Bird & Bird & Contract Law Alerter

Issue 16 - October 2012

Welcome

Welcome to the latest edition of the Bird & Bird Contract Law Alerter. 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 which cover the following 'hot' topics:

- Contract formation and agreements to agree
- Obligations of 'good faith'
- The meaning of 'best' and 'reasonable' endeavours
- Limitations of liability and repudiatory breaches
- 'International supply contracts' and UCTA

If you have any comments of 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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Is it better to 'agree to differ' than to 'agree to agree'?

By Jack Colthurst, Associate, Dispute Resolution Group

In *Barbudev v Eurocom*, the Court of Appeal recently revisited the principles of contract formation in connection with a side letter to a share sale, specifically considering whether the key terms of the side letter were unenforceable as a mere 'agreement to agree', and if not, whether those terms were sufficiently certain.

Facts: Mr Barbudev was formerly the CEO and a major shareholder in Eurocom, a Bulgarian cable company. In 2005, the Warburg Pincus Group ("WPG") made an offer to acquire the issued share capital in Eurocom. During negotiations, Mr Barbudev expressed a strong concern to invest in the newly merged business post-completion. He subsequently alleged that an agreement in principle was reached with WPG that he would invest to acquire a 10% interest in the 'merged' entity post-completion.

In the Share Purchase Agreement for the sale to WPG, the signing of an Investment and Shareholders Agreement (ISA) between Mr Barbudev and WPG was listed as a condition precedent to the closing of the transaction. This was worded such that the condition precedent could be waived upon written notice from either party, which could potentially have deprived Mr Barbudev of the right to make his intended 10% investment. The issue continued to be negotiated by the parties, until the idea of a side letter emerged in their discussions. A side letter was drafted by WPG's solicitors and signed by the parties, stating that WPG would "*offer [*Mr Barbudev*]* the *opportunity to invest in the* [merged entity] *on the terms to be agreed between us which shall be set out in the Investment Agreement and we agree to negotiate the Investment Agreement in good faith with* [Mr Barbudev]." Following the sale to WPG, the ISA was never completed, which led Mr Barbudev to bring proceedings against WPG, in order to enforce the terms of the side letter.

The Court was faced with four interlinked issues:

- Whether Mr Barbudev was given a verbal assurance by an associate of WPG, effectively stating that the side letter was a separate contract protecting his right to invest;
- Whether there was an intention between the parties to create legal relations;
- Whether the side letter was a mere "agreement to agree" or an enforceable contract;
- Whether the terms of the alleged contract were sufficiently certain.

The appeal on the first question was refused, principally because it was a matter of fact on which Mr Justice Blair had made findings when the case was heard at the High Court. On the second issue, Lord Justice Aikens held that there **had** been an intention between the parties to create legal relations. After acknowledging that this issue was to be examined in the light of all the surrounding circumstances, and focusing on the *objective* conduct of the parties as a whole, he stated that the relevant facts in this case were that: the side letter was drafted by solicitors; it used the language of legal relations; it contained a governing law clause and provisions relating to third party rights; and it also contained a confidentiality agreement that the parties "*clearly intended*" would be contractually enforceable between them.

On the third issue of the actual legal effect of the side letter, Aikens LJ stated that this would be "*determined* by *[*the letter's*] terms, albeit in the commercial context in which the Letter is placed*." Although Mr Barbudev clearly *intended* for the side letter to create a binding arrangement, Aikens LJ disagreed, holding that: "*In my view this Side Letter is, without doubt, no more than an "agreement to agree*". *It is an agreement to offer Mr Barbudev "the opportunity to invest in the Purchaser on the terms to be agreed between us". That is not the language of a binding commitment and no amount of taking account of the commercial context and Mr Barbudev's concerns and aims can make it so."* He also referred to the fact that the terms were to be negotiated "*in good faith*" He concluded that this made it clear that the terms of the Investment Agreement were not agreed.

Although it became unnecessary to decide on the fourth issue for the purposes of the appeal, Aikens LJ considered the arguments made by the parties regarding the issue of whether the side letter was sufficiently "certain" in a legal sense. He held that the terms of the alleged contract were not certain, as both parties intended to agree key terms at a later date. For example, Mr Barbudev investing "*not less than €1,650,000"* left open the possibility that he would invest more for a greater stake in the company. Overall, it was clear that there remained many crucial matters that were not agreed in the side letter which had to be agreed before there was a sufficiently certain contract which could be enforced. Essential terms which had been contemplated by the parties were not dealt with in it.

Key Messages: This case provides a useful summary of the approach that courts will take when considering whether parties intended to enter into a contractually binding side letter. Aiken LJ's judgment is also a clear reminder that mere 'agreements to agree' are ordinarily unenforceable as a matter of English law, regardless of the commercial context. Parties intending to enter into a binding side letter should ensure that the terms are complete and unambiguous, and that the drafting of the side letter is expressed in the "language ... of legal relations".

Source: *Barbudev -v- Eurocom Cable Management Bulgaria EOOD & Ors* [2012] EWCA Civ 548, Court of Appeal, Lord Justice Lloyd and Lord Justice Aikens, 27 April, 2012

Butter sachets, stale bagels and a contract bust-up: *Compass Group v Mid-Essex NHS Trust*

By Andrew White, Partner

This High Court contract case involves some bizarre facts. And legally, it's eye-opening, because it's given legal effect to a clause in a commercial contract obliging the parties "to cooperate with each other in good faith".

Facts: Medirest, which is part of the Compass Group, entered into a seven-year contract in 2008 to provide catering services to two hospitals operated by an NHS Trust in Essex. The contract value to Medirest was around £2m, annually. The services were performed during the first few months of the contract in what everyone agreed to be a sub-standard manner. However, Medirest's performance soon improved, and the quality of its catering services met health and safety requirements and received decent patient ratings.

Under the contract, the Trust was entitled to levy payment deductions from Medirest on the basis of "service failure points". Furthermore, if Medirest did not demonstrate a remedy to the Trust, or take steps to prevent a recurrence of service failures, the Trust could aggregate further payment deductions. After nearly a year, when Medirest's initial performance shortcomings had to a large extent been resolved, the Trust's commercial director lodged a colossal **£590,000** claim with Medirest, arising out of the performance failures during the contract's early months. The breakdown of that figure makes bizarre reading: out-of-date ketchup - £46,000; old bagels - £96,060; mousse - £84,450; butter sachets - £94,830 etc. The £590,000 was based on the Trust's interpretation of the service failure mechanism, compounded by Medirest's alleged failure to notify the Trust of steps taken to rectify problems. The Trust started deducting £50,000 a month from charges payable to Medirest. The relationship collapsed, with each party accusing the other of breaches of contract. Following a messy termination saga, the parties ended up in court.

Mr Justice Cranston held that the NHS Trust's use of its contractual powers under the service failure regime amounted to a breach of the Trust's contractual obligation to cooperate with Medirest "in good faith" and "to take all reasonable action..... to enable the Trust and its beneficiaries..... to derive the full benefit of the Contract." The judge held that the obligation to cooperate was not just some woolly aspiration. It required the parties to work together to achieve a "common purpose" of benefiting patients and hospital visitors. As part of "good faith" both parties were obliged not to take unreasonable actions which could "damage their working relationship". Evidence showed that the Trust's commercial director felt Medirest could "afford" the huge payments the Trust claimed, because Medirest was part of the larger Compass group, and because he reckoned Medirest would want to avoid the "adverse publicity" of a dispute. The judge held that the Trust had "abused its contractual powers", and conducted itself so as to "destroy the relationship". Its exercise of its power to make service failure deductions was not a "mechanical process" but a matter of "discretion", and its behaviour had been "arbitrary, capricious and irrational". The Trust failed to respond positively when Medirest sought to resolve the dispute. Overall, the Trust's behaviour had "poisoned the relationship".

Key messages: This case arguably takes the legal effect of an express "good faith cooperation" clause further than any other decided case in the English courts. There have in fact been a stream of cases on the enforcement of good faith clauses in commercial agreements. Most concern how a contractual discretion is exercised (for example, the right to refuse consent to assign). This case goes further: it's about the exercise of a power to enforce a right. Granted, a public authority was involved. And granted, the behaviour of the Trust was extreme. Nonetheless, there are general legal messages in the case. Good faith wording has tended to be scoffed at by deal-hardened commercial negotiators - *"it's too vague to be enforceable", "we just put it in to make their commercial guys feel better"* etc. This case will give businesses and their legal advisers pause for thought. An appeal to the Court of Appeal is pending in around February 2013. Whatever the final outcome, there are important lessons to be learnt.

Source: *Compass Group v Mid-Essex Hospital Services NHS Trust* [2012] EWHC 781 High Court, Queens Bench Division, Mr Justice Cranston, 28 March 2012

Early morning and late at night? 'Best endeavours', Blackpool Airport and the Jet2.com case

By Andrew White, Partner

Under a 15-year commercial agreement, the operators of Blackpool Airport promised to use "best endeavours" to "promote" the services of low cost airline Jet2.com from the airport. A dispute arose over what this involved. In April 2012 the Court of Appeal ruled in favour of Jet2.com, upholding a 2011 High Court decision. Blackpool were held to have breached the obligation. There's been a lot of professional comment about the case (any Court of Appeal decision on "best endeavours" is likely to make headlines, in the legal press, at least.....). Here are two crunch points:

(1) Does 'best endeavours' oblige a party to act uncommercially?

Blackpool is a small regional UK airport, with published daily opening and closing hours. Blackpool argued that the "best endeavours" obligation did not mean it needed to operate outside those opening hours, for the sake of accommodating early morning or late evening Jet2.com flights. Blackpool said that doing so undermined its own commercial interests. They would make a loss employing staff and maintaining systems and facilities, beyond its normal hours, for the benefit of Jet2.com. However, on the facts the Court of Appeal disagreed. It held that it was always necessary to look at "endeavours" obligations in the context of an agreement as a whole, and the surrounding circumstances. The ability of Jet2.com to operate outside Blackpool's published hours was found to be 'fundamental' to the agreement. In view of this, Blackpool should be obliged to operate beyond their published opening hours, *even if Blackpool suffered financial losses as a result*. The Court did concede that if Jet2.com could *never* operate profitably from the airport, Blackpool could not be expected to sink money into the airport for the rest of the contract period. But the Court declined to say when that cut-off point might be.

(2) Is a 'best endeavours' obligation too uncertain to be legally enforceable?

Blackpool ran the additional argument that the "best endeavours" clause was too uncertain to be legally enforceable anyway. The Court of Appeal rejected this. It held that an endeavours clause is not too uncertain to be enforced provided that the goal of the endeavours can be ascertained with certainty. Furthermore, even if the "precise limits" of the obligation are "difficult to define in advance", it will be enforceable provided that the obligation can be given "practical content". On the facts, using "best endeavours" to promote Jet2.com services *was* held to be sufficiently certain.

Key Messages: "Best endeavours" clauses are a common feature of many business agreements involving any sort of long-term commitment or involvement (so too, of course, are 'reasonable endeavours' clauses). This case is bound to lead to more efforts by contracting parties to define, non-exhaustively, the scope of such obligations - as regards time, people, money, or resources.

Source: *Jet2.com Ltd v Blackpool Airport Limited* [2012] EWCA Civ 417, Court of Appeal, Civil Division, Longmore, LJ, Moore-Bick LJ, Lewison LJ, 2 April 2012

Bird & Bird Partner Robin Springthorpe and Associate Annabelle Wheeler represented Jet2.com in this dispute.

The meaning of "due diligence" and "reasonable endeavours" in a construction project

By Joseph Jackson, Associate, Commercial Group

In *Ampurius v Telford*, the High Court was asked to decide the extent of a party's obligation to use "*due diligence*" and "*reasonable endeavours*" in the context of a construction contract. Whilst the Court's judgment was based on the specific facts of the case, the decision will nonetheless be of interest to commercial lawyers as offering guidance on the meaning of two commonly used contractual phrases.

Facts: In October 2008, the parties entered into a contract under which Telford was to construct four waterside properties at a site in Greenwich, parts of which were to be leased to Ampurius. Two key terms in the contract obliged Telford to:

- Carry out the works "w*ith due diligence*" (clause 2.3); and
- Use its "*reasonable endeavours*" to complete the works on time (clause 2.4).

Soon after entering into the contract, Telford ran into funding difficulties and, in June 2009, suspended work on part of the site. In November that year, Ampurius alleged that Telford's actions amounted to a repudiatory breach of the contract and the parties entered into 'without prejudice' talks on how the project was to be progressed. Not satisfied by its discussions with Telford, Ampurius gave notice terminating the contract for repudiatory breach in October 2010. By this time, Telford had just recommenced work at the site and denied that it had committed a repudiatory breach. It countered that Ampurius had itself committed a repudiatory breach through wrongful termination of the contract.

At trial, the High Court found in favour of Ampurius. Mr Justice Roth was asked to decide a number of issues, though his findings in relation to clauses 2.3 and 2.4 are of particular interest:

- Clause 2.3 - Ampurius claimed that Telford had failed to discharge its obligation to use due diligence by not delivering the works on time. Telford countered that the clause did not confer an obligation to complete the construction on time and that its interpretation should be limited to performing the work carefully. In support, it argued that the issue of timing had been expressly covered in clause 2.4. The Court disagreed, finding that the concept of "due diligence" in a construction context usually infers "*due assiduity/ expedition*", as well as due care. The cessation of work on part of the site in 2009 was a clear breach of this obligation (regardless of the reason for that cessation).
- Clause 2.4 - Ampurius also claimed that Telford had not used "reasonable endeavours" to complete the construction on time (namely by February 2011). Telford argued that its obligations under clause 2.4 extended to the requirement to finance the works and as such, it would not be in breach if it could show that "reasonable endeavours" had been used to obtain such

financing. The Court disagreed, finding that in a construction contract, the clause was designed to provide an excuse for delay in respect of matters that could affect the physical conduct of the works for which Telford was not responsible (such as inclement weather or a shortage of materials). It did not cover whether the parties had sufficient financial resources to perform the contract.

The High Court held that, whilst both of these clauses were 'intermediate or innominate' terms, the nature of the breach of both terms was such that they were both repudiatory breaches. It also rejected Telford's claim that Ampurius had affirmed the breaches; these were continuing breaches and neither Ampurius' conduct nor the fact that Telford had resumed work on the site three weeks previously, prevented Ampurius from accepting the repudiation.

Key messages: As with most contractual disputes, the decision reached in this case was based on the specific facts and terms of the contract. Nonetheless, the judgment offers important guidance on how a court might interpret the meaning of two commonly used types of contractual obligation.

The Court's interpretation of clause 2.4 is particularly interesting as the judge acknowledged that Telford's obligation to finance the construction would fall within the scope of its endeavours obligation if a literal interpretation of the wording were applied. However, the Court took an objective reading of the clause to decide that it related only to the physical performance of the work. It is possible that, had clause 2.4 made express reference to financing the project, then this point would not have been argued at trial. The decision therefore highlights the importance of clearly setting out the parties' respective obligations in writing from the outset.

Source: *Ampurius NU Homes Holdings Ltd v Telford Homes (Creekside) Ltd* [2012] EWHC 1820 (Ch), High Court, Chancery Division, Mr Justice Roth, 4 July 2012

Limitations of liability: High Court confirms that they may apply to repudiatory breaches

By Julia Bishop, Associate, Commercial Group

This case came before the High Court in December 2011 and has re-affirmed that the question of whether a limitation of liability clause applies to a repudiatory breach of contract depends on the construction of the clause in question. It also considers the application of the reasonableness test under the Unfair Contract Terms Act 1977 to limitation of liability clauses.

Facts: The case was an application for summary judgment in respect of a dispute concerning a remote network operation centre service agreement entered into in May 2003 under which a company called Vanguard agreed to provide services to Shared Network Services (SNS). The parties contracted on Vanguard's standard terms, although SNS was given an opportunity to negotiate these (which it did not do). The rights and obligations of Vanguard under the contract were subsequently transferred to Nextira.

On 28 February 2005, the virtual private network connection between SNS and Nextira was closed. SNS claimed this was a repudiatory breach of the contract by Nextira, which SNS accepted. SNS claimed it was entitled to damages for wasted expenditure for around €1.75 million plus interest and costs. It commenced proceedings on 8 December 2010.

In its defence, Nextira relied on clause 14.2 of the agreement which stated:

"Vanguard MS's total liability to Service Reseller [SNS] *for damages under this Agreement will not exceed fifty percent (50%) of the service charges paid by Service Reseller to Vanguard MS during the twelve months preceding any claim."*

Nextira provided evidence to show that no service charges had been paid in the 12 months before the date of the claim or had indeed ever been paid by SNS under the agreement. It therefore argued that, under clause 14.2, it was under no liability whatsoever. SNS argued it had been prevented from earning any money under the contract by Vanguard and/or Nextira which was why it had paid no service charges.

SNS argued that Nextira could not rely on clause 14.2 on the basis that: (i) clause 14.2 did not apply to damages for repudiatory breach as these are not damages payable "*under this agreement*" as specified in the wording of clause 14.2; and (ii) clause 14.2 did not satisfy the requirement of reasonableness under section 3 of the Unfair Contract Terms Act 1977 (UCTA).

The Court held that damages for repudiatory breach are as much damages under a contract as any other damages for breach of contract. Mr Justice Flaux commented that SNS's argument was an attempt to revive the doctrine of fundamental breach which had been finally laid to rest by the decision of the House of Lords in 1980 *in Photo Production v Securicor* [1980] AC 827. This doctrine had been that, by rule of law, no term excluding or limiting liability could protect a party in fundamental breach of a contract.

Mr Justice Flaux reiterated that whether a clause excluding or limiting liability covers the events that have occurred is always a question of construction of the contract. He said clause 14.2 would apply in particular because it also stated: "*This limitation will apply regardless of the form of action...*"

In relation to the argument that clause 14.2 was unreasonable, Mr Justice Flaux referred to the so-called reasonableness test in section 11 of UCTA. He said it was clear from the wording of this that the question of reasonableness must be assessed at the time the contract is made, "*not by reference to what has happened during the course of the contract with the benefit of hindsight*". SNS gave evidence that it thought the provision was reasonable at the time the contract was made. It thought it would be making a lot of income and so paying service charges under the contract and so a clause allowing it to recover 50% of those service charges in the event of breach was not unreasonable. Mr Justice Flaux said that, in these circumstances, the argument that clause 14.2 was unreasonable under UCTA was "hopeless".

Key Messages: This decision reminds us that the question of whether a clause excluding or limiting liability covers a particular breach of contract (including an abandonment of a contract) depends on the construction of the contract. In this case, although he didn't refer to the case expressly, Mr Justice Flaux applied the reasoning he had outlined in June 2011 in the case of *AstraZeneca v Albemarle* (covered in Issue 15 of the Bird & Bird Contract Law Alerter). This reasoning was, and continues to be,

at odds with the reasoning set out by Moss QC in the High Court in the 2009 case of *NetTV v MARHedge* where the court had held that limitation of liability clauses should be narrowly interpreted when parties which had abandoned a contract then seek to rely upon them. We understand that the Court of Appeal may soon resolve the conflict of views on this issue.

The case also provides a reminder that the question of whether a clause is reasonable under the provisions of UCTA will be determined by reference to the time at which the contract was entered into. Considering the issue of reasonableness in this case, Mr Justice Flaux noted that clause 14.2 was not an absolute exclusion or limitation clause. He also said there was "nothing inherently unreasonable" in this type of limitation of liability by reference to an amount paid under a contract and that it was in fact "quite common" in commercial contracts.

However, this case highlights the potential risk for a customer in agreeing to limit a supplier's liability by reference to fees paid to the supplier (particularly where a breach may occur before any sums/fees are payable). It is also important to consider such clauses following a breach of contract to ensure that a claim is brought in sufficient time.

Source: *Shared Network Services Limited v Nexira One UK Limited* [2011] EWHC 3845, High Court, Commercial Court, Mr Justice Flaux, 9 December 2011

Air Transworld v Bombardier: High Court sheds light on 'international supply contracts'

By Joseph Jackson, Associate, Commercial Group

The recent decision in *Air Transworld v Bombardier* is important for two reasons. Firstly, it establishes that it is possible to exclude the 'conditions' implied by English law into sale of goods contracts without express contractual reference. Secondly, the judgment offers useful guidance on what constitutes an 'international supply contract' under the Unfair Contract Terms Act 1977 (UCTA).

Facts: Bombardier sold a private jet to an Angolan company, Angoil S.A, under an Aircraft Purchase Agreement ("the **APA**") which was based on Bombardier's standard terms. The APA was then assigned to Air Transworld Ltd, a company controlled by the owner of Angoil, which took delivery of the aircraft. However, soon after purchase the aircraft suffered an engine defect and was forced to make an unscheduled landing. The High Court was asked to decide on whether Air Transworld was entitled to reject the aircraft outside of its warranty period and this largely depended on whether the conditions on satisfactory quality and fitness for purpose implied by the Sale of Goods Act 1979 ("the **SGA**") had been validly excluded under the APA.

The APA contained wording excluding "*all other… obligations… or liabilities express or implied arising by law*". Whilst the exclusion did not make express reference to the word "conditions", the Court held that the wording used was sufficiently precise to exclude the conditions implied by the SGA. When read as a whole, the judge found that the exclusion clause could only be interpreted to mean that Bombardier's obligations were limited to those contained in the APA.

Air Transworld also argued that the warranty exclusion in the APA was rendered unenforceable for not meeting the 'reasonableness' standard required by UCTA. Bombardier argued that UCTA did not apply as the relevant agreements were 'international supply contracts 'under s26 of UCTA. A contract will come within s.26 if (amongst other things) the acts constituting offer and acceptance are performed in different international territories and/or if at the time the contract is concluded, the goods are either in carriage or will be carried from one territory to another. The circumstances leading up to the conclusion of the APA and Assignment Agreement are fairly convoluted, though in short:

- The APA was signed by Angoil in England. It was then faxed to Bombardier in Canada for signature, before the finalised Agreement was faxed back to Angoil in London.
- The Assignment Agreement was signed by Angoil and Air Transworld in London before being scanned and e-mailed to Bombardier in Montreal. Bombardier signed and sent copies of the fully executed document to Air Transworld's representatives in London and Portugal.

On the facts, the Court ruled that the aircraft **had** been purchased under an international supply contract and, therefore, the UCTA reasonableness test did not apply. The Court reasoned that the Assignment Agreement was the relevant contract for deciding whether an international supply agreement had been formed as it was the contract that Air Transworld was party to and upon which it sued. Significantly, it was held that a contract will be considered 'international' unless the totality of the acts which constitute offer and acceptance take place in the same state. In this case, communication and receipt of offer and acceptance of both Agreements had taken place in different states. In any event, the Court also found that the parties had the clear intention to move goods from one state to another, another indicator of an international supply contract.

Key messages: Whilst this judgment shows that it is possible to exclude the implied conditions under the SGA without making express reference to doing so, this remains a risky practice. The Court was able to distinguish this case from a long list of previous authorities because the particular wording used was strong enough to exclude the implied conditions. With this in mind, sellers seeking to exclude the implied conditions should continue to make express reference to "conditions" in their exclusion clauses to limit any possible uncertainty.

The judgment also provides a useful analysis of 'international supply agreements' under UCTA. Interestingly, whilst the Court found that both the APA and the Assignment Agreement were international supply agreements in their own right, the judge remarked that had the APA been a domestic supply agreement, the Assignment Agreement would have effectively converted into an international supply agreement. Contracting parties may therefore be able to take a domestic sales contract out of the scope of UCTA by novating it to an international third party purchaser. This strategy would of course have other implications (including tax and insurance considerations) all of which would need to be weighed up together.

Source: *Air Transworld Limited v Bombardier Inc* [2012] EWHC 243 (Comm), High Court, Commercial Court, Mr Justice Cooke, 20 February 2012

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