists, is misplaced. The law should be developed on a case by case basis.

In the case before him, he held that good faith included specific obligations, first, not to encourage the claimant to incur marketing expenses for products which it knew it could not supply and, secondly, not to damage the claimant's business by authorising the sale of any of the products in the domestic market or any of the territories at a lower retail price than the duty free retail price specified in the agreement.

A final point to note is that Leggatt J. said that it is easier to imply duties of this kind into a skeletal agreement, such as the one he was considering, than in the case of a detailed professionally drafted contract.

This judgment brings together all the relevant strands of previous authority, and seems likely to be followed in such a way as to make a contracting party liable for dishonesty or other deliberate bad faith in the course of the performance of a long-term contract of this kind.

However, beyond that it may be seen as inconsistent with the well-known statement in Interfoto Picture Library Ltd v. Stiletto Visual Programmes Ltd⁵⁴, which Leggatt J. cites at [181]:-

“... English law has, characteristically, committed itself to no such overriding principle but has developed perceived solutions in response to demonstrated problems of unfairness ...”

and perhaps also with what he had earlier said in the context of contractual estoppel in The Lutetian⁵⁵:

“The relationship of owner and charterer is not one of the utmost good faith. One must be careful not to impute unrealistically onerous obligations to those who may choose to

⁵⁴ [1989] 1 Q.B. 433 at 439.

⁵⁵ [1982] 2 Lloyd's Reports 140 and 157.

conduct their relations in a tough and uncompromising way. There is nonetheless a duty not to conduct oneself in such a way as to mislead.”

Therefore, there may be doubt about the breadth of the concept of fair dealing envisaged by Leggatt J. as being within the scope of an implied term, and the suggestion that it always requires the disclosure of relevant information between contracting parties. In some circumstances, it might well be seen as legitimate for a party to withhold information which would be important to the other party to the contract - for example, if to disclose it would be detrimental to other contractual relationships, or to its own separate business. Misleading conduct, as both The Lutetian and Ing Bank, above, show, can more flexibly and appropriately be dealt with by the doctrine of contractual estoppel, where it would be inequitable to allow the party concerned to take advantage of it, without making him liable for damages.

Restraint of trade, penalties

The decision in the Court of Appeal in Pro Active Sports Management Limited v. Rooney⁵⁶ is a high profile recent case. It is reminiscent of a series of cases decided in the 1970s and 1980s, in which pop stars who had already made a fortune under their contracts, on a falling out with their management or recording company, were able to set aside the contracts as being in unreasonable restraint of trade. They were then set to make an even greater fortune.

In Pro Active, the contract in question was an image rights representation agreement, under which Wayne Rooney, then 17 but already bound for stardom, engaged Pro Active to represent him as sole agent for 8 years in return for a commission of 20% on all earnings under the contracts negotiated for him, whether payable before or after termination. Wayne Rooney and the representative fell out after 6 years, and he repudiated the agreement. He argued that the restrictions placed on him by a sole agency for 8 years were in unreasonable restraint of trade.

⁵⁶ [2012] 2 All E.R. (Comm) 815.

The Court of Appeal decided four important points.

First, the court rejected an argument that the doctrine of restraint of trade could not apply to a contract relating to a minor or ancillary activity, the exploitation of image rights, which did not in any way affect Wayne Rooney's day job - playing football. The court held that the doctrine could apply to any activity, whether the main activity or a subsidiary one.

Secondly, the agreement was unreasonable, and therefore in unlawful restraint of trade. It was not a contract on normal terms which absorbed the business activity, without unfairly exploiting it. The main reasons for this conclusion were (1) that neither Wayne Rooney nor his parents had had access to proper legal advice and the terms were in effect dictated (2) that the terms were not as good as might have been negotiated if they had, for example in regard to the tapering off of the rate of commission in later years, and (3) the excessive duration - 8 years is a very substantial part of a footballer's career.

Whether an agreement is in unreasonable restraint of trade usually depends on a balance of different factors, only some of which relate the extent of the restraint, others to inequality of bargaining power.

Third, once a party withdrew from a contract which was in restraint of trade, it was unenforceable even as regards what had happened under the contract before withdrawal. Therefore, Pro Active's only remedy for the services it had provided was to recover commission on a quantum meruit.

Fourth, the rates provided for in the unenforceable contract were no longer binding when it came to assessing the amount properly payable on a quantum meruit. They were relevant, but other evidence of the proper rate had also to be taken account of.

In contrast to Pro Active, the decision of Burton J. in Cavendish Square Holdings B.V. v. Makdessi related to a commercial agreement for the purchase of shares in a large marketing and communications company in the Middle East, which had been fully negotiated between parties who were of reasonably equal bargaining power. These factors were decisive on both issues relating to the non-competition covenants, which were attacked as being in unlawful restraint of trade and, because the effect of a breach was to deprive the seller of further instalments and to require him to sell his shares without a goodwill uplift, and as unlawful penalties.

The decision is a useful one, in that it contains a detailed summary of the principles on both topics at [15, 23] and [25-41] respectively.

Burton J. examined the evidence as to the negotiation of the agreement, and said that, whilst the details did not matter, it was clear that these were negotiations for a substantial vendor – purchaser agreement, negotiated on a level playing field [14].

He said that there had been no reported case in which an otherwise reasonable restriction was held to be unreasonable on grounds of duration, and clearly considered that the parties were the best judges of the reasonableness as between themselves of the terms they had negotiated, and that there was nothing in the public interest which justified interference.

Burton J.’s decision on the penalty issue is perhaps more surprising, but his review of the authorities led him to the conclusion that, in modern times, there was considerable reluctance to treat a contractual provisions as an unenforceable penalty [28], and that the relevant questions were (i) was there a commercial justification? (ii) was the provision extravagant or oppressive? (iii) was the predominant purpose of the provision to deter breach? (iv) if relevant, was the provision negotiated on a level playing field? [53].

He concluded that, the provisions had a legitimate purpose, to “decouple the parties on a conventional basis”, and that the only reason for treating the provision as a penalty was

that there was “double-counting” as the purchaser was also able to claim damages, and had done so, receiving \$500,000. He held that he had no jurisdiction to adjust the terms of the contract so as to remove that which made it a penalty, but, following the decision of the Court of Appeal Ian Jobson v. Johnson⁵⁷ invited the claimant to give credit for the \$500,000, in which event it would be entitled to enforce the provision.

Relief from forfeiture

This topic is dealt with in the judgment of the Privy Council in Cukurova Finance International Limited v. Alfa Telecom Turkey Limited⁵⁸. ATT had lent \$1.352 billion to Cukurova, secured on CFI’s 51% shareholding in another company, in the hope and expectation that Cukurova would default, and so entitle ATT to appropriate and thus acquire its shareholding, which is in essence what happened. ATT then held a press conference in Istanbul, where Cukurova was based, making derogatory statements intended to make it difficult for them to raise finance. ATT then issued press releases which were also designed to put off any potential lenders.

Various issues arose on the appeal, but the relevant one for present purposes is the jurisdiction to relief from forfeiture [86-97]. The Board held that there was jurisdiction to grant relief from forfeiture only:

- (a) in respect of the transfer of proprietary or possessory rights under the contract (i.e. not in respect of mere contractual rights); and
- (b) where the primary object of the bargain was to secure a stated result which could be effectively attained when the matter came before the court, and where the forfeiture provision was added as security to produce that result.

The jurisdiction was not limited to real property, and it was not an objection that the transaction was commercial in nature.

⁵⁷ [1989] 1 W.L.R. 1026.

⁵⁸ [2013] UKPC 2.

Those requirements were met in the instant case, concerning an equitable mortgage of shares granted to secure the repayment to the loan, which Cukurova was now in a position to achieve.

On the question of whether relief from forfeiture should be granted, the Board held, following earlier authority, that the factors relevant to the appropriateness of relief included the applicant's conduct, whether his default was wilful, the gravity of the breaches and the disparity between the value of the property of which forfeiture is claimed in comparison with the damage caused by the breach.

The Board also referred to the comment in Snell at [13-015]:-

“Although this confers an apparently broad discretion, it is likely to be very difficult to establish a case for relief against forfeiture in a commercial context, involving a freely negotiated contract. In such cases, courts will place considerable emphasis upon the need for certainty.”

In the end, the Board, while accepting that the need for certainty was a very relevant consideration, decided that in a case which involved a combination of unusual features which were most unlikely to be repeated, it was right to grant relief from forfeiture on appropriate terms, which would usually include interest and costs. The unusual features included the lender's conduct and the fact that Cukurova had tendered payment within a month of the appropriation.

Termination of employment contract: elective not automatic

In Société Générale v. Geys⁵⁹, the Supreme Court resolved the long-standing controversy as to whether the repudiation by one party (whether employer or employee) to a contract of employment automatically terminates the contract, or whether, as with any other

⁵⁹ [2012] UKSC 63.

contract, the other party can choose whether to accept the repudiation and terminate the contract, or not to accept it and keep the contract in being.

The issue usually matters in cases of immediate dismissal by the employer, where the amount due on termination may depend on the date on which the employment ended, or the date may affect pension rights, or rights to a bonus or other financial considerations.

Or it may matter in cases of wrongful repudiation by the employee, for example where restraints on competition subsist while the contract is in being.

The Supreme Court decided, Lord Sumption dissenting, that the elective theory was correct; as in the case of any other contract, a contract of employment continues in existence until validly terminated, or until a wrongful dismissal or resignation has been accepted by the other party.⁶⁰

There were three main reasons for the decision:-

(1) Any other conclusion would enable the contract breaker to benefit from his own wrong e.g. by paying less than would be due if the contract remained in existence until validly terminated, in the case of a wrongful dismissal, and by terminating non-competition obligations early, in the case of a wrongful resignation.

(2) There was no justification for treating a contract of employment as an exceptional case. It is true that, as the law stands, neither party can obtain specific performance of a contract of employment, and the employee cannot present himself at work and then claim his wages - he must claim damages and has a duty to mitigate by seeking other work. But these are all matters which concern remedies for breach, they do not affect the continued existence of the contract.

⁶⁰ See [15-20, 42, 63-97, 99-102].

(3) The preponderance of previous authorities⁶¹ favoured the elective theory, and there were also authorities which upheld non-competition clauses and obligations as regards disciplinary proceedings, which would not have survived if the contract of employment was terminated.⁶²

Lord Wilson, who gave the leading judgment for the majority, also indicated the possibility that the authorities which prevent an employee from obtaining an order for specific performance for the contracts of employment might be due for reconsideration, particularly in a case in which there was no real loss of trust and confidence between the parties [77, 79].

Illegality

Illegality, as was said in a recent case, is “notoriously knotty territory”, to put it mildly.⁶³

Potentially, the most important development in this field in English law is not a decided case, but a lecture given to the Chancery Bar Association in April by Lord Sumption (just before his appointment), which is available on the internet, in which he explains how the English law on illegality has become the mass of contradictions that it is. It seems likely that it will prove to be influential.

The 18th century cases established the principle that courts will not entertain any action based on an illegal contract, because it is beneath its dignity to do so.

Although this is a rational principle, its inevitable result is that in many cases the defendant gets an undeserved windfall – contractual benefits may have been conferred for which he now does not have to pay, or he may get to enjoy property free from an adverse claim.

⁶¹ Notably Thomas Marshall (Exports) Ltd. v. Guinle [1979] Ch. 227; Gunton v. Richmond on Thames L.B.C. [1981] Ch. 448.

⁶² See Lord Wilson at [69-75].

⁶³ ParkingEye Ltd. v. Somerfield Stores Ltd. [2013] 2 W.L.R. 939 at [28, 43].

Many of the difficulties in this area arise from the court's attempts, notably in Tinsley v. Milligan⁶⁴, to avoid a result which is objectionable, both because it is unduly harsh to the claimant and because it rewards the defendant for his illegal conduct - which is contrary to any sensible moral basis for the rule.

The question is whether the law is likely to be changed by the Supreme Court, as and when appeals reach it. There are at least two good reasons for thinking that it is.

First, in most areas of contract law, the Supreme Court is reluctant to overrule previous authorities, even though it has the power to do so, because contracts will have been entered into on the basis of the existing law. Commercial conduct has been based on an understanding of what the law is.

There should be no such reluctance in cases of illegality. If someone has entered into a contract believing, for example, that its illegality will prevent it from being enforced, he is not deserving of protection.⁶⁵

Secondly, the Law Commission, in its most recent report, has come down against proposed legislation along the lines of the New Zealand Illegal Contracts Act, which would have conferred a wide discretion on the court to regulate the consequences of illegal transactions. This was in part because of its view that it should be left to the courts to clarify the existing law.

That being the case, one would expect the Supreme Court to take the opportunity to do so, as and when it arises. The most likely development is that the decisions which prevent restitutionary claims for property transferred and contractual benefits provided under illegal contracts will be overruled, even in cases where both parties are guilty of the illegality. That is because the idea of the court's dignity being offended if it is called

⁶⁴ [1994] 1 A.C. 340.

⁶⁵ See ParkingEye at [54] per Toulson L.J..

upon to deal with the consequences of an illegal transaction is an outdated one, and because it is highly undesirable for such a notion to result, as it still does in some cases, in a windfall for one of the guilty parties.

So it may be that the one bit of Latin which we all remember – *potior est conditio defendentis* – will be consigned to history, and that the courts will, in cases in which contracts are unenforceable due to illegality, seek to restore both parties to their original position.⁶⁶ As Lord Sumption put it, the present principle that, where a transaction is affected by illegality, the loss should lie where it falls, and the rejection of restitutionary claims, are “probably the main sources of injustice in the current law”.

The present law is represented by the decision of the House of Lords in Tinsley v. Milligan establishing the rule that the claimant will be able to recover notwithstanding the illegality, if he is not obliged to rely on the illegal contract as part of his pleaded case.

Therefore, the claimant in that case, whose claim to an equitable interest in property arose from an illegal agreement to cheat on social security, was able to succeed because she could rely on the presumption of advancement arising from the payments she had made, without reference to the agreement.

By contrast, in the later case of Collier v. Collier,⁶⁷ where the object of the illegal agreement was to defeat the claims of the claimant’s creditors, the presumption, as between the claimant father and the defendant daughter, went the other way. Therefore, the father could not establish his claim without relying on the illegal transaction, and failed to recover.⁶⁸

These two cases should have had the same result, since the moral blameworthiness and the connection between the illegality and the transactions were equal. It is to be expected

⁶⁶ But the Australian courts have a more nuanced approach to restitution in cases involving illegality: see Elise Bant [2012] L.Q.R. 341.

⁶⁷ [2002] EWCA Civ 1095.

⁶⁸ See also Tribe v. Tribe [1996] Ch. 107.

that the Supreme Court will seek to introduce a more rational, consistent and proportionate rule, in which the main considerations are the degree of blameworthiness involved in the illegal conduct, and whether to permit the claim would be to allow a party to profit from it, as opposed to merely recovering his property.⁶⁹

There are two recent decisions of the Court of Appeal, in cases which do not involve the particular issue focussed on by Lord Sumption, but which indicate that the courts main future be guided by policy considerations, rather than by previous authorities, and that illegality defences would only succeed where it is necessary and proportionate to uphold the law by such means.

Les Laboratoires Servier v. Apotex⁷⁰ related to a claim by Apotex for damages pursuant to a cross undertaking given at the time of a subsequently discharged injunction. The Court of Appeal allowed an appeal against the decision of the judge that the damages claim was barred by illegality, because it was in respect of the opportunity to sell in the United Kingdom products which, if so, would have been manufactured and exported in breach of Canadian law.

Etherton L.J., with whom Kitchin and Laws L.JJ. agreed, declined to review the many authorities cited in support of arguments on both sides which he regarded as “too dogmatic and inflexible”. Analysing the decided cases would be complex, lengthy and largely unrewarding since decisions turned on their own particular facts, and the authorities did not follow a consistent pattern [63].

He held that an illegality defence be allowed, as the Law Commission had recommended, only where it could only be justified by reference to furthering the purpose of the rule which the illegal conduct had infringed, legal consistency (as to which see Safeway v.

⁶⁹ Tinsley was not followed by the Australian High Court in Nelson v. Nelson (1999) 132 A.L.R. 133, and it is subject to some criticism in the recently published Law of Contract in Singapore at 13.147, 13.150.

⁷⁰ [2013] Bus. L.R. 80; the Court of Appeal gave permission for an appeal to the Supreme Court.

Twigger, below), preventing the claimant from profiting from its wrong, deterrence and the maintenance of the integrity of the legal system [66-8]. In addition, in the instant case, an important policy consideration might be comity, that is respect for the law and courts of other countries [69]. The defence will succeed only where it is a just and proportionate response to the illegality involved in the light of the policy considerations underlying it [66, 23-4].

In the instant case, Apotex's manufacturing costs were an essential element of its calculation of loss profit, and it therefore had to rely directly on the manufacturing would have been unlawful in Canada. Nevertheless, for a variety of reasons arising from the detailed facts of the case, including Apotex's honest belief that the pattern was invalid, for which it had reasonable arguments, the Court rejected the illegality argument. The Supreme Court has allowed an application by the claimants for permission to appeal.

A similar approach was taken by the Court of Appeal in ParkingEye (fn. 63), in which ParkingEye had entered into a contract to supply the defendant with an automated monitoring and control system at some of its supermarket car parks, and subsequently to monitor the customers use of the car parks, including imposing charges for exceeding the free parking time. This involved sending out letters to customers, some of which contained deliberate falsehoods, suggesting that ParkingEye had authority to, and would, bring proceedings for recovery of the charges. Somerfield thought to meet a claim for damages for wrongful repudiation of the agreement by alleging illegality, asserting that ParkingEye's intention to do this at the outset of the contract "was so imbued with moral turpitude that the law [would] not assist it to enforce the contract", a submission which Sir Robin Jacob rejected as being "unduly sanctimonious" [37-8].

He also held that the issue was one of proportionality, and that the defence would succeed only if this would further one of the specific policies underlying or identified by Etherton L.J. in the earlier case, and if it was proportionate to allow the defence.

He too “ducked out” of any analysis of previous decisions, for the same reasons as Etherton L.J. [28], and held that the illegality defence should fail for a variety of reasons grounded in the facts of the case, including that the illegality was incidental to the main performance of the contract, that the judge had found that there was no dishonesty and that ParkingEye would not have continued to write the offending letters if Somerfield had objected [28-38].

Toulson L.J. agreed, while adding [53]:

“This is not to suggest the list of policy factors should become a complete substitute for the rules about illegality and the law of contract which the courts have developed, but rather that those rules are to be developed and applied with a degree of flexibility necessary to give proper effect to the underlying policy factors”.

Both Etherton L.J. in the first case [at 70-1] and Sir Robin Jacob in the second case [at 39] stressed that they were not reverting to the judicial discretion rejected by the House of Lords in Tinsley v. Milligan. Proportionality required the court to assess how far denying the claim to remedy would further the underlying policy reasons for the rule, and whether such a refusal would be justified having regard to the conduct of the claimant and the closeness and the connection between that conduct and the claim.

It will be interesting to see whether the Supreme Court endorses this more flexible, proportionate and fact-based approach to illegality, whether it will revert to a stricter approach, or whether, as Lord Sumption suggested, the French approach allowing the illegal party a restitutionary claim, but not the recovery of profit, will be adopted.

Turning to other recent decided cases on illegality, there are three involving contractual liability for penalties and costs resulting from illegal acts.

The first is the decision of the Court of Appeal in Safeway Stores Limited v. Twigger,⁷¹ which was decided in December 2010. The case related to a penalty for anti-competitive

⁷¹ [2010] EWCA Civ 1472.

activity imposed by the O.F.T. under the Competition Act 1998, and the costs of dealing with the enquiry which ultimately resulted in that penalty.

Following a takeover, Safeway sought to recover both the penalty and the costs from the defendant directors and employees who had been involved in the activity, on the ground that they had acted in breach of their contractual and fiduciary duties to their employers by being so involved.

The defendants obtained summary judgment in the Court of Appeal, on the ground that Safeway's claim was in respect of its own illegality, and that the *ex turpi causa* principle therefore applied.

The Court of Appeal, following the decision of the House of Lords in Gray v. Thames Trains Limited,⁷² held that the underlying principle was a rule of policy taking two forms. In the narrower form, the rule is that the claimant cannot recover for damage which is the consequence of the sentence imposed upon him for a criminal act. The penalty was imposed upon Safeway as an undertaking which had itself infringed the competition rules. It was a liability which was personal to the undertaking, and not a vicarious liability. Therefore, Safeway could not, consistently with public policy, seek to recover from the third parties the penalty imposed for its own illegal actions.

As Longmore L.J. said

“... it would be inconsistent for a claimant to be criminally and personally liable (or liable to pay penalties to a regulator such as the OFT) but for the same claimant to say to a civil court that he is not personally answerable for that conduct”.

The wider form of the principle is that a claimant may not recover for damage which is the consequence of his own criminal act. That applied to the claim for the costs of dealing with the O.F.T. investigation. They were the consequence of the unlawful conduct, and therefore could not be recovered.

⁷² [2009] 1.A.C. 1339.

Two thoughts on this decision. First, it is not clear how far it would apply in a case in which the criminal liability or liability to a penalty could be said to be vicarious. Secondly, counsel for the successful defendants was Jonathan Sumption, and his comment on the case, in the recent lecture, in this:

“It was at least arguable, although not in fact argued, that the economic objective of the legislation about price-fixing would have been better served by visiting its consequences on the individual who were actually responsible, and not just on the company which was legally responsible.”

That illustrates a difficulty often encountered in cases of illegality. The courts tend in this area to apply formulaic rules, without sufficient attention to their purpose which is to discourage, and to avoid rewarding, illegal behaviour. However, that said, it is difficult to see how a court could possibly enforce a contract to indemnify a party against a criminal penalty, without subverting the criminal justice system. Less difficulty perhaps with the costs.

The next two cases arise out of the alleged illegal activities in the Murdoch empire, and result, I suspect, from the criticism in Parliament of the costs paid for News of the World employees criminal defences. Both Rupert and James Murdoch said they would stop paying unless they were legally obliged to.

The more recent is the decision of the Court of Appeal in Coulson v. News Group Newspapers Limited.⁷³

The case concerned an agreement entered into on 26th February 2007 between the parties, which set out the terms on which Andy Coulson resigned as editor of the News of the World and provided that, to the extent that it was lawfully able to do so, News Group

⁷³ [2011] EWCA Civ. 1547.

would pay his legal costs and expenses arising from his having to defend judicial proceedings as a result of his having been editor of the News of the World

In July 2011, Mr. Coulson was arrested and interviewed under caution in connection with similar allegations, and also unlawful payments to police officers. He was not charged, and was released on bail.

The question was whether he was entitled to recover legal costs incurred by him in defending the criminal allegations.

There were a number of issues, but the one which is relevant for present purposes is whether the agreement, which the Court of Appeal held covered criminal proceedings as a matter of construction, was unenforceable because of the *ex turpi causa* principle.

On that issue the Court of Appeal held that there was nothing objectionable in an agreement to provide funds to enable someone to defend himself in criminal proceedings, as opposed to indemnifying him against penalties or orders for costs in the event of being found guilty [33, 61].

Previously, there had been the decision of the Chancellor in Glenn Mulcaire v. News Group Newspapers Limited⁷⁴, which was decided on 21st December 2011.

This concerned an agreement between Glenn Mulcaire and News Group relating to the civil proceedings brought by the victims of phone hacking against both of them. The agreement was that Mr. Mulcaire would not defend the proceedings, but would co-operate by providing information and in other ways, in return for which he would be indemnified against liability for damages and costs.

⁷⁴ [2011] EWHC 3469 (Ch).

This entirely sensible agreement operated satisfactorily, until Rupert Murdoch, in response to hostile questions from the Culture Media and Sports Committee of the House of Commons, said that News Group would stop paying Mr. Mulcaire's costs if not legally bound to do so.

Mr. Mulcaire then brought proceedings, and again there were a number of issues, but the one which is relevant for present purposes is whether this agreement was contrary to public policy and void.

The Chancellor held that it was not. He referred to the principle of law that an indemnity against civil or criminal liability resulting from the deliberate commission of a crime by the person to be indemnified was not enforceable. However, he said, there was no case in which this had been applied to an agreement made after the relevant criminal event in relation to civil proceedings.

He held that the mischief to which the rule of public policy was directed did not preclude such agreements, whether in relation to the costs of defending the claim or in relation to satisfying the judgment in the civil proceedings.

The good sense of the decision is clear, but it is not entirely easy to reconcile it with the wider principle stated in Safeway, namely that a party cannot recover for damage which is the consequence of his own criminal act. Any damages and costs for which Mr. Mulcaire is liable would be the consequence of criminal acts. Safeway was not referred to in the Chancellor's judgment.

There is to be no appeal. It may be that the decision was not unwelcome to either party.

A footnote, before leaving the topic of illegality. First, should anyone have a client unfortunate enough to fall into the hands of Somali pirates, and become involved in

raising finance for his release, there is an interesting discussion about the legality of ransom payments in Masefield AG v. Amlin Corporate Member Limited⁷⁵. Put shortly, ransom payments are not illegal or contrary to public policy. However, this does not mean that, if the pirates were foolish enough to take a cheque, they could recover on it.

Economic duress

The next subject is economic duress. There are two recent cases.

The first is a decision of Christopher Clarke J. in the case of Kolmar Group AG v. Traxpo Enterprises Pte Ltd.⁷⁶ This was a fairly straightforward case in which the claimants had bought methanol to sell to an important customer. After the contract had been entered into, the price of methanol rose sharply, and the defendant refused to supply at the contract price. The claimants had chartered a ship and faced claims for demurrage and for dead freight, as well as anxiety about their customer, and agreed to price rises. Once they had the methanol, they brought an action to recover the excess, and succeeded both on the grounds of economic duress, and for the tort of intimidation.

The case is useful, in that the judge summarised the law succinctly at [92], in four propositions:

- (1) Economic pressure can amount to duress if it is (a) illegitimate and (b) constitutes a “but for” cause inducing the claimant to enter into the contract or make a payment.
- (2) A threat to break a contract will generally be regarded as illegitimate, especially if the defendant knows that his threatened course of action would be a breach of contract.
- (3) It is relevant to consider whether the claimant had a real choice or realistic alternative – if not, that is evidence that the duress did cause the new contract terms.

⁷⁵ [2011] 2 All E.R. (Comm.) 764.

⁷⁶ [2011] 1 All E.R. (Comm.) 46.

(4) The presence or absence of protest may also be relevant on causation, but the absence of protest does not conclusively show that the payment was voluntary.

The second case, is the decision of Cooke J. in Progress Bulk Carriers Limited v. Tube City IMS LLC.⁷⁷

The facts of this case were rather more complex. Progress had chartered its vessel to Tube City for the carriage of a cargo from the U.S. to China, but then chartered it to another party and was therefore in repudiatory breach. Tube City did not accept the breach as terminating the contract, and Progress agreed to find an alternative vessel and compensate Tube City for all damages resulting from the original breach of contract.

Then – skipping a few intervening facts - Progress made a “take it or leave it” offer of the substitute vessel, with a reduced freight rate, but requiring Tube City to waive all claims for loss and damage. This Tube City accepted under protest.

The case is interesting mainly for the discussion of the circumstances in which conduct which was not in itself unlawful could amount to illegitimate pressure. The take it or leave it offer was not in itself unlawful.

Cooke J., following earlier authority, held that conduct which was not in itself unlawful could amount to illegitimate pressure, although it would be unusual in a commercial context. However, in the present case, the root cause of the problem was the repudiatory breach of contract, and the subsequent conduct of the contract breaker was designed to put the innocent party, Tube City, in a position in which it had to waive all claims for loss and damage so as to avoid further losses under its contract with the Chinese receiver.

⁷⁷ [2012] 2 All E.R. (Comm.) 855.

Therefore, the arbitrators' decision, that there had been economic duress, was correct.

On causation, Cooke J. adopted a different and perhaps slightly less rigorous test: was the duress a significant cause in the decision to enter into the contract? Which is correct is open to argument.

Damages

As in the case of Belize, a few years have now elapsed since the decision of the House of Lords in The Achilleas⁷⁸, and it is now possible to assess its impact; again so far not great.

The facts in The Achilleas were that the claimant owner chartered its vessel to the defendant charterers with a re-delivery date of 2nd May 2004. By April 2004, market hire rates had risen and the owners fixed a follow on charter, under which the charterer had the right to cancel if the vessel was not available by 8th May. The vessel was not returned until 11th May, so that the charterers had a right to cancel and by that time market rates had fallen sharply. The owners therefore had to agree to a reduction of \$8,000 per day.

The owners therefore, instead of claiming the usual damages, consisting of the difference between the charter and market rates of hire for the overrun period, claimed the loss which they had suffered as a result of what was in effect the cancellation of the charter and the substitution of a new charter at lower rates, for the whole period of the follow on charter, which was several months.

⁷⁸ Transfield Shipping Inc. v. Mercator Shipping Inc. [2009] 1 A.C. 61.

On a straightforward application of Hadley v. Baxendale, the answer was clear – it was obviously not unlikely that the owners would arrange a follow-on charter and that late redelivery would result in loss arising from having to cancel or renegotiate it.

It seems unlikely that permission to appeal would have been given against the arbitration award in favour of the owners, had it not been for the large disparity between the usual measure of damages for the 9 day overrun period, which would have been \$158,000, and the loss suffered as a result of having to renegotiate the time charter for 6 months, which was about \$1,365,000.

Despite the disparity, the arbitrators by a majority, the judge and the Court of Appeal all applied Hadley v. Baxendale, holding that this was the kind of loss which would have been contemplated as arising in the usual course of things, and that the defendant was liable notwithstanding the unforeseeable amount, in accordance with previous authority.

The House of Lords disagreed, and uphold the dissenting arbitrator, although for different reasons. Two of its members, Lord Hoffmann and Lord Hope held that foreseeability, in the not unlikely sense, was not always sufficient even in a case falling within the first limb of Hadley v. Baxendale. They held that, in exceptional cases, of which this was one, it was necessary also to consider whether the contract-breaker ought fairly to be taken to have accepted or assumed responsibility for the kind of loss claimed and that, in the instant case, it was not.

Lord Rodger and Baroness Hale decided the case on different grounds, and it is not entirely clear whether Lord Walker agreed with Lord Hoffmann and Lord Hope, or with Lord Rodger, or with both. So it is not clear that there was a majority decision in favour of one ratio.

Nevertheless it appears that, at least in some cases, the courts may have to consider not only Hadley v. Baxendale foreseeability but also whether the contract-breaker ought fairly to be taken to have accepted responsibility for the kind of loss involved (Lord Hoffmann),

for what loss it can be presumed the party in breach has assumed responsibility (Lord Hope), or what would be the common intention of reasonable parties to the contract of the kind involved (Lord Walker). It is all a matter of contractual interpretation: in effect, what were the unspoken implied terms relating to the acceptance of responsibility for loss?

Since the parties have not spoken, this approach seems to amount in practice to the court deciding what was fair and reasonable, but this simple way of putting it is rarely employed.

In the well known decision in the South Australia case⁷⁹, what was held to be outside the scope of the valuer's responsibility was loss arising from a general fall in the property market. This was foreseeable, but not something about which the valuers had advised.

Here, the loss of the follow-on charter was, one would have thought, obviously within the scope of the duty to redeliver the vessel on time, indeed it was the direct consequence of the breach of duty and of nothing else. The decision is therefore not merely an extension of the South Australia principle to all contracts, it goes a long way beyond it.

The reasons given by Lord Hoffmann, Lord Hope and Lord Walker for excluding the loss arising from the follow-on charter differed slightly, but there were two main ones. First, the arbitrators had found that the market would have expected that the charterer's liability would be to pay the difference in hire rates for the overrun period only. Second, since the arrangements made by the owners for the follow-on charter were outside the charterers' knowledge and control, the risk – if there was a potential liability – could not be assessed by them; therefore they could not be taken to have assumed it.

As to the first of these points, the market's expectation meant no more than that nobody had ever made a claim on any different basis in the short period since the decision in The Peonia⁸⁰ in which such a claim would have been possible. Anyhow, why should bankers

⁷⁹ [1997] A.C. 191.

⁸⁰ [1991] 1 Lloyd's Reports 100.

or shipowners be able to limit damages through a market expectation, rather than only by an express term of the contract like everyone else?

As to the second point, it is surely routine, for example, in sale of goods cases, for damages for faulty goods, late delivery or non-delivery to be based on contractual arrangements made by the buyer with third parties, unknown to and outside the control of the seller.

The result, if desirable at all, might more easily have been achieved by just following Victoria Laundry, where the Court of Appeal held the defendants liable for loss of profit, but not to the extent of the profit under “unusually profitable contracts”. Lord Walker referred to Victoria Laundry, and it may be that what he had in mind, in drawing attention to the unusual volatility of the market, was that the follow-on charter was to be seen as “unusually profitable”. However Lord Hoffmann and Lord Hope clearly, and Lord Walker probably, decided the case on different grounds.

Of the other members of the House, Lord Rodger purported to base his decision squarely on Victoria Laundry, referring to the particularly lucrative terms of the follow-on charter on which the claim for damages was based. But that should have led him to hold that the charters were liable for ordinary loss of profit over the whole period⁸¹, not for the market difference over the short overrun period. Lord Rodger explicitly declined to consider whether South Australia should be extended or whether liability for damages should be based on assumption of responsibility.

Baroness Hale in effect sat on the fence, saying that this was an exam question to which she did not know the answer; if the appeal were to be allowed, she preferred it to be on the ground set out by Lord Rodger only.

It is clear that The Achilleas cannot be regarded merely as a Victoria Laundry unusually profitable contract case. What are the implications? It can provide scope for argument in

⁸¹ See Cory v. Thames Ironwork Co. (1868) L.R. 2 Q.B. 181.

some cases that the contract breaker has not accepted responsibility for consequences of the breach which would have been well within his contemplation at the time of the contract. It can be seen as establishing an additional principle limiting recoverable loss to loss which is reasonably foreseeable, within the scope of the duty and, now, of a kind for which the defendant impliedly accepted responsibility.

When it was first decided, this case looked as if it might be a recipe for a long period of uncertainty and unpredictability. It has been said⁸² that South Australia has “generated much litigation as the courts struggle to break free from it”, and it was feared that the same might be true of its successor.

However, so far this has not proved to be the case. Lord Hoffman said earlier in his speech [11] that:

“... cases of departure from the ordinary foreseeability rule based on individual circumstances will be unusual, but limitations on the extent of liability in particular types of contracts arising out of general expectations in certain markets, such as banking and shipping, are likely to be more common.”

And the later decisions of English courts have continued to treat Hadley v. Baxendale as the standard rule, while recognising that there may be exceptional cases where –

“... the court, on examining the contract and the commercial background, decides that the standard approach would not reflect the expectation or intention reasonably to be imputed to the parties.”⁸³

However, the judges in the later decisions have politely but firmly said that they do not consider the decision in The Achilleas to have effected a major change to the correct approach to the recoverability of damages for breach of contract. In effect, they have sidelined it.

⁸² Burrows op. cit. p. 121.

⁸³ See Supershield Ltd v. Siemens Building Technologies FE Ltd [2010] All E.R. (Comm.) 1185 at [43]; see also the Amer Energy [2009] 1 Lloyd’s Rep. 293; Silvia Shipping Co. Ltd v. Progress Bulk Carriers Ltd [2010] 2 Lloyd’s Rep. 81; Pindell v. AirAsia Berhad [2011] 2 All E.R. (Comm.) 396 at [84].

Ironically, in the one case in which The Achilleas may have made a difference, the Supershield case (fn. 81), its effect has been to extend not limit liability. The Court of Appeal held that the contractual duty in that case was to provide safeguards against disasters which were unlikely to happen, and that loss which was not likely (in the Heron II sense) to happen was nevertheless recoverable. It was no answer to say that the occurrence was unlikely, when it was the defendant's duty to prevent it.⁸⁴

In the most recent case, John Grimes Partnership v. Gubbins⁸⁵, which concerned damages arising from volatility in the property market, Sir David Keene, with whom the other members of the Court agreed, referred to what Toulson L.J. had said in Supershield (above), and added:-

“I too agree with the summary of the law provided by Toulson L.J. in Supershield, although I would put it in slightly different language. It seems to me to be right to bear in mind, as Lord Hoffmann emphasised in The Achilleas, that one is dealing with the law of contract, where the situation is governed by what has been agreed between the parties. If there is no express term dealing with what types of losses a party is accepting potential liability for if he breaks the contract, then the law in effect implies a term to determine the answer. Normally, there is an implied term accepting responsibility for the types of losses which can reasonably be foreseen at the time of contract to be not unlikely to result if the contract is broken. But if there is evidence in a particular case that the nature of the contract and the commercial background, or indeed other relevant special circumstances, render that implied assumption of responsibility inappropriate for a type of loss, then the contract-breaker escapes liability. Such was the case in The Achilleas.”

A simpler, and perhaps equally accurate, way of putting it is to be found in the judgment of Sir Anthony Evans in Mulvenna v. The Royal Bank of Scotland⁸⁶, when he said that there were some cases in which the court regarded it as unreasonable to impose liability for a particular consequence of the breach, and therefore cut off the chain of consequences.

Two further points arise from the discussion in the John Grimes case.

⁸⁴ See [44-5]; Rubenstein v. HSBC Bank [2013] 1 All E.R. (Comm) 915 at [108-9] per Rix L.J..

⁸⁵ [2013] EWCA Civ. 37 at [24].

⁸⁶ [2003] EWCA Civ. 1112 at [33].

First, the suggestion in The Achilles that damages might be irrecoverable where their amount would depend on events outside the control of the contracting party and could not be assessed at the time of the contract: the Court of Appeal in John Grimes effectively buries this, making the point that this is true in all cases in which damages depend on the movement of markets, and that there are many cases in which damages have been awarded as a result of changes in the market price [27].

Secondly, the Court of Appeal confirms that the scale of the loss does not render it irrecoverable: it is not infrequently the case that the breach of a contract of modest size gives rise to a substantial claim in damages [30].

Piercing the corporate veil in contract

Next, piercing the corporate veil, and the very recent decision of the Court of Appeal in VTB Capital Ltd v. Nutritek International Corporation, now upheld in the Supreme Court.⁸⁷

This was a jurisdiction battle, in which in the Court of Appeal the parties were represented by 14 counsel, including 7 on the side of the appellants, illustrating once again what a great boon Russian litigation has become. In the Supreme Court the number dwindled to a mere 9.

The two issues relevant for present purposes were whether there was a good arguable case (1) that Nutritek, the 1st defendant, had been set up to perpetrate a fraud, such that the corporate veil should be pierced and (2) that the consequence of this was that the other defendants, who were the persons behind Nutritek, were parties to its contracts.

The Court of Appeal held, conventionally, that the only cases in which it is appropriate to pierce the corporate veil are “where special circumstances exist indicating that it is a mere facade concealing the true facts” [48-9].

⁸⁷ [2012] EWCA Civ 808, [2013] UKSC 5.

The real interest in the case lies in the discussion of the consequences: once the court has determined, in a particular case, that the veil of incorporation of the company should be pierced, does it follow that the controllers of the company are, or must be treated as, parties to the contracts entered into by the company. This proposition was rejected by the Court of Appeal, upholding the judge at first instance but overruling the view of Burton J. in two other cases that this was at least arguable.

The Supreme Court left open the wider question as to the existence of the doctrine of piercing the corporate veil, but upheld the decision of the Court of Appeal that such a doctrine could not justify treating the controllers of the company as parties to the company's contract. To do so, when this had never been anybody's intention, would be inconsistent with the basic principles of contract law, as well as with the principle established in Salomon v. Salomon,⁸⁸ that a company has a separate legal personality.

⁸⁸ See [72, 131-148, 151, 243]; Lord Clarke would have left the point open: [238].