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# Commercial Contracts Bulletin

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# Termination Clauses: Contractual Breaches v Common Law Breaches

In the May edition of the Commercial Contracts Bulletin we reported on the High Court's guidance on the common law right to terminate for repudiatory breach in *C&S Associates Ltd v Enterprise Insurance Company Plc* [2015] EWHC 3757 (Comm). The Court has further considered this issue in the recent case of *Vinergy International (PVT) Ltd v Richmond Mercantile Limited FZC* [2016] EWHC 525 (Comm) where the High Court confirmed that there is no general principle that a contractual termination clause will apply to a common law termination for repudiatory breach.

## Facts

Richmond Mercantile Limited FZC ('**Richmond**') entered into a 10 year agreement to supply Vinergy International (PVT) Ltd ('**Vinergy**') with bitumen (colloquially referred to as Tarmac) (the '**Agreement**'). The Agreement contained the below clause regarding termination:

*'Either party may terminate this Agreement immediately upon: (i) failure of the other party to observe any of the terms herein and to remedy the same where it is capable of being remedied within the period specified in the notice given by the aggrieved party to the party in default, calling for remedy, being a period not less than twenty (20) days.'*

Four years into the term, Richmond purported to terminate the Agreement on the basis of three repudiatory breaches: (i) breach of exclusivity provisions; (ii) failure to pay an invoice; and (iii) failure to pay demurrage. Vinergy denied liability for the repudiatory breaches, stating Richmond had unlawfully terminated the Agreement by not allowing it a chance to remedy the alleged breaches in accordance with the above clause and that Richmond was therefore liable to pay damages. In 2014, a tribunal hearing held that Richmond had lawfully terminated the Agreement.

On appeal by Vinergy, the High Court laid out the question of law as being whether Richmond was able to rely on its common law right to terminate the Agreement due to a repudiatory breach, so as to

completely bypass the notice and remedy requirements in the termination clause. In other words, was Richmond obliged to follow the Agreement's termination provisions and give Vinergy notice and an opportunity to cure the breach, subsequent to terminating the Agreement for a common law repudiatory breach?

## The Decision

The High Court rejected the argument by Vinergy that the notice provisions applied to any termination under common law. Therefore, Richmond had no obligation to follow the Agreement's termination provisions with respect to the common law termination for repudiatory breach. The Court held that whether or not notice was required in circumstances of a common law repudiatory breach would depend on 'the true construction of the [Agreement]' and subsequently Mr Justice Teare found that it could not be inferred from reading the clause that its provisions would apply to a repudiatory breach. It was further stated that there is no general principle of law in support of this.

The Court held there was nothing in the clause which expressly referred to the right of a party to accept a repudiatory breach as terminating the Agreement. The provision only applied to the specific contractual rights to terminate i.e. when the other party had failed to observe 'any of the terms' of the Agreement, then subsequently failed to remedy the failure within a specific period.





It was said that in any case, even if it could be implied that the clause applied to repudiatory breaches which are capable of remedy, it could not apply to the breach of exclusivity provisions by Vinergy as that is a breach incapable of remedy. The only type of breaches that would have been within the scope of the clause would be those that were remediable.

#### **Comment**

Although this decision is not progressive in terms of 'new law' or any particularly binding precedent, it does reinforce the fact that care should be taken when drafting termination provisions and when considering how such provisions may be interpreted at a later date.

From a drafting perspective, it would be advisable to expressly set out whether or not the parties to an agreement wish for termination provisions to apply to repudiatory breaches at common law, as the above case demonstrates the difficulty in arguing that such provisions should apply to repudiatory breaches as a matter of construction or as an implied term.

From an opposing view, care should also be taken if you are considering whether or not to observe contractual termination procedures in the context of a repudiatory breach. If you choose not to follow such procedures, depending on whether you are the aggrieved party or the party in breach, this may prove to be costly if the provisions are later interpreted to apply (or not to apply as the case may be) to common law situations as well as contractual ones. The cautious approach would of course be to observe contractual termination procedures regardless of the type of breach.

# Do 'In Writing Only' Variation Clauses Have Any Effect?

In *MWB Business Exchanges Centres Ltd v Rock Advertising Ltd* [2016] EWCA Civ 553, the Court of Appeal has confirmed that including an 'in writing only' variation clause (also known as an 'anti-oral variation' clause) in a commercial agreement does not prevent the parties from orally varying the terms of the agreement. This judgment builds on obiter comments previously made by the Court of Appeal in *Globe Motors Inc v TRW Lucas Variety Electric Steering Ltd* [2016] EWCA Civ 396, which found that anti-oral variation clauses do not prevent subsequent variation of the contract orally.

## Facts

MWB Business Exchange Centres Ltd ('**MWB**') operated managed office space in central London. Rock Advertising Ltd ('**Rock**') was the licensee of a premises operated by MWB. Rock decided to expand its business and entered into a licence agreement in writing with MWB for larger premises at an increased fee (the '**Licence**'). Rock's business did not develop as it had anticipated and four months later it had incurred fees of £12,000. MWB raised proceedings claiming the arrears of the licence fees.

Rock argued that an oral agreement had been made between MWB's credit controller and Rock's managing director to re-schedule the licence payments due under the Licence. This oral agreement provided that Rock would pay less than the amount originally agreed for the first few months but thereafter it would pay more, with the result that the arrears would be cleared by the end of the year. In response, MWB flatly denied that the parties had reached an oral agreement and also sought to rely on the terms of the Licence itself. Clause 7.6 of the Licence provided that:

*'This licence sets out all of the terms as agreed between MWB and the licensee. No other representation or terms shall apply or form part of this licence. All variations to this licence must be agreed, set out in writing and signed on behalf of both parties before they take effect.'*

## Decision

The judge at first instance found that, on the evidence presented, an oral agreement had indeed been made between the parties. However, the judge agreed with MWB and held that clause 7.6 precluded an oral variation of the Licence. On appeal, the Court of Appeal overturned the first instance decision and found in favour of Rock. It held that clause 7.6 did not prevent any variation of the Licence other than one in writing and in accordance with its terms.

The Court held that the most powerful consideration was the principle of party autonomy. In coming to this conclusion, the Court considered and adopted the reasoning in *Globe Motors*, which found that the principle of freedom of contract entitles parties to agree whatever terms they choose. The parties were therefore free to include terms regulating the manner in which the contract can be varied, but just as the parties could create obligations at will, they could also discharge or vary them.

The Court also relied on a previous case, *World Online Telecom v I-Way Ltd* [2002] EWCA Civ 413, which held that where parties have made their own law by contracting, they can in principle unmake or remake it despite the existence of an anti-oral variation clause in the relevant agreement. Applying this reasoning, the Court in this instance found that clause 7.6 did not preclude an oral variation of the terms of the Licence.





#### Comment

This judgment casts doubt on the effectiveness of anti-oral variation clauses. It also illustrates that the courts will give paramount consideration to the principle of party autonomy when determining whether or not a contract has been varied despite the presence of an anti-oral variation clause. This decision further serves as a reminder that parties should ensure that employees are aware that their verbal communications or actions could contractually bind their employer.

# Court of Appeal Confirms the Meaning of the 'Purpose' in a Commercial Contract

In *Starbev GP Ltd v Interbrew Central European Holdings BV* [2016] EWCA Civ 449, the Court of Appeal endorsed the approach of the High Court in interpreting the meaning of the 'purpose' in a commercial contract to mean the dominant purpose, rather than the sole purpose.

## Facts

A brewing business owned by Interbrew Central European Holdings BV ('**Interbrew**'), a subsidiary of Anheuser Busch Inbev NV/SA ('**ABI**'), was purchased by Starbev LP ('**Starbev**'). The sale and purchase agreement ('**SPA**') provided that part of the consideration due to ABI would be deferred until the business was resold and this would be calculated as a percentage of the profit made from the resale. An anti-avoidance clause in the SPA stated that any non-cash consideration used for 'the purpose of reducing the payments due' to the seller would be treated as cash for the purposes of calculating the deferred consideration.

The business was resold. The payment structure included a 'convertible note'. The note gave Starbev a right to early realisation for an amount lower than the actual value of the note. Starbev exercised this right and as a result, a lower amount was payable to ABI under the terms of the SPA. Interbrew and ABI argued that Starbev's use of the convertible note intended to reduce the payments due to ABI and therefore breached the anti-avoidance clause in the SPA. Starbev's counterargument was that the anti-avoidance provision would only apply if a reduction in payments due to ABI was the sole purpose for the use of the note.

## Decision

The issue for the Court to determine was whether the word 'purpose' in the anti-avoidance provision meant: (1) the sole purpose; (2) a single purpose, even if it was one of many; or (3) the dominant purpose.

The Court of Appeal endorsed the High Court's interpretation, finding that the 'purpose' meant the

dominant purpose, and upheld the earlier High Court finding that 'reducing the payments due to ABI was indeed the dominant purpose of the transaction'. As such, the Court found that the anti-avoidance clause in the SPA was triggered.

The Court of Appeal stated that the High Court had been entitled to rely on the statement of Lord Sumption in *Hayes v Willoughby* [2013] UKSC 17. Lord Sumption stated that 'a person's purposes are almost always to some extent mixed, and the ordinary principle is that the relevant purpose is the dominant one'.

Furthermore, the Court of Appeal noted that construing the 'purpose' to mean the sole purpose would allow Starbev to easily subvert the aims of the anti-avoidance clause and this was 'not at all plausible as the objective meaning of the clause in this contractual context'.

## Comment

This decision clarifies the meaning of the 'purpose' in the context of a commercial contract, where it is likely to be construed as referring to the dominant purpose.

Uncertainty surrounding the 'purpose' of particular actions can be avoided by precise drafting. The phrase can be made more specific, for example: (1) 'for the sole purpose of'; (2) 'for the dominant purpose of'; or (3) 'if the purpose includes...'. If it is intended that the 'purpose' should mean a specific purpose, this should be clearly stated within the terms of the contract.

This decision also suggests that the courts will give a wide meaning to anti-avoidance clauses included in commercial contracts to ensure that such clauses cannot be easily avoided and are effective in practice.

# Contractual Interpretation and Commercial Pragmatism

Despite stressing the importance of certainty in commercial contracts, the Court of Appeal in *Reveille Independent LLC V Anotech International (UK) Limited* [2016] EWCA Civ 443 found that the commercial conduct of the parties was sufficient to have waived the execution formalities.

## Facts

Reveille Independent LLC ('**Reveille**'), the producer of MasterChef USA (a cooking competition hosted by chef Gordon Ramsay) claimed that a merchandising deal memo sent to Anotech International (UK) Limited ('**Anotech**'), a manufacturer of cookware utensils, constituted a binding contract despite a failure to comply with the execution formalities set out in the memo.

The memo provided that Reveille would promote Anotech's products in three episodes of MasterChef USA and Anotech would display the MasterChef USA brand on its products for sale in the USA and Canada. The terms of the memo stated that it would not be binding on the parties until executed by both parties. Reveille had returned the deal memo to Anotech with manuscript amendments, however negotiations broke down and Reveille did not sign the memo.

Despite this, Anotech began performing its obligations under the deal memo by providing Reveille with cookware to be used on MasterChef USA. Reveille also approved a request by Anotech to use MasterChef USA's intellectual property in an episode filmed in Chicago.

It was held in the first instance that a binding contract had been formed based on the conduct of the parties. Reveille appealed, arguing that Anotech's performance of its obligations was not enough to conclude that a binding contract had come into existence in light of an express requirement for signature.

## Decision

The Court dismissed Reveille's appeal on the grounds that there were clear and unequivocal acts by both parties to fulfil their respective obligations under the contract. The Court found that Reveille had been acting as if Anotech was a licensee of the MasterChef USA

brand by using its cookware on its broadcasted episodes. This led to a binding contract from around the date on which Anotech began marketing its products with the MasterChef USA branding. However, the absence of a signature did create uncertainty as to the commencement date of the agreement.

The Court highlighted the importance of certainty in commercial contracts, as well as in commercial negotiations. Notably, the Court appeared to caveat commercial dealings, providing that 'the reasonable expectations of honest, sensible business persons must be protected'. Acceptance by conduct, in a commercial context, can create binding contracts even if the contractual signing requirements are not adhered to. Importantly, in this case the waiver of the requirements by conduct had not prejudiced either party. However, the judgment may have been different had it produced a different outcome.

## Comment

The judgment demonstrates the Court's willingness to interpret commercial intention in contracts, but this should not be relied upon when drafting commercial contracts. Certainty in commercial contracts is the safest way to avoid dispute and having to rely on interpretations of commercial common sense.

In *Marley v Rawlings* [2014] UKSC 2, Lord Neuberger suggested that commercial common sense can be applied but should not be used to compromise the importance of the language used in the drafting. He also set out that commercial common sense should not be invoked retrospectively; the natural meaning of a contract will prevail, if clearly drafted, even if one party suffers commercially.

It is important to draft commercial contracts in clear, concise and understandable language. The intentions of the parties should be clearly set out and the formalities of the contract observed. Following these steps will go a long way to avoiding the necessity of judicial interpretation, which may lead to an unpredictable outcome.



# 'I Like Cats and Dogs which are Black and Fluffy': The Pitfalls of Long Sentences in Contract Drafting

In *Andrew Wood v Sureterm Direct Ltd & Capita Insurance Services Limited* [2015] EWCA Civ 839, the Court of Appeal considered the issue of contractual interpretation.

## Facts

Capita Insurance Services Limited ('**Capita**') purchased the entire share capital of an insurance broker, Sureterm Direct Ltd ('**Sureterm**') from Mr Wood and other sellers. The sale and purchase agreement ('**SPA**') contained an indemnity under which Sureterm agreed to indemnify Capita:

*'against all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and all fines, compensation or remedial action or payments imposed on or required to be made by [Sureterm] following and arising out of claims or complaints registered with the FSA, the Financial Services Ombudsman or any other Authority against [Sureterm], the Sellers or any Relevant Person and which relate to the period prior to the Completion Date pertaining to any mis-selling or suspected mis-selling of any insurance or insurance related product of service.'*

Following completion, Sureterm conducted an internal investigation into allegations of mis-selling of insurance products and reported its findings to the Financial Services Authority ('**FSA**'). The FSA ordered Sureterm to pay approximately £1.35 million in compensation to affected customers. Capita claimed this amount plus interest together with expenses from Sureterm under the above indemnity.

The issue in dispute was whether Capita could claim for expenses which arose from self-reporting rather than from claims or complaints to the FSA. Capita argued that they could claim because the 'actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred' did not have to arise 'out of claims or complaints registered with the FSA', as long as they related to mis-selling in the relevant period. Sureterm argued that such losses must arise out of a claim or complaint to the FSA. The High Court ruled in favour of Capita.

Mr Wood appealed the High Court's decision, which was unanimously overturned by the Court of Appeal.

## Grammatical and logical considerations

In the Court of Appeal, Clarke LJ referred to the decision in *Arnold v Britton* [2015] UKSC 36. The Court noted that contractual interpretation is an iterative exercise and that the Court should look where the different constructions lead and how they fit with other provisions in the contract. The Court should be very slow to reject the natural meaning of a provision, although the more 'unbusinesslike' the result of plain interpretation is, the clearer the words must be to lead to that result.

The Court therefore considered the natural meaning of the indemnity and found that it excluded claims for self-reporting. The Court stated that there were two categories of loss contemplated by the indemnity:

- (A) *'all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred'; and*
- (B) *'all fines, compensation or remedial action or payments imposed on or required to be made by Sureterm following and arising out of claims or complaints registered with the FSA...'*

On a natural construction of the indemnity, the Court held that both categories were subject to the requirement that such loss must arise out of a claim or complaint to the FSA. Clarke LJ argued that just as the sentence 'I like cats and dogs which are black and fluffy' is least likely to mean 'I like cats which are fluffy and dogs which are black and fluffy', in this case it was unlikely that the condition specified at the end, but not the one preceding it, should apply to the category of losses beginning 'all actions...'. As Sureterm had self-reported itself to the FSA, Capita could not therefore rely on the indemnity.

### Commercial considerations

The Court of Appeal rejected Capita's argument that Sureterm's interpretation of the indemnity lacked any good commercial reason. The Court stated that the natural meaning of the words used in a contract should not be departed from unless their meaning is ambiguous. Furthermore, Capita had an alternative basis for its claim under the warranties in the SPA. The fact that the indemnity was a bad bargain and it was too late to institute a warranty claim did not justify an alternative interpretation. The reluctance of the courts to support a commercial interpretation in the absence of ambiguity highlights the importance of clear and precise drafting in commercial contracts.

Capita obtained permission to appeal in February 2016 and, unless the parties settle this case in the near future, there may soon be a sequel to this judgment.

# Consequential Loss: The Court of Appeal's Interpretation

The Court of Appeal has considered the language used in exclusion clauses to exclude liability for consequential losses in *Transocean Drilling UK Ltd v Providence Resources Plc* [2016] EWCA Civ 372. It was held that where a contract is made between parties of equal bargaining power using clear and unambiguous language, a court must give effect to the true intention of the parties – in this case not allowing any of the respondent's 'spread costs' to be recovered.

## Background

Consequential loss is a legal concept and its meaning has been subject to ongoing debate by the courts. Clauses are frequently drafted with the intention of excluding 'indirect or consequential loss' and include a list of specific exclusions. However, this approach often leaves room for uncertainty and challenge as to whether particular events are covered by the definition of 'consequential loss' and are thus non-recoverable.

## Facts

Transocean Drilling UK Limited ('**Transocean**') entered into a contract with Providence Resources Plc ('**Providence**') for the hire of a drilling rig. The contract placed an obligation on Transocean to provide the rig in good working condition. During the period of the contract, there was a delay of 27 days as a result of a defect in the rig. A claim was lodged by Providence for the costs it suffered as a result of the delay, including wasted costs of third party personnel and the cost of equipment and services known as 'spread costs' to the value of USD \$10 million.

Transocean contended that its liability for such costs was excluded under clause 20 of the negotiated industry standard 'LOGIC' contract. Clause 20 sought to exclude each party's liability to the other for any indirect or consequential loss or damages under English law, including loss of use (including without limitation, loss of use or the cost of use of property, equipment, materials and services including those provided by contractors or subcontractors).

The High Court held that Transocean had breached its contract with Providence as the rig was not provided in good working condition and Providence was entitled to recover its 'spread costs' for the period of the delay. The High Court stated that: (i) the exclusion clause should be interpreted against Transocean as it was the party seeking to rely on the clause (the principle of *contra proferentum*); and (ii) there is a presumption in the absence of clear words to the contrary that a party to a contract does not intend to abandon any remedies for its breach. Transocean appealed the High Court decision.



### Decision

The Court of Appeal overturned the decision of the High Court and allowed the appeal on the basis that 'spread costs' fell within the definition of consequential loss and thus were non-recoverable by Providence under the contract. In reaching its decision, the Court of Appeal made a number of interesting observations:

- Firstly, it commented that the exclusion clause in question was not a typical or industry standard exclusion clause which might typically be agreed between a commercially strong party and a weaker second party whereby the former seeks to exclude or limit liability for its breaches of contract. In these circumstances, the parties were of equal bargaining power and entered into mutual undertakings to accept the risk of consequential loss flowing from the other party's breach. Accordingly, the clause had to be viewed as an important part of the party's negotiations to allocate losses. In any event, the Court held that it had a duty to give effect to the true meaning of the language used by the parties, acknowledging the principle of freedom of contract which requires courts to give effect to parties' intentions.

- Furthermore, the Court of Appeal held that the High Court had been wrong to interpret the contested clause 20 by construing it contra proferentum against Transocean. This, in the view of the Court of Appeal, was only the correct approach where the language used was one-sided and ambiguous. In such cases only the court may choose the meaning that is less favourable to the party who introduced or relies upon the clause. It therefore had no part to play in this case.

### Comment

The decision of the Court of Appeal in *Transocean v Providence* highlights the reluctance of the courts to interfere where a commercial contract is the result of extensive negotiations between sophisticated and well-represented entities of equal bargaining power. Parties are able to make such bargains as they please but are then bound by the bargains and the operation of clauses agreed to. Accordingly, the case serves as a reminder to lawyers to draft liability clauses very carefully in order to avoid unintended consequences and similar disputes.



## The political landscape has moved.

Our Brexit Next: Legal Implications website provides checklists covering a broad range of industry areas, guiding you through what a Brexit could really mean for your business. You can also look at what we think the Brexit process might look like and the future options for the UK in its relationship with the EU.

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