Bird & Bird & Contract Law Alerter

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Welcome

Welcome to the latest edition of the Bird & Bird Contract Law Alerter and the first for 2012. It's a practical guide to recent contract law developments in the UK. Our aim is to provide reviews which focus on the core contract issues which are raised by the case. Many of the commercial themes and messages raised are relevant internationally.

This issue is packed with relevant cases. We've asked contributors to look at several of them in depth:

- Contract 'abandonment' and limiting liability: the AstraZeneca decision
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If you have any comments or questions on the Alerter, please do not hesitate to contact any of the editorial team or your usual Bird & Bird contact.

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Contract 'abandonment' and limiting liability: the AstraZeneca decision

By Andrew White, partner, Bird & Bird

It's a cliché that English law respects 'freedom of contract'. But in practice it means a lot. One consequence is that parties to a contract can exclude or limit liability for many types of defaults, and resulting losses. This freedom is wider than in many other countries.

It is permissible to limit liability for so-called 'repudiatory' breach: ie breach which "goes to the root" of the contract. Such a breach does not 'neutralise' the contract, or the limitation of liability clause. On the contrary, at precisely that moment the defaulting party can in principle rely on the limitation clause.

Whether the clause is effective to limit liability for repudiation is a question of interpretation of the contract, read as a whole.

In 2009 this issue was examined by the High Court in the well-known case of *NetTV v MARHedge* (reviewed in Issue 9 of the Contract Law Alerter). The defaulting party had abandoned a contract half way through in breach of contract, and then wanted to rely on a clause in the contract which provided that *"neither party will be liable..... for loss of profit"* to the other, in order to avoid the innocent party's claim for financial damage. The Court held that there was a so-called 'presumption' that an exclusion clause does **not** protect a defaulting party from its own contract abandonment. Therefore the language which would be needed to achieve the exclusion needs to be "strong and explicit". The Court held that on the facts the clause language was **not** strong or explicit enough. The outcome was that the abandoning party could not rely upon the above clause to limit its liability. This decision prompted much discussion and some controversy.

Another High Court judge has now expressed grave concerns about the *NetTV* case. The judge - Mr Justice Flaux - has strongly challenged the reasons of the court in NetTV. The case is called *AstraZeneca v Albemarle*, and although

his analysis of *NetTV* is not crucial to the *AstraZeneca* decision, he seems to be sending a clear public signal of concern over the *NetTV* outcome.

Flaux J argues that:

- there is in fact no "strong presumption" that exclusion clauses do not cover deliberate repudiatory breach; in fact it is just a question of interpretation of the clause;
- the decision in *NetTV* was wrong, because it relied upon a "selective" reading of the key caselaw precedents from the Supreme Court; and
- the *NetTV* case has wrongly revived the doctrine of so-called "fundamental breach", which somehow deprives the defaulting party of any contractual protection.

Mr Justice Flaux went so far as to say that the *NetTV* decision was "regressive" and "does not properly represent the current state of English law…". That is a pretty scathing assessment.

Key message: The statements in *AstraZeneca* have restored a greater degree of certainty to contract drafting, negotiation and advice. Following the court's reasoning, a suitably widely drafted exclusion clause should be interpreted so as to cover liability even arising from deliberate contract abandonment. This would appear to be the case even if the clause language in question makes no specific mention of "repudiatory breach", deliberate or otherwise. It would then be for the other party to demand that deliberate contract abandonment is "carved out" from the exclusion clause. In reality, such negotiations are happening quite often already.

Source: *AstraZeneca v Albemarle* [2011] EWHC 1574, High Court, Commercial Court, Mr Justice Flaux, 21 June 2011

Contractual interpretation: the Supreme Court highlights the importance of 'business common sense'

By Russell Williamson, Associate, Dispute Resolution Group

In *Rainy Sky v Kookmin Bank*, the Supreme Court recently revisited the principles of contractual interpretation and - in particular - considered what part arguments based on 'business common sense' could play when determining what parties had meant by their contractual words.

Facts: The case concerned the construction of on-demand refund guarantees issued by Kookmin Bank to secure advance payments made by buyers to a shipbuilder under a shipbuilding contract. Rainy Sky, as one of the buyers, agreed to buy a vessel from a shipbuilder and payment of the first instalment was conditional upon the shipbuilder providing bank issued refund guarantees, under which the bank would refund the advance payments if the vessel was never built.

However, the wording of the guarantee did not entirely correspond with the shipbuilding contract. While the shipbuilding contract provided that the builder's insolvency triggered the repayment of the advance payments, paragraph 2 of the guarantee stated that the payments would be refunded upon certain conditions, including cancellation of the contract or rejection of the vessel. Significantly, the guarantee did not specify insolvency as one of the grounds.

After the shipbuilder went insolvent, Rainy Sky called on the guarantee. The question in issue was whether the obligation on the bank in paragraph 3 of the guarantee to repay *"all such sums due to you under the Contract"* referred to the repayment of the advance payments as provided for under the shipbuilding contract (which were repayable on insolvency) or merely the sums mentioned in paragraph 2 of the guarantee (where repayment occurred only in limited circumstances such as cancellation of the contract).

The Supreme Court confirmed that the proper approach of contractual construction is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person with all the background knowledge that would have been available to the parties at the time of the contract would have understood the parties to have meant.

The Supreme Court went on to state that, where the reasonable person is able to reach two different constructions, the Court can adopt the construction which is consistent with business sense. In particular, it is not necessary to conclude that a certain interpretation would produce an absurd or irrational result before having regard to the contract's commercial purpose.

In this scenario, the buyer's view that the guarantee covered refund payments made under the shipbuilding contract following the insolvency of the shipbuilder was preferred because it was consistent with the commercial purpose of the guarantees (i.e. to secure against insolvency of the builder); while the bank's more limited interpretation of the guarantee would produce a *"surprising and uncommercial result"*.

Key messages: This case clearly demonstrates that the Courts will embrace commercially sensible interpretations of ambiguous or unclear contracts. This flexible approach is of course welcome, although it does raise a question about what is meant by the concept of 'business common sense'. In his judgment, Lord Clarke referred to a statement made by Longmore LJ in *Barclays Bank plc v HHY Luxembourg SARL* [2010] EWCA Civ 1248, that where a clause has two meanings and neither flout common sense, it is appropriate for the Court to adopt the more (rather than the less) commercial construction. There may, however, be cases where the line between such interpretations is difficult to draw.

As ever, the most effective way to minimise any such risks is for parties to ensure that their contracts are drafted as clearly as possible to leave no room for doubt. In this case, simple cross-referencing would have avoided the whole dispute.

Source: *Rainy Sky S.A. and others (Appellants) v Kookmin Bank (Respondent)* [2011] UKSC 50, Supreme Court, Lord Phillips, Lord Mance, Lord Kerr, Lord Clarke, Lord Wilson, 2 November 2011

"Opting-in" - High Court gives guidance on online marketing and repudiatory breach

By Andrea Garford-Tull, Associate, Commercial Group

Facts: Playup operated an interactive gaming business that allowed betting on sporting events via mobile phones or the internet for a share of a prize pool. Givemefootball (GMF) hosted the official website of the Professional Footballers' Association. GMF invited Playup to sponsor the PFA's fans awards, which enabled football fans to vote online for their player of the month and player of the year; and the parties entered into a sponsorship agreement. Under the sponsorship agreement GMF was to provide targeted marketing opportunities consisting of monthly emails to at least one million *opted-in* recipients and bi-monthly SMS messages to at least a quarter of a million *opted-in* recipients. GMF warranted and represented that its data subjects had "provided [GMF] with prior notification of their consent to receiving direct marketing from [Playup]".

Playup subsequently discovered that a large proportion of GMF's database of opted-in recipients were bought in from a third party (and thus had potentially never interacted with the official website of the PFA) and it terminated the sponsorship agreement, claiming damages for breach of contract and certain repayments. GMF denied any breach and counterclaimed for the balance of the sponsorship fee.

The term *opted-in* was not defined in the sponsorship agreement and both parties offered different interpretations. Mr Justice Walker held in favour of Playup in stating that opted-in "referred to people who had interacted with the Official Website [of the PFA] so as to give consent to the receipt of marketing." He subsequently held that GMF had substantially failed to deliver the promised number of email and SMS messages to *opted-in* recipients and that this amounted to a repudiatory breach, entitling Playup to terminate the sponsorship agreement.

In reaching his decision, Mr Justice Walker stated that "the whole purpose of the sponsorship agreement was to offer something which was obtainable only by association with the [PFA fans awards]" and that the distinction "between the "avid football fans" who opted-in to [the official PFA website] and the members of the public who, enticed by the lure of a prize draw, happened to say that they were football fans, was in [his] view of a fundamental nature...". In his statements relating to whether GMF had committed a repudiatory breach, Mr Justice Walker stated that Playup had "lost a major proportion of what it was fully entitled to regard as a vital benefit." In his view the email programme was *so* important that had GMF failed to provide at least two thirds of the promised email recipients, he still would have deemed this a repudiatory breach; however, in relation to GMF's failure to provide SMS message recipients, his view was that this was not sufficient, on its own, to amount to repudiation.

Key messages: This case relies on existing principles of construction and does not introduce any new legal concepts. However, it provides useful considerations on the meaning of the terms *opted-in* and *targeted*, the scope of data subject consent and guidance on the common law framework for assessing repudiation of a contract.

Source: *Playup Interactive Entertainment (UK) Pty Ltd v Givemefootball Ltd* [2011] EWHC 1980, High Court, Commercial Court, Mr Justice Walker, 28 July 2011

Contractual interpretation: the unintended effects of poorly drafted termination provisions

By Lucy England, Senior Associate, Commercial Group

Two recent Court of Appeal decisions on contractual termination rights highlight the reluctance of English courts to interfere with the commerciality of a transaction. They also show the cost that a poorly drafted contract can cause to a party and the importance of ensuring a contract reflects the parties' intentions.

In the first case, *Gesner Investments Limited v Bombardier Inc*, Gesner (the buyer) contracted with Bombardier (the seller) for the construction and purchase of an aircraft. Bombardier was late in tendering the aircraft for inspection and delivery and the issue before the court was whether, after 90 days of non-excusable delay, Gesner was entitled to terminate the contract immediately (as it had done) or whether it could only do so by serving written notice on Bombardier and granting it a further 10 day period to remedy the breach.

The confusion arose because of the drafting of the purchase agreement. Article 8 set out the procedure to be followed in the event of *excusable* and *non-excusable* delay. In relation to the former, there was a requirement for notice to be given and also for Bombardier to return all amounts paid by Gesner if the agreement was then terminated. In relation to non-excusable delay (where one would have thought that the drafting would have been even more favourable to the buyer), Article 8.4 provided for the payment by Bombardier of liquidated damages during the period of non-excusable delay. However, the Article provided that if, after 90 days of such non-excusable delay, Gesner sought to terminate, then the liquidated damages would have to be returned to Gesner and termination of the agreement would be 'pursuant to Article 9'. Article 9, and in particular Article 9.2, set out a general procedure for contractual termination which contained an obligation on Gesner to serve written notice and grant a further 10 day remediation period.

If Gesner was entitled to terminate without further notice, Bombardier was obliged to return all amounts received on account of the purchase price, plus interest. If Gesner was not entitled to terminate without further written notice, Bombardier's termination on the grounds that Gesner had failed to take delivery and pay the final instalment price for the aircraft took effect, and Bombardier was entitled to retain 10% of the purchase price by way of liquidated damages. The amount in dispute was $4.4m.

The court dismissed the appeal and held in favour of Bombardier: after 90 days of non-excusable delay, Gesner was required to serve further notice on Bombardier pursuant to Article 9.2. Even though the drafting in clauses 8.4 and 9.2 were highly favourable to Bombardier, the language in the contract was relatively clear. The judgment emphasised that a court should be particularly careful before seeking to impose its own ideas of fairness on a commercial contract between parties of equal bargaining power.

The court in the second case, *BVM Management Limited v Roger Yeomans (T/A The Great Hall at Mains)*, was required to answer the question whether a right to terminate on 3 months' notice formed part of an oral

contract made between the parties. The contract was for the provision of event management services by BVM at The Great Hall at Mains. Various drafts of a management services agreement had passed between BVM and the Yeomans but a final contract was never signed. Each draft included a right for either party to terminate on 3 months' notice and even though the director of BVM had made it clear in meetings that he required the contract to be for a fixed period of two years, he had not questioned the 3 month termination provision. There was no question over whether the other terms of the draft management services agreement applied - it was agreed they did - the only term in dispute was the 3 month termination provision. In addition to the draft management services agreement, other contracts for catering services that had been agreed between the director of BVM (in his position at a previous company) and the Yeomans also included a right to terminate on 3 months' notice.

The court dismissed the appeal from BVM and agreed with the Judge at First Instance that the 3 month termination provision *did* form part of the oral contract. The contract was consistent with BVM's desire for some security because a two year term had been agreed but there was no legal difficulty in including a right to terminate at an earlier stage if the parties had agreed such a provision, which on the facts, the Judge held they had.

Key messages: These cases once again illustrate the importance of precise drafting, of ensuring a contract reflects the parties' intentions and ensuring a finalised contract is reduced to writing. Some simple, practical lessons flow from these cases: ensure that all cross referencing is correct and that what the parties believe they have agreed is written into the contract.

Sources: *Gesner Investments Limited v Bombardier Inc* [2011] EWCA Civ 1118, Court of Appeal (Civil Division), Rix LJ, Longmore LJ, Patten LJ, 11 October 2011.

BVM Management Limited v Roger Yeomans (T/A The Great Hall at Mains) [2011] EWCA Civ 1254, Court of Appeal (Civil Division) (Lord Neuberger (MR), Aikens LJ, Lewison LJ), 3 November 2011.

Court of Appeal interprets meaning of *'Liabilities'* under indemnity

By Carolyn Burbridge, Senior Associate, Commercial Group

This Court of Appeal decision highlights the importance of careful drafting when including indemnity provisions in asset purchase agreements.

Facts: In 2008 Rust Consulting was found liable for breach of contract and negligence in respect of construction related services that it had carried out in connection with a shopping centre owned by "Eagle One" in early 1996. Rust was already in liquidation and had no assets and so its liquidators consented to judgment for the full amount of the £8 million claimed against it.

However, in December 1996 PB Limited, part of the same corporate group as Rust, had entered into an Asset Purchase Agreement ("APA") with Rust for the acquisition of its business. In this APA, PB had agreed to "responsibility for the satisfaction, fulfillment and discharge of all of the Liabilities and the Contracts of the Business outstanding at the Effective Date." The Liabilities included those "reflected in the accounts" of Rust as at the Effective Date. In the APA, PB had also indemnified Rust against all proceedings, claims and demands in respect of the same.

As the principal creditor of Rust, Eagle One replaced the liquidators and decided to claim the £8 million damages from PB under the indemnity given by PB in the APA.

A key issue was whether Rust could make a claim under the indemnity on the basis that its liabilities to Eagle One were within the meaning of the defined term "Liabilities".

The Court of Appeal confirmed that the liability of Rust to the shopping centre owner was part of the liabilities taken on by PB as it was indeed "reflected in the accounts" of Rust. This was the case even though it was a contingent liability and was not referred to specifically (and could not have been given that the claim was not made until several years later). The reference in a note in the accounts to the company having "contingent liabilities in the ordinary course of business" was deemed sufficient.

This further supports that careful drafting is essential in contracts. The use of the word "reflected" was crucial here. Had the drafting instead indicated that there needed to be a specific provision for the liability in question then it seems likely that PB would have successfully argued that it had not assumed the liability.

Similarly, wording in the recitals was also seen by the Court to support Rust's argument as it referred to "all liabilities" being taken on by PB. Although it is commonly accepted that recitals or preamble are not legally binding they can be referred to in order to establish the intention of the parties if the contract is otherwise ambiguous. It is a useful reminder that the drafting here should not be overlooked and should receive the same amount of diligence as the rest of the contract.

Source: *Rust Consulting Ltd v PB Ltd* [2011] EWCA Civ 899, Court of Appeal, Civil Division, LJ Ward, LJ Richards and LJ Tomlinson, 26 July 2011

Does using a confusingly similar trade mark constitute a repudiatory breach?

By Claire Brunel-Cohen, Senior Associate, Commercial Group

Facts: The claimant, Future Publishing, published a well-known and widely read computer gaming magazine, under the name (and a distinctive logo) "EDGE". Under a trading agreement between Future Publishing and the defendant, Edge, Edge had assigned to Future Publishing the trade mark "EDGE" (and the associated goodwill) in respect of certain printed materials. Future Publishing claimed that Edge had adopted a logo that was an obvious replica of the "EDGE" mark.

Amongst a number of issues, the High Court considered whether Edge, by using such a replica logo, was in repudiatory breach of the trading agreement. The High Court held that Edge's use of the replica logo amounted to a repudiatory breach of the trading agreement because: (i) Edge had breached critically important provisions of the trading agreement which protected Future Publishing's goodwill in the "EDGE" mark (by prohibiting Edge from using, or allowing any other person to use, the "EDGE" mark in a way which could reasonably be confusing with Future Publishing's use of the mark in accordance with the trading agreement); (ii) such breach was deliberately

calculated to cause confusion with the "EDGE" mark; and (iii) such breach caused substantial damage to Future Publishing's reputation (partly due to Edge's increasingly bad reputation in the gaming industry, which would adversely affect Future Publishing's reputation if it was thought that the two companies were connected). The fact that the breach by Edge was deliberate was a relevant factor in the High Court's decision, although the mere fact that the breach was deliberate did not, in and of itself, make the breach repudiatory.

Source: *Future Publishing Limited v (1) Edge Interactive Media Inc; (2) Edge Games Inc; and (3) Timothy Langdell* [2011] EWHC 1489 (Ch) – High Court, Chancery Division, Proudman J, 13 June 2011

Repudiatory breaches: when does the innocent party "affirm" the contract by delaying taking action?

By Esther Johnson, Solicitor, Bird & Bird

This case involving the Force India Formula One team came before the Court of Appeal in 2010. The issues raised by the case - namely what constitutes a repudiatory breach and whether an innocent party is deemed to have "affirmed" the contract - are hot topics in 2012.

Facts: In 2007, the Spyker F1 Team ("the Team"), entered into a sponsorship agreement with two Abu Dhabi companies, Etihad Airways ("Etihad") and Aldar Properties ("Aldar") (together the "Sponsors"), shortly before the first Grand Prix of the season.

In August 2007, the Team was sold to Orange India Holdings, the ultimate owner of which was Dr Vijay Mallya, a prominent Indian entrepreneur. Dr Mallya was keen to create a strong affiliation with India - the Team was subsequently re-branded as "Force India" and the cars were given new livery with prominent branding for a new sponsor, Kingfisher, a competitor to Etihad.

Under the terms of the contract, the Sponsors were to be the most prominent brands and Etihad was to be the sole and official airline associated with the Team. The contract also stipulated that the Team would not do anything by way of sponsorship or marketing which could be deemed to be in conflict with the Sponsors' main activities. As regards termination rights, either party had a contractual right of termination if the other party committed a "material breach" which, if remediable, was not put right within 10 days.

Following the take over of the Team by Dr Mallya and the subsequent re-branding, the relationship between the parties deteriorated. The Sponsors ultimately decided to terminate the contract in January 2008 claiming, inter alia, that the re-branding was in breach of contract. Force India thereafter brought proceedings in the High Court against the Sponsors asserting that the Sponsors had not been entitled to terminate the contract as they had failed to voice their objections to the changes and had delayed communicating their termination. They argued, therefore, that they had affirmed the contract.

The High Court agreed with Force India and held that Etihad was not entitled to terminate – Etihad had affirmed the contract and waived its right to terminate as it had known about the Team's breaches but had failed to take any action.

The Sponsors appealed. The Court of Appeal found that there had been a series of irremediable breaches of the agreement by *Force India* which had ultimately become repudiatory. Lord Justice Rix considered the termination rights under the contact and found that irrespective of what was provided for in the contract, the Sponsors were permitted to accept the repudiation under common law and terminate the contract.

In considering whether the delay demonstrated a decision to affirm the contract, Lord Justice Rix held that this case did not present the typical case where mere delay may demonstrate a decision to affirm. Such cases occur when time is of the essence, whereas in this case, the situation was not urgent as the termination took place during the winter break in the Grand Prix season. During the delay, the Sponsors were considering their position. In addition, Lord Justice Rix held that this was not a case 'where firm protest is immediately necessary to prevent the party in breach from being misled' about whether the innocent party had decided to affirm the contract. There was, therefore, no affirmation, waiver or acquiescence which prevented the Sponsors from exercising their common law right to accept Force India's repudiation of the contract.

Key Message: The case highlights that whether or not a contract has been affirmed will be considered on the facts of the case. If time is not of the essence, a period of delay in accepting the repudiation may be justified. This should not, however, be automatically assumed: much will depend on the particular facts and circumstances involved as to how the impact of the delay will be viewed by the courts.

Source: *Force India Formula One Team Limited v (1) Etihad Airways PJSC & (2) Aldar Properties PJSC* [2010] EWCA 1050, Court of Appeal, Civil Division, Rix LJ, Patten LJ and Sir Mark Waller, 6 October 2010

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