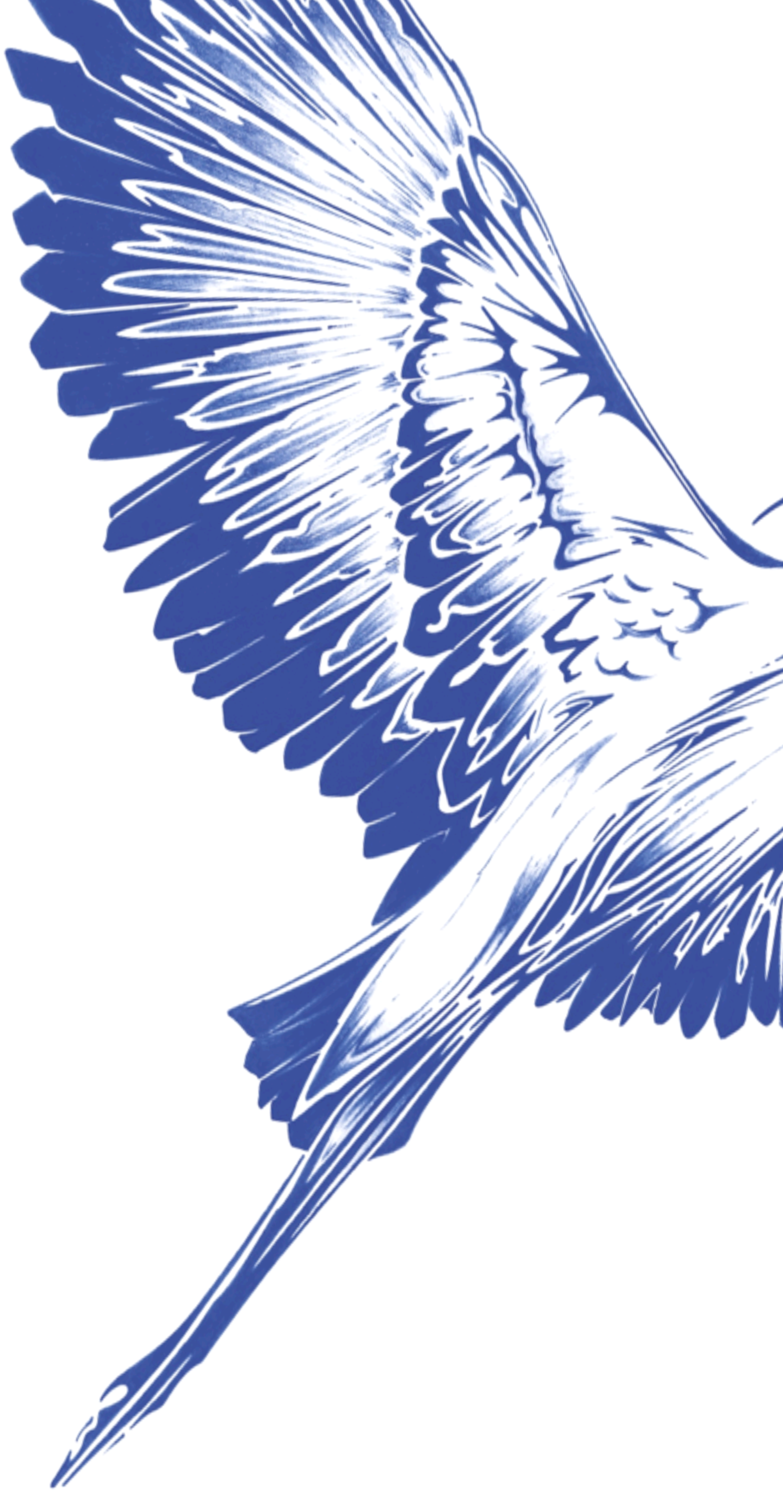
CLEVELAND & CO

External in-house counsel

KEY CONTRACT CASES LEARNINGS FROM 2015

September 2016



Case	Background & Key Principles	Drafting Tip
MARKS AND SPENCER PLC v BNP PARIBAS SECURITIES SERVICES TRUST COMPANY (JERSEY) LTD [2015] UKSC 72	This case concerned the rules on implied terms. The lease in the *Marks and Spencer* case contained the following common required provisions if the tenant wished to exercise the break clause: (i) give at least 6 months' prior written notice; (ii) ensure that there were no arrears of rent payable on the break date; and (iii) pay an additional break premium on or prior to the break date. When serving the break notice, the tenant followed the provisions accordingly and the break date was set at 24 January 2012. However, as rent was paid quarterly and in advance, the tenant had paid rent until 24 March 2012 and the dispute was whether in the absence of express provision in the lease, the tenant was entitled to a refund of the prepaid rent from the period 24 January to 24 March. The court held that the term should not be implied. **Principle:** The Supreme Court held that the rules on implying terms into contracts should consider the following: (1) terms should only be implied into a contract where it is necessary to give business efficacy to the contract or so obvious that it goes without saying – both tests do not need to be satisfied; (2) it is not sufficient to show that the proposed implied term is fair or reasonable, or that the parties to the contract would have agreed to the terms had they	• Ensure that all the terms you wish to be included are expressly set out. • You can exclude implied terms in many of your commercial contract clauses e.g. entire agreements clause, warranties or limitation of liability provisions. Here you can set out that "except as set out in this contract, all warranties, terms…express or implied, in respect of the product/service to be provided under this contract are excluded to the fullest extent permitted by law". • Note that when excluding implied terms, the Unfair Contract Terms Act 1977 will apply which may limit in some cases the exclusion of certain implied terms).

Case	Background & Key Principles	Drafting Tip
	been suggested to them; (3) whether a term should be implied or not should be determined as at the date of the contract; (4) no term can be implied into a contract which contradicts an express term; and (5) the more sophisticated the parties are, if they have been provided with legal advice and the more detailed the contract, the view will be that terms are less likely to be implied.	
CAVENDISH SQUARE HOLDING BV V TALAL EL MAKDESSI AND PARKINGEYE LTD V BEAVIS [2015] UKSC 67	These cases concerned the rules on penalty clauses. The main purpose of the rule against penalties is to prevent a claimant from recovering a sum of money that bears little or no relationship to the loss actually suffered as a result of the defendant's breach. In the former case, Makdessi arranged a share sale agreement between himself and Cavendish in order to sell his controlling interest in his business to C. The agreement laid out certain restrictive covenants, the breach of which could deprive M of certain deferred consideration and the requirement to transfer his remaining shares to the buyer at a price excluding the value of goodwill. In the latter case, Beavis was charged for overstaying the free-parking period. Both parties argued that the clauses were unenforceable penalties and in both cases the Supreme Court held that the clauses were enforceable. They held that a clause is not penal where:	• In order to avoid a clause being found to be a penalty, you should draft the clause as a primary obligation rather than a secondary one. For example, a contract obliges A to perform Z and further provides that if A does not perform Z he will pay B a sum of X. This is a secondary obligation and therefore capable of being a penalty. To avoid this, rephrase the clause so that the contract states that if A does not perform Z they will pay B a sum of X. • Bear in mind that the courts will ultimately look to the substance rather than the form.

Case	Background & Key Principles	Drafting Tip
	(1) the sanction it imposes protects a legitimate interest of the innocent party; and (2) the impact of the sanction is proportionate to the defence of that legitimate interest. **Principle:** a clause may now be enforceable even if it is not a genuine pre-estimate of the innocent party's loss or if it is designed to deter a breach of contract. Additionally, in Makdessi the relevant clause provided an adjustment to the purchase price which is a primary obligation and therefore the rules on penalties were not engaged. Going forward this may mean that it is possible to draft around the rule on penalties.	
MSC MEDITERRANEAN SHIPPING COMPANY SA V COTTONEX ANSTALT [2015] EWHC 283 (COMM)	This case concerned the limitation on the right to affirm a contract following repudiatory breach. A repudiatory breach is a breach which the law accepts as sufficiently serious to warrant termination of the contract. MSC shipping containers delivered Cottonex cotton to Bangladesh. Cottonex had an agreement to deliver that cotton to a third party. As a separate matter, the third party initiated proceedings against Cottonex, obtained title to the goods, but subsequently decided they did not want the cotton. Cottonex was unable to remove the cotton or arrange for the containers to be redelivered, as the Bangladesh custom authorities would not allow the containers of cotton to be removed without a court order, and therefore repudiatory breach occurred. The containers remained there for 3.5 years. In the agreement between Cottonex and MSC, Cottonex were supposed to redeliver	• If you have clauses dealing with the right to terminate a contract for repudiatory breach, for clarity, you can include wording that if the innocent party chooses to affirm the contract, there must be a legitimate interest to do so - the option to affirm must be taken on good faith i.e. must not be exercised arbitrarily, capriciously or unreasonably. • If you have clauses allowing liquidated damages, include wording so that the claiming party reviews their position periodically to determine whether it continues to suffer actual financial loss, and that steps should be taken to mitigate that loss. • You can also include specific language that contractual discretion must be exercised in good faith for the purpose for which it was conferred and it must not be

Case	Background & Key Principles	Drafting Tip
	the containers after the contents were discharged and if they weren't returned, MSC could claim demurrage. By trial date the containers still had not been returned and the total amount of demurrage that had accrued was over $1 million. Cottonex argued that demurrage could not be claimed after the date by which they repudiated the contract. The court held that once Cottonex stated repudiation of the contract, MSC can affirm the contract and claim demurrage only if they had a legitimate interest to do so. **Principle:** the claimant's right to keep the contract alive in the face of repudiatory breach is not absolute, and if there is no legitimate interest in keeping the contract alive, the agreement should be terminated and damages sought i.e. to replace the abandoned containers.	exercised arbitrarily, capriciously or unreasonably.
D&G CARS LTD V ESSEX POLICE AUTHORITY [2015] EWHC 226 (QB)	This case concerned contractual obligations of good faith. D&G carried out a vehicle recovery business and were contracted by the Essex police to recover, dispose of and crush certain vehicles. Specific instructions were given to crush one vehicle, but instead the company used the body of the vehicle for another project. The police authority claimed that this was a material breach and that they could consequently terminate the contract. The existence of an implied term to act with honesty and integrity was not disputed but whether the actions of D&G amounted to a breach of this duty of good faith was discussed. The court held that there was an implied term in a contract to act with honesty and integrity which although not expressed were implicit to give "business efficacy to the	• To avoid ambiguity, clearly define what constitutes acting in good faith and whether it applies generally or to a specific set of circumstances e.g. act honestly in all your dealings with the other party; not provide misleading information on which the other party relies; and not withhold information or consent without good reason.

Case	Background & Key Principles	Drafting Tip
	arrangements”. **Principle:** actions which are obviously contrary to the implied term of acting with integrity can amount to a breach of contract, and justify termination of the contract if it can be shown that the act was inconsistent with the maintenance of an intended long-term contractual relationship.	
MYERS AND ANOTHER V KESTREL ACQUISITIONS LTD AND OTHERS [2015] EWHC 916 (CH)	This case concerned implied terms of good faith. The claimants sold shares in their sub-prime lending business to Kestrel. Part of the consideration for the shares were vendor loan notes in Kestrel. Kestrel had also in turn issued discounted loan notes to fund the cash element needed to buy the shares. **Principle**: the judges held that a duty of good faith would not be implied in circumstances where: (1) the parties had been professionally advised; (2) they were contracting on an arm’s length basis; and (3) the contractual documentation was detailed and extensive.	• If you want to rely on their being a duty of good faith imposed on the parties, ensure that they are expressly provided for in your documentation.
ARNOLD V BRITTON & ORS [2015] UKSC 36	This case concerned the importance of language used in a contract. English law adopts an objective approach to contractual	• If a clause is important, and one that you may want to rely on later in court, ensure that it is drafted clearly and without confusion. This is especially important in relation to any fee sections. Make sure it includes clear and

Case	Background & Key Principles	Drafting Tip
	interpretation – looking at the natural meaning of the words and the background. (*ICS v West Bromwich Building Society 1998*). There was a long lease contractual agreement of holiday chalets between the landlord and the tenants. Within the contract there was an annual service charge fees which would rise by 10% per year. In the long term the service charge fee would become incredibly expensive, e.g. by 2072 the tenants would be paying service charges of over £550,000 per annum regardless of what the landlord had actually spent on such services. The tenants argued that in reality, the service charge fee + 10% p/a reflected a cap on the contributions required and so all they were required to pay in terms of service charges was their share of the landlord's actual costs up to the level of the cap. The High Court at first instance agreed with the lessees but it failed before the Court of Appeal. **Principle**: the Supreme Court held that the clearer the natural meaning of the words, the more difficult it would be for a court to justify interpreting the meaning of the words in a different way. The judges stated that it would not be correct for the court to reject the natural meaning of a provision simply because it seems an imprudent term for the parties to have agreed to.	consistent wording, and that the fee structure itself is not contradictory or so complex that it could be seen as ambiguous.
KEOWN V NAHOOR AND OTHERS [2015] EWHC 3418 (CH)	This case concerned breach of fiduciary duty and the burden of proof requirement. In breach of his fiduciary duties, an accountant was found liable for sums appropriated in breach which included sums	• Include terms in your contract that explicitly state the duty of care one party owes to the other and that relationship is a fiduciary one.

Case	Background & Key Principles	Drafting Tip
	which the claimant could not conclusively prove had been misappropriated by the accountant. Mr Nahoor ("**N**") was engaged and paid an annual salary by Mr Keown ("**K**") to look after the financial side of K's business. N was paid an additional fee to N's daughter and son that would occasionally help N with this work. In 2011 K found out that his business accounts were inaccurate and more than £600,000 had been transferred from K's business account to an account owned by N. K was seeking repayment of these sums (minus his salary which K contractually agreed to pay) fraudulently transferred to N's accounts. The claim was brought on the following basis: (1) breach of duty to account as a fiduciary; (2) unjust enrichment; and (3) proprietary claim based on a constructive trust. K sought repayment of sums paid to N's son & daughter on the grounds of knowing receipt, unjust enrichment and a propriety claim to a constructive trust. **Principle**: there was a constructive trust over the misappropriated sums because N was a fiduciary who had control over the bank account and abused the trust entrusted to him by misappropriating sums from K's account. This means that K had a proprietary claim to the misappropriated money. Consequently, this finding also meant that K had a proprietary claim over the misappropriated money that was also paid to N's son & daughter.	

DISCLAIMER

WHY WE'RE DIFFERENT

Cleveland & Co are specialists in financial services, investment management and commercial contracts and related courses. Our team's in-house experience means we understand client challenges and we work alongside you to create solutions. We can provide insight on real vs hypothetical risks and help your team evolve.

WE OFFER

Cleveland & Co offer you fixed fees and retainer structures that provide you with certainty of cost and we offer industry experience that cuts through common legal complexity.

CONTACT

EMMA CLEVELAND
Managing Director

+44.79.6387.8756
ecleveland@cleveland-co.com
www.cleveland-co.com