

# **THE DANGERS OF INFORMALITY: FORMATION OF CONTRACTS, LETTERS OF INTENT, WORK DONE IN ANTICIPATION OF A CONTRACT MATERIALISING, 'NO ORAL MODIFICATION' CLAUSES AND THE INTERPRETATION OF CONTRACTS**

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A range of topics will be covered in this session grouped loosely around the title 'the dangers of informality'. Topics covered include the point in time at which the parties actually enter into a contractual relationship. For example, in the case of work done under a letter of intent, at what point in time do the parties enter into a contractual relationship? What if work is done on a 'subject to contract' basis? Or work is done but no contract materialises between the parties? What role if any might good faith play in the regulation of the relationship between the parties. What legal consequences arise if the parties agree an oral modification to their contract notwithstanding the existence of a no oral modification clause in the contract? Finally, how do the courts interpret commercial agreements (and on this issue we shall go beyond informal contracts and include formally drawn up agreements which have been negotiated with the benefit of professional advice)?

As was the case in the two earlier sessions in this series, I shall proceed by asking questions and then provide brief answers to these questions. Short accounts of recent cases can be found in the Appendix to these notes. One or two of the cases in the Appendix are included as part of a review of leading recent cases on English contract law in the last few months.

## **If a party issues a letter of intent, is that letter contractually binding?**

No single answer can be given to this question because much depends on the terms of the letter of intent and on the facts and circumstances of the case. In *Cunningham v Collett and Farmer* [2006] EWHC 1771 (TCC), 113 Con LR 142 Judge Coulson (as he then was) distinguished between two 'distinct types of letters of intent'. The first is a letter of intent 'properly so called' which is expressly designed to have no binding effect whatsoever and the second is a letter of intent which is intended to give rise to limited rights and liabilities. A letter of intent which is contractually binding is likely to take the form of a time-limited commitment to pay for services rendered up to a particular sum with the expectation that, by the end of the agreed period of time, the parties will have entered into a binding contract (see, for example, *ERDC Group Ltd v Brunel University* [2006] EWHC 687 (TCC), [2006] BLR 255). A letter of intent is less likely to create a contract between the parties in the situation where the parties are in active disagreement over the terms that are to apply to their relationship (see, for example, *British Steel Corporation v Cleveland Bridge and Engineering Co Ltd* [1984] 1 All ER 504 where no contract was found to exist because the parties had failed to reach agreement on, among other things, liability for late delivery). Problems can also arise in the case where the letter of intent has expired but no formal contract has been concluded between the parties. In the case where significant work has been done a court may conclude that there was a contract in existence

between the parties notwithstanding the fact that no formal contract had been entered into between the parties (see *Anchor 2020 Ltd v Midas Construction Ltd* [2019] EWHC 435 (TCC), 184 Con LR 215, discussed in more detail in the Appendix). The judicial inclination to find the existence of a contract in such a case is driven in large part by the wish to reach a commercially sensible outcome (and the conclusion that no contract has been entered into where substantial amounts of work has been done for which payment has been made may not be seen as a commercially realistic outcome).

**Will a court find that the parties have entered into a contract where work is done on a ‘subject to contract basis’?**

The general answer is that a court will not find the existence of a contract in such a case. The effect of the ‘subject to contract’ stipulation will be to negate the existence of a contract between the parties (*Astra Asset Management UK Ltd v The Co-operative Bank plc* [2019] EWHC 897 (Comm), discussed in more detail in the Appendix). Further, the effect of a ‘subject to contract’ stipulation may also be to provide a defence to a claim in restitution or unjust enrichment (*Regalian Properties plc v. London Docklands Development Corporation* [1995] 1 WLR 212). However, it is important to ensure that there is no waiver of the ‘subject to contract’ stipulation because the effect of waiver may be to impose a contractual liability to pay for work done (*RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH & Co KG (UK Production)* [2010] UKSC 14, [2010] 1 WLR 753).

Rather than use a ‘subject to contract’ stipulation, it is possible for parties to use ‘subject to’ in relation to other matters to be agreed between the parties. A recent example is provided by the case of *Nautica Marine Ltd v Trafigura Trading LLC* [2020] EWHC 1986 (Comm) (discussed in more detail in the Appendix) where Foxton J distinguished between the case where the ‘subject to’ provision creates a pre-condition to the existence of a contract and the case where the ‘subject to’ provision is a performance condition which has the effect that performance does not have to be rendered if the ‘subject’ is not satisfied.

**Is it possible to make entry in a contract conditional upon the signing of a contractual document?**

Yes it is, but it is important to make any such intention clear and to avoid conduct which might be taken to suggest that the condition precedent has been waived. It is easy to drift into a contract in a case where work is being done and time is passing without the conclusion of a formal contract. If work is done and accepted, a court may infer that the parties have in fact entered into a contract and that the condition precedent has been waived on the facts. This is another area where it is important to avoid any suggestion of a waiver of the condition precedent.

**How certain must the agreement be before it will be regarded as a binding contract?**

If the agreement between the parties is no more than an agreement to agree then it will not amount to a binding contract (*Barbudev v Eurocom Cable Management Bulgaria EOOD* [2012] EWCA Civ 548, [2012] 2 All ER (Comm) 963). The parties must reach agreement on

the essential terms of the contract because the court will not make the contract for the parties (*RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH & Co KG (UK Production)* [2010] UKSC 14, [2010] 1 WLR 753). But not every term amounts to an ‘essential’ term so that, for example, the trigger event for the obligation to make payment has been held not to amount to an essential term of a contract between an estate agent and his client (*Wells v Devani* [2019] UKSC 4, [2020] AC 129). The courts tend to be reluctant to find that an agreement is too uncertain to be enforced where it is found that the parties had the intention of being contractually bound and have acted on the basis of their agreement. Further, there is no need first to identify the existence of a contract before considering whether to imply a term into that contract. A term can be implied into what would otherwise be an incomplete agreement if it is necessary to do so in order to make the contract work as intended by the parties.

### **What is to be done where work is done in anticipation of a contract which never materialises?**

If no contract materialises between the parties, then there is obviously no possibility of a contractual claim. But this does not mean that there is no claim at all. There may be a claim in restitution or unjust enrichment (see *British Steel Corporation v Cleveland Bridge and Engineering Co Ltd* [1984] 1 All ER 504). In order to bring such a claim, the claimant must establish: (i) that the defendant was enriched, (ii) the enrichment was at the expense of the claimant, (iii) it would be unjust to permit the defendant to retain the benefit without paying for it and (iv) there is no defence to the claim. A ‘subject to contract’ stipulation may have the effect of excluding the possibility of a claim in restitution or unjust enrichment (*Regalian Properties plc v. London Docklands Development Corporation* [1995] 1 WLR 212).

### **To what extent will the court be willing to imply terms into a contract which has been concluded informally?**

The test for the implication of a term is one of necessity rather than reasonableness and this is true whether the contract is entered into informally or formally. At the same time, the case in which the courts seem least willing to imply a term into a contract is the case in which the parties have entered into a contract of some length which has been negotiated with the benefit of professional legal advice (*Impact Funding Solutions Ltd v Barrington Support Services Ltd* [2016] UKSC 57, [2017] AC 73, [31]–[32]). In such a case, had the parties wished to incorporate the term into the contract, they could easily have done so by writing it in express terms. The fact that they have not done so is often good evidence that no such term was intended by the parties. By contrast, where the agreement between the parties is characterised by a degree of informality or the contract has been concluded orally or by conduct, the court may be more willing to imply a term into the contract in order to make the contract work as the parties must have intended (*Wells v Devani* [2019] UKSC 4, [2020] AC 129).

### **When will the courts imply a term into a contract that the parties must act in good faith in the performance of the contract?**

This continues to be a difficult issue in English contract law and the recent first instance decisions on this issue are not easy to reconcile. The courts are most likely to imply a good

faith term into a contract which is held to be a ‘relational’ contract (*Al Nehayan v Kent* [2018] EWHC 333 (Comm), [2018] 1 CLC 216, [167]–[174]; *Bates v Post Office Ltd (No.3: Common Issues)* [2019] EWHC 606 (QB), [711] and [725]–[726] and *Essex County Council v UBB Waste (Essex) Ltd (No 2)* [2020] EWHC 1581 (TCC), [104] – [106].

A non-exhaustive list of the characteristics of a ‘relational’ contract was set out by Fraser J. in *Bates v Post Office Ltd* at [725] in the following terms:

‘What then, are the specific characteristics that are expected to be present in order to determine whether a contract between commercial parties ought to be considered a relational contract? I consider the following characteristics are relevant as to whether a contract is a relational one or not:

1. There must be no specific express terms in the contract that prevents a duty of good faith being implied into the contract.
2. The contract will be a long-term one, with the mutual intention of the parties being that there will be a long-term relationship.
3. The parties must intend that their respective roles be performed with integrity, and with fidelity to their bargain.
4. The parties will be committed to collaborating with one another in the performance of the contract.
5. The spirits and objectives of their venture may not be capable of being expressed exhaustively in a written contract.
6. They will each repose trust and confidence in one another, but of a different kind to that involved in fiduciary relationships.
7. The contract in question will involve a high degree of communication, co-operation and predictable performance based on mutual trust and confidence, and expectations of loyalty.
8. There may be a degree of significant investment by one party (or both) in the venture. This significant investment may be, in some cases, more accurately described as substantial financial commitment.
9. Exclusivity of the relationship may also be present.’

Divergent judicial views have been expressed in relation to this development. In *Essex County Council v UBB Waste (Essex) Ltd (No 2)* [2020] EWHC 1581 (TCC), [106] these characteristics were described as ‘helpful indicia’ but at the same time doubt has been cast on the utility of this attempt to define a ‘relational’ contract from which a good faith duty is then derived (see *UTB LLC v Sheffield United Ltd* [2019] EWHC 2322 (Ch), [202] – [204], *Russell v Cartwright* [2020] EWHC (Ch), [87] and *Cathay Pacific Airways Ltd v Lufthansa Technik AG* [2020] EWHC 1789 (Ch), [216]). Rather than ask whether the contract is ‘relational’ (on the basis of which a duty of good faith is then derived), the preferable approach would appear to be to examine all the facts and circumstances of the case, including the alleged ‘relational’ nature of the contract, when answering the question whether a reasonable reader of the contract would consider an obligation of good faith to be so obvious as to go without saying or whether such an obligation is necessary for the proper working of the contract between the parties.

Three points should be noted about these developments. The first is that a relational contract should not be equated with a long term contract. While there is likely to be a long-term component to a relational contract (see point 2 in the summary by Fraser J in *Bates*), the defining characteristic of a relational contract is more likely to be the high degree of trust reposed by the parties in each other and their reliance on informal understandings rather than the formal text embodied in the contract which they have concluded. A long term contract which has been negotiated in substantial detail with the benefit of professional legal advice is unlikely to be a relational contract into which a court will readily imply a duty of good faith.

The second is that the courts have tended to be reluctant to conclude that a contract amounts to a relational contract for this purpose (see *Morley v Royal Bank of Scotland plc* [2020] EWHC 88 (Ch), discussed in more detail in the Appendix).

The third is that, if the aim is to ensure that there is no good faith term in a contract, the easiest way to ensure that this is so is to say so expressly in the contract given that the courts cannot imply a term into a contract that is inconsistent with an express term of the contract.

### **Can contracting parties informally depart from a no oral modification clause?**

The Supreme Court in *MWB Business Exchange Centres Ltd v Rock Advertising Ltd* [2018] UKSC 24, [2019] AC 119 upheld the validity as a matter of English law of no oral modification clauses and held that an oral agreement which did not comply with the terms of the no oral modification clause was consequently ineffective. But it left open the possibility that effect could be given in an appropriate case to an oral agreement by virtue of an estoppel. Although the Supreme Court recognised the possibility that estoppel could give effect to an otherwise ineffective oral variation of the contract, it stopped short of identifying what would for this purpose amount to an estoppel. Must the estoppel take the form of a representation that no reliance will be placed on the no oral modification clause or will it suffice to point to conduct which is simply inconsistent with the terms of the no oral modification clause?

The courts in subsequent cases have recognised that estoppel can have the effect of giving legal force to an agreement which has been reached without going through the formality prescribed by the no oral modification clause (*Great Dunmow Estates Ltd v Crest Nicholson Operations Ltd* [2019] EWCA Civ 1683, [2020] 2 All ER (Comm) 97, [26]; *C Spencer Ltd v MW High Tech Projects UK Ltd* [2019] EWHC 2547 (TCC), [2019] BLR 643, [69]) but have so far largely failed to define the limits of any such estoppel. However, it would appear that conduct that is inconsistent with the terms of the no oral modification clause will not be enough, of itself, to give rise to an estoppel (*Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait)* [2020] EWCA Civ 6, [2020] 1 Lloyd's Rep 269, discussed in more detail in the Appendix). Rather, the courts are likely to look for an unequivocal representation that the variation or amendment was valid notwithstanding its informality. This may not be an easy requirement to satisfy given that in many cases the parties to the contract are unlikely to have been aware of the existence of the no oral modification clause. It is likely to be a rare case in which the parties were aware of its existence and represented that it would not be applied to a variation which failed to comply with its terms.

## **What approach do the courts take towards the interpretation of contract terms?**

A summary of the approach taken by the courts to the interpretation of contract terms was recently set out by Leggatt LJ in the following terms (*Minera Las Bambas SA v Glencore Queensland Ltd* [2019] EWCA Civ 972, [20])

The principles of English law which the court must apply in interpreting the relevant contractual provisions are not in dispute. They have most recently been summarised by the Supreme Court in *Wood v Capita Insurance Services Ltd* [2017] UKSC 24; [2017] AC 1173 at paras 10-14. In short, the court's task is to ascertain the objective meaning of the relevant contractual language. This requires the court to consider the ordinary meaning of the words used, in the context of the contract as a whole and any relevant factual background. Where there are rival interpretations, the court should also consider their commercial consequences and which interpretation is more consistent with business common sense. The relative weight to be given to these various factors depends on the circumstances. As a general rule, it may be appropriate to place more emphasis on textual analysis when interpreting a detailed and professionally drafted contract such as we are concerned with in this case, and to pay more regard to context where the contract is brief, informal and drafted without skilled professional assistance. But even in the case of a detailed and professionally drafted contract, the parties may not for a variety of reasons achieve a clear and coherent text and considerations of context and commercial common sense may assume more importance.

It can be seen from this summary that the approach taken by the courts to the interpretation of informally concluded contracts may not be the same as that adopted when seeking to interpret a contract which has been drawn up with the benefit of professional legal advice. In the case of informal contracts, the courts may pay more attention to the factual matrix, whereas in the case of agreements drawn up with the benefit of professional legal advice, the courts are likely to attach more significance to textual analysis of the terms set out expressly in the contract itself.

## **What do the courts do when there is a divergence between the natural and ordinary meaning of the words used by the parties and a commercially sensible construction of these words?**

Much will depend on the nature of the contract between the parties and the clarity of the drafting of the disputed term. Where the term is clearly drafted and the parties to the contract have had access to professional legal advice, it is likely that the courts will give most weight to the meaning of the disputed term (see *Arnold v Britton* [2015] UKSC 36; [2015] AC 1619). But where the contract is poorly drafted or the parties have not had access to legal advice, then it may be that commercial common sense will weigh more heavily on the scales. However, cases can still be found where the courts have expressed a greater willingness to attach importance to commercial common sense. For example, in *First National Trustco (UK) Ltd v McQuitty* [2020] EWCA Civ 107, [39] Peter Jackson LJ stated:

When construing a document the court must determine objectively what the parties to the document meant at the time they made it. What they meant will generally appear from what they said, particularly if they said it after a careful process. The court will not look for reasons to depart from the apparently clear meaning of the words they used,

but elements of the wider documentary, factual and commercial context will be taken into account to the extent that they assist in the search for meaning. That wider survey may lead to a construction that departs from even the clearest wording if the wording does not reflect the objectively ascertained intention of the parties.

The final sentence from this quotation seems to indicate a broader role for context and commercial common sense than that envisaged by the Supreme Court in *Arnold v Britton*.

### **What is the scope of the factual matrix?**

In *Lehman Brothers International (Europe) (in administration) v Exotix Partners LLP* [2019] EWHC 2380 (Ch), [2020] 1 All ER (Comm) 635, [109] – [110] Hildyard J concluded that evidence of knowledge or information actually known to both parties prior to entry into the contract is plainly admissible as part of the factual matrix. Such evidence should be taken (in assessing the response of a reasonable and objective observer to the words in which the parties expressed themselves) to have informed the parties in making their agreement. But he concluded that the purpose of considering that as part of the admissible factual matrix was to determine the objective intention emerging from those words, and not to show what were the parties' subjective intentions or understandings.

In determining what is 'reasonably available' to both parties, the court should adopt a 'restrained' approach given the 'almost unlimited information and knowledge now available through the internet' and the fact that the parties are not subject to a duty to carry out investigations prior to entry into the contract. Rather, the question to be asked should focus on the knowledge a reasonable observer would have expected and believed both contracting parties to have had and each to have assumed the other to have had at the time of entry into the contract. It will not suffice to establish that the reasonable observer believed that the parties 'might' have had such knowledge. But a court can take account of specialist or unusual knowledge which only parties who entered into a contractual engagement of the sort in question might reasonably have been assumed to have had (see also *Challinor v Juliet Bellis & Co* [2013] EWHC 347 (Ch), [277]).

### **What is the relationship between interpretation and implication?**

The Supreme Court in *Duval v 11-13 Randolph Crescent Ltd* [2020] UKSC 18, [2020] 2 WLR 1167 affirmed that the court should first seek to interpret the clause in dispute and it is only once the process of interpreting the express words of the contract is complete that the court should proceed to consider whether or not to imply a term into the contract.

## **APPENDIX**

### **LETTERS OF INTENT**

In *Anchor 2020 Ltd v Midas Construction Ltd* [2019] EWHC 435 (TCC), 184 Con LR 215 one of the issues before the court was whether or not the parties had entered into a legally binding contract. They had entered into a series of letters of intent in relation to the construction of a retirement home, the last of which expired on 30 June 2014. The parties intended to contract pursuant to a JCT Design and Build Contract. Midas, the contractor, signed a copy of that contract on 21 July 2014 but Anchor, the employer, did not do so. In the present litigation Midas submitted that the parties had not entered into a binding contract, largely as a result of the fact that Anchor had not signed the contract documents, so that it could seek recovery for the work which it had done on a *quantum meruit* basis.

Waksman J held that the parties had entered into a contract, notwithstanding the failure of Anchor to sign the contract documents. He found that the parties had reached agreement on the essential terms of their agreement by 21 July. The factor relied upon by Midas to support the proposition that the parties had not entered into a contract was that it had sent to Anchor a 'Risk Register' the effect of which was, according to Midas, to allocate certain risks of the project to Anchor so that, were the risk to materialise, it would be borne by Anchor and not by Midas. The status of this Risk Register was a matter of dispute between the parties. Midas submitted that it amounted to a counter-offer but this submission was rejected by Waksman J. He held that the fact that the parties continued to dispute the status of the Risk Register did not have the consequence that they had not entered into a contract. The conduct of the parties was consistent with the existence of a binding contract and the existence of a debate between the parties as to whether or not that contract should be varied.

Midas also submitted that the parties had not intended to be bound because their intention was only to be bound when the contract documents had been signed by both parties. Although both parties no doubt initially intended that each party would sign the contract documents, the fact that Anchor failed to sign was held not to be fatal to the existence of a contract between the parties. The factors which were held to support the existence of a contract were that the contract documents had been signed by Midas (who were anxious to ensure that a binding contract had been put in place) and the continued performance by Midas (and it was held that the fact of performance is a matter of 'considerable weight' in the case of a contract such as the present which involved 'works of considerable substance requiring detailed documents'). Finally, it was held that the terms of the Risk Register were not part of the contract between the parties.

### **NO CLAIM IN CONTRACT OR UNJUST ENRICHMENT**

In *Munkenbeck and Marshall v The Vinyl Factory Ltd* [2019] EWHC 3225 (TCC) Mr Adam Constable QC held that the claimant was not entitled as a matter of contract law to recover a fee of 8% of the construction costs for the work which it had designed. While such a fee had been put to the defendant by the claimants, it amounted to no more than an invitation to enter



negotiations and was not an offer which had been accepted by the defendant. Nor were the claimants entitled to succeed with their restitutionary claim given that their relationship was governed by the terms of their contract and it was held not to be possible to resort to a claim in unjust enrichment to recover a sum held not to be recoverable under the terms of the contract between the parties.

### **‘SUBJECT TO CONTRACT’**

Matters might have been otherwise had the documents which passed between the parties been on a ‘subject to contract’ basis. Such was the case in *Astra Asset Management UK Ltd v The Co-operative Bank plc* [2019] EWHC 897 (Comm). The case was one in which the claimant asserted that the defendant was in breach of a contract for the sale to the claimant of certain debts and security interests. The defendant was held to be entitled to summary judgment in relation to the claimant’s breach of contract claim on the ground that it was clear that the parties had never reached the point of intending to create legal relations in respect of the intended sale and purchase of the rights. The principal reason for so concluding was that the discussions between the parties had been undertaken on a subject to contract basis. So, for example, the recital to the Exclusivity Agreement between the parties stated that ‘the Buyer and the Seller intend to enter into the Transaction subject to contract.’ For the claimant it was submitted that the words ‘subject to contract’ had not been used as a term of art. This submission was rejected by the Judge who held that it is a term of art with an established meaning. Further, he stated that to disapply or depart from its established meaning without a very good reason would be liable to disappoint the reasonable expectations of parties engaged in commercial discussions. Given the ‘subject to contract’ stipulation it was held that the dealings between the parties were incapable of giving rise to a contract and there was no evidence of any waiver of the ‘subject to contract’ stipulation.

However, it should be noted that it was also held not to be appropriate to grant to the defendant summary judgment in respect of the claimant’s claim in restitution on the basis that it had performed valuable services which had been facilitated and encouraged by the defendant. The matter was one to be determined at trial, having regard to matters such as whether the defendant had received an incontrovertible benefit as a result of the work done by the claimant, whether either party was at fault, the ‘subject to contract’ stipulation and the terms of the Exclusivity Agreement.

### **‘SUBJECT TO’ HELD TO BE A PRE-CONDITION RATHER THAN A PERFORMANCE CONDITION**

In *Nautica Marine Ltd v Trafigura Trading LLC* [2020] EWHC 1986 (Comm) Foxton J held that the parties had not entered into a concluded contract as a result of the non-fulfilment of a ‘subjects’ clause which was held to be a pre-condition to the existence of a contract between the parties.

The claimants were the owners of a vessel and their case was that they had entered into a contract with the defendant for the charter of the vessel. The defendant denied that any contract had been concluded between the parties. The parties had reached agreement which was stated

to be ‘SUBJECTS TO CHRTRS’S/S/R/MGT APPROVAL LATEST S1700 HOURS.’ It was common ground between the parties that ‘S/S/R/MGT’ stood for ‘Stem/Suppliers/Receivers/Management’ and that ‘Stem’ was an acronym for ‘subject to enough material’ which meant subject to the charterers confirming that they had sufficient cargo to load on the vessel. This being the case, the conclusion of the charter party was subject to (i) the availability of sufficient cargo, (ii) the supplier’s approval subject, (iii) the approval of the receivers of the cargo and (iv) the approval of Trafigura’s management.

Foxton J noted that ‘subject to details’ in the charter party market had a similar effect to a subject to contract stipulation in commercial contracts so that the effect of a ‘subject to details’ clause was to prevent any contract being concluded until all the terms had been agreed. While this is the general effect of such a clause, Foxton J acknowledged that it is possible for parties to decide nonetheless to enter into a contract on those terms which have been agreed while continuing to negotiate the outstanding terms (as is the case with a ‘subject to contract’ clause).

However, the usual construction of a ‘subject to contract’ or a ‘subject to details’ stipulation is that the drawing up of a formal agreement or the satisfaction of other conditions is a pre-condition to the existence of a contract between the parties. But in other cases the ‘subject’ has been held not to be a pre-condition but ‘instead has the effect that performance does not have to be rendered if the “subject” is not satisfied’ (for example, where a contract of sale is made subject to obtaining an export or an import licence). The latter type of case was described by Foxton J as a performance condition.

Courts are more likely to treat ‘subjects’ dependent on one party concluding a contract with a third party as pre-conditions rather than as performance conditions. Foxton J concluded that

while each case will depend on its own individual facts and commercial context, it is clear that a ‘subject’ is more likely to be classified as a pre-condition rather than a performance condition if the fulfilment of the subject involves the exercise of a personal or commercial judgment by one of the putative contracting parties (e.g. as to whether that party is satisfied with the outcome of a survey or as to the terms on which it wishes to contract with any third party).

Applied to the present facts it was common ground that the subject to Trafigura’s management approval and to the availability of supplies were both pre-conditions. Given that the first and the fourth of the conditions set out above were held to be pre-conditions Foxton J expressed his reluctance to conclude that the others could be anything other than a pre-condition. He therefore held that the supplier’s approval subject was a pre-condition, not a performance condition, with the consequence that its non-fulfilment had the consequence that no contract had been concluded between the parties.

## **BANKS, GOOD FAITH AND ECONOMIC DURESS**

In *Morley v Royal Bank of Scotland plc* [2020] EWHC 88 (Ch) the claimant property developer brought an action against the defendant bank following on losses which he sustained after he was unable to repay a debt owing to the bank and the properties which were used as security for the loan had dropped sharply in value following the 2008-2009 financial crisis. The claimant submitted that the bank had breached its duty to exercise reasonable skill and care in

the provision of banking services and that the bank had tortiously intimidated him and subjected him to economic duress by threatening to appoint a receiver who would arrange for the entire portfolio to be transferred in a 'pre-pack' to a subsidiary company of the bank.

Kerr J dismissed the claim. He held that the bank had not breached its duty to exercise reasonable skill and care in the provision of banking services. Of more significance, perhaps, is his analysis of the duty of good faith which the claimant submitted was owed to him by the bank. Kerr J held that the contract between the parties was not a 'relational' contract to which a duty of good faith attached. The relationship between the parties was simply that between two parties to an ordinary loan facility and the decision of the bank to call in the loan was an exercise of its contractual rights, not the exercise of a discretion. The bank did, however, have a discretion in two respects. First, the bank had a power to obtain a revaluation of the charged assets and the second element of discretion arose in connection with the bank's power to charge a default interest rate. These discretions had to be exercised for purposes rationally connected to the bank's commercial interests and not so as to vex the claimant maliciously. Kerr J found on the facts that all of the bank's actions were rationally connected to its commercial interests.

The relationship between the parties was an arm's length relationship and account had to be taken of the fact that the claimant owed to the bank some £75 million which was secured by the properties the subject of the charge. The bank had acted in accordance with its legitimate commercial interests and so it could not be said to have breached any duties owed to the claimant.

In relation to economic duress and intimidation, it could not be said that the bank had done anything which was unlawful. The threat to appoint a receiver was one which it was entitled to make. More difficult was the bank's threat to resort to a 'pre-pack', a problem that was compounded by the fact that the threatened sale was to a subsidiary of the bank. A bank taking such steps is likely to find it difficult to demonstrate that it has taken reasonable steps to obtain the best price reasonably obtainable. Thus in 'the conventional case' steps such as those taken by the bank could form the foundation for a claim against the bank. But in the present case the claimant did not have a financial interest in the outcome of the receivership because the negative equity on the properties was such that he could have 'no conceivable financial interest in the properties'. This being the case, any breach by the receiver of its obligations would not cause the claimant any loss. In these 'unusual' circumstances it was held that the defendant had not done any act which was unequivocally unlawful. It had gone 'close to the borderline' but was found to have stayed just the right side of it. In the circumstances it was no more than the 'rough and tumble of the pressures of normal commercial bargaining.' In any event the delay by the claimant of five years was held to be such as to lead to the conclusion that the claimant had affirmed the transactions.

## **NO ORAL MODIFICATION CLAUSES AND ESTOPPEL**

The Court of Appeal in *Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait)* [2020] EWCA Civ 6, [2020] 1 Lloyd's Rep 269 held that an estoppel had not been established which entitled

a party to rely on a variation which did not satisfy the terms of a no oral modification clause in the contract between the parties. The alleged amendment was therefore ineffective.

The Supreme Court in *MWB Business Exchange Centres Ltd v Rock Advertising Ltd* [2018] UKSC 24, [2019] AC 119 upheld the validity as a matter of English law of no oral modification clauses and held that an oral agreement which did not comply with the terms of the no oral modification clause was consequently ineffective. It also recognised that effect could be given to an otherwise ineffective variation by means of an estoppel, albeit the limits of that estoppel were not established by the Supreme Court. The issue in the present case was one that related to the essential ingredients of any such estoppel.

In the present case the contract provided that ‘The Agreement may only be amended or modified by a written document executed by duly authorised representatives of both Parties.’ It was argued by one party that an additional party had been added to the agreement although no written amendment to that effect had been agreed. The Court of Appeal rejected the submission.

The attempt was made to rely on the conduct of the party alleged to be bound by the agreement in support of the submission that an estoppel had been established which prevented that party from relying on the no oral modification clause. In advancing this submission particular reliance was placed on the second sentence of Article 2.1.18 of the Unidroit Principles of International Commercial Contracts which provides that ‘a party may be precluded by its conduct from asserting such a clause to the extent that the other party has reasonably relied on that conduct.’ On the facts of this case the conduct was said to be the performance of some of the obligations under the contract, such as the payment of invoices and evidence of silence amounting to acquiescence.

In rejecting the submission, the Court of Appeal pointed out that the examples given of the operation of the second sentence of Article 2.1.18 consisted not only of conduct by the parties but of unequivocal representations which were relied upon by the other party. In the absence of any unequivocal representation that the variation or amendment was valid notwithstanding its informality, it was held that the conduct of the parties was not sufficient to establish an estoppel. This being the case, the no oral modification clause applied according to its terms with the consequence that the party alleged to be bound by the agreement had not in fact been added as a party to it.

## **INTERPRETATION AND IMPLICATION**

In *Duval v 11-13 Randolph Crescent Ltd* [2020] UKSC 18, [2020] 2 WLR 1167 all of the leases in a block of flats with a common landlord contained an absolute covenant by the lessee not to cut, maim or injure any wall within or enclosing the demised premises (clause 2.7) and further contained a covenant by the landlord to enforce any covenants entered into with the landlord by a tenant of any residential unit of a similar nature to those contained in clause 2 if the tenant so requested and subject to payment by the tenant of the costs of doing so (clause 3.19). The lessee of one of the flats asked the landlord for permission to carry out works to a load-bearing

wall that would have amounted to a breach of clause 2.7. The landlord was willing to grant consent but the claimant, one of the other lessees of a flat in the block, sought a declaration that this would amount to a breach of clause 3.19. The Supreme Court held that clause 3.19 prevented the landlord from giving permission to work which, in the absence of consent by the landlord, would amount to a breach of clause 2.7.

The Supreme Court held that the appropriate approach to a case of this type was first to interpret the clauses in dispute and it was only once the process of construing the express words of the contract was complete that the court would consider whether or not to imply a term into the contract. The basis for this conclusion was that ‘until one has worked out what the parties have expressly agreed, it is difficult to see how one can decide whether a term should be implied into the contract and, if so, what it is’ (see [26]).

The first issue to be considered was therefore the scope of clause 2.7. The Supreme Court held that it was directed at activities in the nature of waste, spoil or destruction which went beyond routine alterations and improvements and were intrinsically such that they could be damaging to or destructive of the building. In relation to clause 3.19 it was held that the first part of it consisted of a promise by the landlord that every lease of a residential unit would contain covenants similar to those to be found in clause 2. The more difficult question was whether clause 3.19 entitled a landlord, at the request of a lessee, to licence structural work which fell within clause 2.7 and which, absent a licence from the landlord, would amount to a breach of clause 3.19. Clause 3.19 did not say in express terms that the landlord could not give a lessee permission to carry out structural work falling within the scope of clause 2.7. The vital question was whether such a limitation was implicit in clause 3.19.

The Supreme Court held that there was an implied term of the agreement between the landlord and each lessee that the landlord would not put it out of its power to enforce clause 2.7 by licensing what would otherwise be a breach of clause 2.7. The purpose of clause 2.7 was to provide a degree of protection to all of the lessees of the flats in the building. Further, clause 2.7 was an absolute covenant and, under clause 3.19, the other lessees of the flats were entitled, on supplying the necessary security, to require the landlord to enforce it as an absolute covenant. It would be ‘uncommercial and incoherent’ to say that clause 3.19 could be deprived of practical effect by the landlord giving its consent to the lessee to carry out the work in breach of clause 2.7 before another lessee made an enforcement request and provided the necessary security. It was held that the parties could not have intended that ‘a valuable right in the objecting lessee’s lease could be defeated depending upon who manages to act first, the landlord or that lessee.’

It was therefore held that the claimant lessee was entitled to a declaration to the effect that the waiver by the landlord of a breach of the covenant in clause 2.7 by a lessee or the grant of a licence to commit what would otherwise be a breach of that covenant would amount to a breach of clause 3.19 of the leases held by all of the other lessees in the building.

## **DISPUTE RESOLUTION PROVISION HELD TO OPERATE AS A CONDITION PRECEDENT TO LITIGATION**

In *Ohpen Operations UK Ltd v Invesco Fund Managers Ltd* [2019] EWHC 2246 (TCC), [2019] BLR 576 O'Farrell J held that the framework agreement between the parties contained a dispute resolution procedure that operated as a condition precedent to the commencement of legal proceedings by the claimant and she granted to the defendant a stay in order to enable a mediation between the parties to take place. But she also concluded that the prospects of a settlement would be improved if the parties were clear as to the ambit and basis of the claims and defences relied upon by the respective parties. She therefore directed that pleadings should be served so that the parties could clarify the issues in advance of the mediation.

It was common ground between the parties that a term of a contract which requires the parties to follow a specified resolution process 'can in principle create a condition precedent to the commencement of court proceedings.' In this connection O'Farrell J made reference to *Cable & Wireless plc v IBM United Kingdom Ltd* [2002] EWHC 2059 (Comm), [2003] BLR 89 *Holloway v Chancery Mead Ltd* [2008] EWHC 2495 (TCC), [2008] 1 All ER (Comm) 653, *Tang v Grant Thornton International Ltd* [2012] EWHC 3198 (Ch), [2013] 1 All ER (Comm) 1226 and *Emirates Trading Agency LLC v Prime Mineral Exports Pte Ltd* [2014] EWHC 2104 (Comm), [2015] 1 WLR 1145 and from these cases she derived the following principles which should be applied to any case in which a party seeks to enforce an alternative dispute resolution provision by means of an order staying proceedings:

- 'i) The agreement must create an enforceable obligation requiring the parties to engage in alternative dispute resolution.
- ii) The obligation must be expressed clearly as a condition precedent to court proceedings or arbitration.
- iii) The dispute resolution process to be followed does not have to be formal but must be sufficiently clear and certain by reference to objective criteria, including machinery to appoint a mediator or determine any other necessary step in the procedure without the requirement for any further agreement by the parties.
- iv) The court has a discretion to stay proceedings commenced in breach of an enforceable dispute resolution agreement. In exercising its discretion, the Court will have regard to the public policy interest in upholding the parties' commercial agreement and furthering the overriding objective in assisting the parties to resolve their disputes.'

## **THE NATURE OF A GUARANTEE AND THE CONDITIONS NECESSARY TO MAKE A CALL**

In *Yuanda (UK) Co Ltd v Multiplex Construction Europe Ltd* [2020] EWHC 468 (TCC) Fraser J held that the guarantee which had been entered into between a bank, a contractor and a sub-contractor created a secondary liability on the part of the bank to make payment. The document was not an on-demand bond which created a primary liability on the bank to make payment.

This being the case, the contractor (who was the beneficiary under the guarantee) was held to be in no better position under the guarantee than it was under the sub-contract. The ability of the contractor to make a valid call under the guarantee depended on it establishing that a sum was due to it under the underlying sub-contract between the parties. It was held that such liability could be established by a decision of an adjudicator which awarded to the contractor a sum of money in respect of the dispute which had been referred by the contractor and the sub-contractor to adjudication and the decision of the adjudicator was expected shortly after judgment was given by Fraser J.

Yuanda obtained the guarantee from the Australia and New Zealand Banking Group Ltd (hereafter 'the Bank') as security for its performance of the sub-contract. The guaranteed amount was stated to be a sum not exceeding £4,411,490.70. Under the terms of the guarantee the Bank was the Guarantor, Multiplex was the Contractor and Yuanda the Sub-Contractor. Clause 1 of the Guarantee provided as follows:

‘The Guarantor guarantees to the Contractor that in the event of a breach of the Contract by the Sub-Contractor, the Guarantee shall subject to the provisions of this Guarantee Bond satisfy and discharge the damages sustained by the Contractor as established and ascertained pursuant to and in accordance with the provisions or by reference to the Contract and taking into account all sums due or to become due to the Sub-Contractor.’

Fraser J concluded that the Guarantee was a performance bond. He did so by reference to clause 1 of the Guarantee (see above). In particular, he drew attention to the words ‘guarantees’, ‘in the event of a breach of Contract by the Sub-Contractor’ and the undertaking of the Guarantor to ‘satisfy and discharge the damages sustained by the Contractor as established and ascertained pursuant to and in accordance with the provisions of or by reference to the Contract.’ These are all words or phrases consistent with the existence of a secondary liability. Further, he held that there was ‘a complete absence’ of the type of words that one would expect to see in an on-demand bond which created a primary liability to make payment (the most obvious omission being any reference to a ‘demand’ or any synonym for demand).

## **ULTRA VIRES CONTRACT NOT ENFORCEABLE**

In *School Facility Management Ltd v Governing Body of Christ the King College* [2020] EWHC 1118 (Comm) Foxton J held that the claimants were not entitled to bring a claim for damages or in debt under a contract which it had entered into with the defendants for the provision of modular buildings for the defendant College. As a result of the way in which the contract with the College was structured (as a finance lease), the College did not have the capacity to enter into the contract because of its failure to obtain the required consent of the Secretary of State. The case acts as a reminder of the problems that can arise when entering into a contract with a public body in the event that the court concludes that the public body did not have the contractual capacity to enter into the contract. The claims of the claimants in contract and tort failed, although there was some small comfort for the claimants in the form of the dismissal of the counter-claim by the College to recover the payments which it had made to the claimants under the contract and the success of their own unjust enrichment claim in

respect of the period between the failure of the College to make payment and the date of judgment.

## THE SCOPE OF RESTRAINT OF TRADE

In *Peninsula Securities Ltd v Dunnes Stores (Bangor) Ltd* [2020] UKSC 36, [2020] 3 WLR 521 the Supreme Court reconsidered the application of the restraint of trade doctrine as it applies to restrictive covenants which restrict the use which can be made of land. In so doing it departed from the decision of the House of Lords in *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269. The latter case was authority for what came to be known as the 'pre-existing freedom' test, according to which the restraint of trade doctrine would not apply where the land was acquired subject to an existing restrictive covenant but that the doctrine would apply where land which was already owned became subject to a restrictive covenant. The distinction was best expressed by Lord Morris of Borth-y-Gest in *Esso* when he said that 'there is a clear difference between the case where someone fetters his future by parting with a freedom which he possesses and the case where someone seeks to claim a greater freedom than that which he possesses or has arranged to acquire.' This distinction did not commend itself to the Supreme Court in the present case and so it was departed from in favour of what was described as the 'trading society' test (a test adopted by Lord Wilberforce in *Esso* but which had not at that time found favour with the other judges in the House of Lords).

The essence of the 'trading society' test is a broader approach according to which terms of a contract which reflect 'the accepted and normal currency of commercial relations' are not subject to the restraint of trade doctrine because they have already satisfied the test of public policy contained within the restraint of trade doctrine. Such terms 'have become part of the accepted machinery of a type of transaction which is generally found acceptable and necessary, so that instead of being regarded as restrictive they are accepted as part of the structure of a trading society' (per Lord Wilberforce in *Esso*).

The significance of the change can be seen from the facts of the present case. A developer of a shopping centre, who had been looking for an anchor tenant for the development, leased part of the premises to Dunnes Stores which operated a number of substantial retail outlets in Ireland. Dunnes insisted that the lease contain a restrictive covenant in terms that the development would not contain another unit in size measuring 3,000 square feet or more for the purpose of trading in textiles provisions or groceries in one or more units. The developer subsequently assigned its rights to Peninsula Securities Ltd who wished to bring in another substantial tenant because the shopping centre was declining in financial terms.

One of the questions before the Supreme Court was whether or not the restraint of trade doctrine applied to the restrictive covenant. The Supreme Court held that it did not because it satisfied the 'trading society' test. It was held that it had 'long been accepted and normal' for the grant of a long lease in part of a shopping centre to include a restrictive covenant on the part of the lessor in relation to the use of other parts of the shopping centre. There was held to be no



ground for considering that social changed required the re-examination of the conclusion that the restrictive covenant did not engage the restraint of trade doctrine. This being the case, the lessor was held not to be entitled to a declaration that the restrictive covenant was unenforceable at common law as being in restraint of trade.