

## COMMERCIAL LAW (LL202)

**Course duration:** 54 hours lecture and class time (Over three weeks)

**Summer School Programme Area:** Law

**LSE Teaching Department:** Department of Law

**Lead Faculty:** Dr Solène Rowan, Dr Andrew Summers, Dr Nick Sage, Professor Michael Lobban, Dr Joseph Spooner, and Dr Paul MacMahon (Dept. of Law)

**Pre-requisites:** Introduction to legal methods or equivalent.

**Course Aims:** The course provides an introduction to English commercial law as a whole, combined with in-depth coverage of some specific aspects. The first portion considers fundamental principles of the common law of contracts as applied to business-to-business transactions. Topics include (among others) pre-contractual duties, interpretation, third-party rights, and remedies for breach of contract. The course then considers how commercial disputes are resolved, concentrating on the international context and the role of arbitration. The final third of the course focuses on the common law's approach to two particular kinds of commercial dealings: financial transactions and the sale of goods. These examples are chosen to illustrate the kinds of problems arising across different market sectors. The objectives of the course are twofold: first, for students to become familiar with the fundamental principles of commercial law, so that they can apply these principles to a wide range of transactions. Secondly, by the end of the course, students will be able to a critical approach to the material so they can debate and make proposals for reform.

**Note: this is a draft syllabus and is likely to change in minor ways. An updated course syllabus will be available at the beginning of the course.**

### Texts

Reference Texts:

M. Chen-Wishart, *Contract Law*, 5th edn (2015) (Abbreviation: Chen-Wishart)

R. Goode, Commercial Law, 5th edition, London, Penguin (2017) (Abbreviation: Goode)

H. Beale, W. Bishop, M. Furmston, Contract: Cases and Materials, 5th edn (Oxford, OUP, 2007) (Abbreviation: BBF)

**Assessment:****Formative Assessment**

This will not count towards your final overall grade but will help you prepare for the first summative assessment.

Format: Essay plan

Date: Friday of week one

Feedback/results due: Monday of week two

**Summative Assessments**

Format and weighting: Essay (40%)

Date: Friday of week two

Results due: By Tuesday of week three

Format and weighting: Two hour final examination (60%)

Date: Friday of week three

Results due: Within a week of the exam

***The precise time and location of the exam will be circulated during the programme.***

2

**List of Topics and Table of Contents**

<u>Topic 1 Introduction, Freedom of Contract, and Contract Formation</u> .....	3
<u>Topic 2 Pre-contractual duties and the duty of good faith</u> .....	9
<u>Topic 3 Express Terms, Implied Terms, and Interpretation</u> .....	15
<u>Topic 4 Commercial Contracts and Commercial Circumstances: Mistakes, Frustration and Contractual Variation</u> .....	22
<u>Topic 5 Remedies for Breach of Contract</u> .....	30
<u>Topic 6 Exclusion Clauses and Agreed Remedies</u> .....	36
<u>Topic 7 Multi-Party Projects: privity of contract and the rights of third parties</u> .....	40
<u>Topic 8 Commercial Dispute Resolution and International Commercial Contracts</u> .....	44
<u>Topic 9 Financial law (1): Introduction and Debt Finance</u> .....	57
<u>Topic 10 Financial Law (2): Credit and Secured Finance</u> .....	67
<u>Topic 11 Sale of Goods (1): Implied Terms &amp; Damages for Defective Goods</u> .....	75
<u>Topic 12 Sales of Goods (2): Termination and Acceptance</u> .....	81

## Topic 1 Introduction, Freedom of Contract, and Contract Formation

### 1. Freedom of Contract

What policies and principles should predominate in the approach of the law towards commercial contracts? Should contracts between businessmen be regarded as a field for freedom of contract, so that, subject only to fraud and duress, they should be permitted to make legally enforceable contracts with any content that they choose? Do arguments based upon efficiency support such freedom of contract? Are there any valid policy reasons to limit freedom of contract? Should the law be concerned about fairness? Should the law be concerned about externalities? Is any interference with freedom of contract in commercial contracts an example of unjustified paternalism?

#### (a) English law and 'Fairness'

Consider *Union Eagle Ltd v Golden Achievement Ltd* [1997] 2 All ER 215, PC (BBF 590). In this case, the appellant entered a written contract to purchase a flat in Hong Kong for \$HK4.2 million, paying a 10% deposit. The contract provided that completion (ie payment of the balance of the price) was to take place before 5.00pm on 30/9/91, that 'time was of the essence in every respect', and that if the purchaser failed to comply with any of the terms of the contract, the deposit was forfeited 'as and for liquidated damages (and not a penalty).' A messenger carrying the payment arrived 10 minutes late at the vendor's solicitor's office, the payment was refused, and the seller purported to rescind the contract and keep the deposit. The purchaser sought specific performance, but was unsuccessful and appealed to the Privy Council. Consider the following questions:

3

Should the Privy Council have forced the transfer of property (an order of specific performance) or rejected the claim on the ground that the appellant had failed to produce the money on time? Should the claimant be permitted to rely on an excuse that the messenger was late without fault because the lifts were broken in the building where the defendant's office was located? What policy considerations should influence the court?

Speaking on behalf of the Privy Council, Lord Hoffmann concluded that the claimant was seeking to rely on the 'beguiling heresy' that the courts enjoy an unlimited and unfettered discretion to intervene to give relief from forfeiture of rights where it is unconscionable for the respondent to insist on its contractual entitlements. Lord Hoffmann observed:

'It is worth pausing to notice why it continues to beguile and why it is a heresy. It has the obvious merit of allowing the court to impose what it considers to be a fair solution in the individual case. The principle that equity will restrain the enforcement of legal rights when it would be unconscionable to insist upon them has an attractive breadth. But the reasons why the courts have rejected such generalisations are

founded not merely upon authority (see Lord Radcliffe in *Campbell Discount Co. Ltd v. Bridge* [1962] AC 600, 626) but also upon practical considerations of business. These are, in summary, that in many forms of transaction it is of great importance that if something happens for which the contract has made express provision, the parties should know with certainty that the terms of the contract will be enforced. The existence of an undefined discretion to refuse to enforce the contract on the ground that this would be "unconscionable" is sufficient to create uncertainty. Even if it is most unlikely that a discretion to grant relief will be exercised, its mere existence enables litigation to be employed as a negotiating tactic. The realities of commercial life are that this may cause injustice which cannot be fully compensated by the ultimate decision in the case.'

In short, Lord Hoffmann argues that any power of the courts to intervene on grounds of fairness threatens to undermine commercial life and therefore such powers should be rejected or at least confined to narrow, certain exceptions.

If the appellant had merely asked for all (or some) of his deposit back, should he have got it? If the contract had stated that in the event of any dispute between the parties, the dispute should be determined by Professor Hugh Collins, in the light of business practice and fairness, but in his absolute discretion, and he had awarded specific performance to the appellant, (mostly because he had never received a Golden Achievement award from the defendant but also because he felt sorry for the appellant who had missed the deadline through no fault of his own), should a court enforce that order?

4

### (b) Externalities

The parties to a commercial contract are likely to be concerned about their own interests, but not those of third parties. The question arises when the law ought to control the content of contracts to prevent harm to third parties.

Consider *Mayhew v King* [2010] EWHC 1121 (Ch). This is an application of the 'anti-deprivation' principle which says, in summary, there cannot be a valid contract that a man's property shall remain his until his bankruptcy, and on the happening of that event shall go over to someone else, and be taken away from his creditors. This rule protects creditors in the event of insolvency by preventing the debtor from transferring assets out of the reach of creditors.

What other kinds of externalities (interests of 3<sup>rd</sup> parties), if any, should be grounds for invalidating commercial contracts?

E.g. Competition law/anti-trust law (to protect consumers and other competitors).

## 2. Formation of Contracts

For a binding contract to be formed in English common law, the parties must reach 'agreement' and the agreement must be supported by 'consideration'.

### (a) Agreement

Chen-Wishart, Chapter 2.

#### (1) Offer and Acceptance

As in most legal systems, the test of whether and when the parties have reached an agreement is usually determined through an analysis of offer and acceptance. In *Gibson*, the court insists on strict fidelity to the rules of offer and acceptance with the effect that even though the parties were in agreement on the principal terms (price and subject matter), there was no binding contract. *Gibson v Manchester City Council* [1978] 1 WLR. 520, [1978] 2 All ER 583, CA; reversed, [1979] 1 WLR.294, [1979] 1 All ER 972, HL; BBF: 195. In the Court of Appeal, Lord Denning said that 'one ought to look at the correspondence as a whole and at the conduct of the parties and see therefrom whether the parties have come to an agreement on everything that was material'. Lord Diplock, in the HL, insisted on a 'conventional' approach of seeking in the written documents an 'offer' and an 'acceptance' on the same terms. Which approach best corresponds to the reasonable expectations of businesses?

5

Although the common law does not permit acceptance by silence, it does permit acceptance by the conduct of performing the contract. *Brogden v. Metropolitan Railway Co* (1877) 2 App Cas 666, HL; BBF: 208

#### (2) Battle of Forms

Businesses usually prefer to enter contracts on their standard terms of business. The parties may believe or at least hope that they have reached an express agreement, but in fact the inconsistency of the standard forms of business combined with the insistence of both parties to have their own standard form govern the transaction raises a doubt whether agreement on (significant) details was ever reached.

A court in the UK can decide (a) that no contract was agreed; or (b) the terms of one party's standard form governed the contract; or (c) that a contract was agreed but not on either party's standard form terms.

*Butler Machine Tool Co Ltd v Ex-Cell-O Corp (England) Ltd* [1979] 1 All ER 965, CA (BBF 225)

Is there a last shot rule? If so, is it justified? Can the court apply such a rule without ignoring some of the evidence that the parties had not yet reached agreement? Are there any other possible options to resolve the issue?

UNIDROIT General Principles for International Commercial Contracts, Art.2.22

'Where both parties use standard terms and reach agreement except on those terms, a contract is concluded on the basis of the agreed terms and of any standard terms which are common in substance unless one party clearly indicates in advance, or later and without undue delay informs the other party, that it does not intend to be bound by such a contract'.

Would this rule resolve the problem in *Butler Machine Tool*?

The empirical evidence is that battle of forms problems are frequent, that businesses know that there is a problem of inconsistency, yet proceed with transactions nevertheless. Often they are concerned to reach agreement on the 'real deal', but not necessarily on the 'paperwork'. How might a business view an insistence by the other party on sorting out the paperwork before any contract can be concluded?

### **(3)     *Never Reaching an Agreement***

6

In some cases, it is clear that the parties never reached an agreement and never supposed that they had done so, yet despite the absence of an express contract, performance on the contract may have started, or even have been completed. What are the rights of the parties with respect to work performed and goods delivered in anticipation of a contract? In the absence of a contract, what is the legal basis for a claim?

*British Steel Corp v Cleveland Bridge and Engineering Co Ltd* [1984] 1 All ER 604 (BBF 39)

What kind of remedy does this leave the seller to recover payment for the work and goods? Breach of contract, tort, restitution? Which solution would the buyer prefer, and which the seller? Why are contracts performed before a contractual agreement has been completed?

### **(4)     *The Significance of the Formal Agreement***

In some cases, the parties are agreed on pretty much everything, but they have not completed the final step, such as an exchange of signed written contracts, as required under the terms of their agreement, yet performance of the contract has commenced and perhaps even been completed. Does the failure to complete the final step mean that there is no contract?

\**RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH and Co KG* [2010] UKSC 14, [2010] 1 WLR 753

### **(b) The Common Law Doctrine of Consideration**

Chen-Wishart, Chapter 3

#### **(1) Concept of consideration:**

The idea of an exchange. The exclusion of donative promises.

Two concepts of consideration?

- Mutual requests
- Benefit and Burden

Requests and Conditional Promises: *Shadwell v. Shadwell* (1860) 9 CBNS 159, 142 ER 62; BBF: 124

Unilateral Contracts: promise in return for requested action that is performed

7

Implied requests

Adequacy of consideration

Pre-existing Duty: Different types of duties:

general legal duties: eg promise not to hit someone

contractual duties owed to third parties: eg promise to perform a term of employment

modification of contracts: *Williams v Roffey Bros & Nicholls (Contractors) Ltd* [1991] 1

QB 1, [1990] 1 All ER 512, CA; BBF 111 Should consideration be a requirement for modifications?

Is the doctrine of consideration a covert mechanism for testing the fairness of transactions?

Does the test of consideration conform to a test of efficiency (wealth-maximisation)?

#### **(2) Intention to Create Legal Relations**

The need for a qualification to the doctrine of consideration due to over-inclusiveness.

The origins of the doctrine of intention to create legal relations

### (3) *Equitable Estoppel*

Is there a second substantive test of legal enforceability to deal with a problem of under-inclusiveness in the doctrine of consideration? The reliance model suggests that unrequested detrimental reliance upon a promise or undertaking should be protected by an equitable remedy where the reliance was reasonable and where it would be unconscionable to default on the promise or undertaking.

Proprietary estoppel: *Crabb v. Arun District Council* [1975] 3 All ER 865, CA; BBF: 155

Is this contract? A promise is enforced, but the remedy is equitable (order to grant right of way), and no compensatory damages awarded (yet).

#### Questions for Class Discussion:

1. What does 'freedom of contract' mean? How does it operate in practice?
2. Assess the justice of the decision in *Union Eagle Ltd v Golden Achievement Ltd*.
3. What are the reasons often given for distinguishing between the law governing commercial contracts (between 2 businesses) and the law governing other sorts of contracts such as consumer contracts? Are there good reasons for favouring freedom of contract in commercial contracts?
4. What factors should a judge take into account in deciding whether parties who have commenced work prior to the completion of a formal contract should be given contractual or restitutionary remedies?
5. Does English law need a doctrine of consideration as a test for the enforceability of contracts, or could it be safely abolished? What purposes does it serve?

8

## Topic 2 Pre-contractual duties and the duty of good faith

### 1. Introduction

Traditionally, the general principle of English law is that parties owe each other no duties during the process of negotiation but with some exceptions (e.g. misrepresentation, fraud).

The rationale of this general principle is that (a) parties are free during negotiations to find the best deal the market has to offer, and (b) imposing obligations on parties before they voluntarily assume them is an interference with liberty and freedom of contract.

However this general principle is viewed today with some scepticism for reasons which will be discussed. Accordingly, it has been suggested in recent years that English law (a) should have or (b) does have a different underlying principle. The most common formulation of that principle is the duty to bargain in good faith, a duty recognised in some other legal systems in Europe (e.g. Germany's principle of 'culpa in contrahendo'). There are other possible formulations e.g. the duty to bargain with care.

9

***Would the recognition of a different underlying principle make any difference in practice?***

***Would the adoption of such a general principle be too vague to be workable?***

This topic requires that you know (a) the scope of the 'exceptions' to the traditional principle of no obligations (b) have a view on whether the 'exceptions' already comprise a different principle (c) if so, what that principle is, and (d) what difference in practical results the (open) adoption of a different principle would make in English law.

**Reading (focus on starred items):**

\**Walford v. Miles* [1992] 2 A.C. 128; B.B.F. 271

\**Esso Petroleum Co Ltd v. Mardon* [1976] 2 All ER 5; B.B.F. 328

*East v. Maurer* [1991] 2 All ER 733, CA; B.B.F. 372

Misrepresentation Act 1967, s2(1); B.B.F. 372, 377

\**Petromec Inc v Petroleo Brasiliero SA Petrobras* [2005] EWCA Civ 891, paras 120-

1

- \*Rt. Hon Lord Steyn, 'Contract law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 *LQR* 433
- \*H. Hopkins 'Contractual Obligations to Negotiate in Good Faith: Faithfulness to the Agreed Common Purpose' (2014) 130 *LQR* 131
- \*L. Trakman and K. Sharma, 'The Binding Force of Agreements to Negotiate in Good Faith' (2014) 73 *CLJ* 598
- M. Bridge, 'Doubting Good Faith' (2005) 11 *New Zealand Business Law Quarterly* 426

R. Brownsword, *Contract Law: Themes for the Twenty-First Century*, Chapter 5; BBF extracts pp 283-287

Goode, pp 95-6

## 2. The general principle

The general principle in English law is that there is no obligation during the process of negotiation owed by parties to each other. Traditionally the English courts are reluctant to recognise a duty to negotiate in good faith. *Walford v. Miles*.

Considering the decision in more detail:

10

- (a) Did the purchaser receive damages despite the finding that the lock-out agreement was unenforceable? What effects would upholding the lock-out agreement have had in practice? Why was the lock-out agreement held to be binding in *JSD Corp PTE v Al Waha Capital PJSC* [2009] EWHC 3376 (Ch)?
- (b) Compare the status of agreements to use 'best endeavours' (i) in the *performance* of a contract, and (ii) in the *negotiation* of a contract? *Little v Courage Ltd* (1995) 70 P. & C.R. 469; *Multiplex Constructions UK Ltd v Cleveland Bridge Ltd* [2006] EWHC 1341 (TCC) (part of extensive litigation over the Wembley Stadium).
- (c) What if there is an express agreement to negotiate in good faith? *Petromec Inc v Petroleo Brasileiro SA Petrobras* [2005] EWCA Civ 891.

## 3. What might the 'exceptions' to the general principle about parties' negotiations be?

- (a) Misrepresentation and misleading statements
  - (i) Equitable remedy of rescission.

## (ii) Damages:

- fraud/deceit in tort. \**East v. Maurer* [1991] 2 All ER 733, CA; BBF 372

- negligent misstatement in tort under Hedley Byrne. \**Esso Petroleum Co Ltd v. Mardon* [1976] 2 All ER 5; BBF 328, *Box v. Midland Bank plc* [1979] 2 Lloyd's Law Reports 391, *South Australian Asset Management Corp. v. York Montague Ltd* [1997] AC 191, [1996] 3 All ER 365, BBF 384. (Note the SAAMCO case and others e.g. *Nykredit Mortgage Bank plc v. Edward Erdman Group Ltd* [1997] 1 WLR 1627 arose from the property boom and crash of the early 1990s and there may be similar issues in the cases which emerge from the credit crunch and its fallout.)

- Misrepresentation Act 1967, s2(1); BBF 372, 377. There are advantages for claimants in proceeding under the Act.

- Breach of collateral contract (collateral warranty). *Esso Petroleum Co Ltd v. Mardon*.

- (not available for innocent misrep).

11

## (b) Failure to disclose information

(i) Terms: *Interfoto v. Stiletto* [1998] 1 All ER 348 and see week 1's lecture.

(ii) Facts: Contracts of utmost good faith/ uberrimae fidei e.g. insurance. In practice this means that insurance contracts may be vulnerable to challenge by insurers. *Carter v Boehm* (1766) 3 Burr. 1905

## (c) Abuse of positions of trust

Duty of good faith owed to principal by agent/fiduciary. Goode p 177 onwards. An example of a fiduciary relationship is business partners' relationships to one another (e.g. in law firms). It has recently been argued, unsuccessfully, that a commercial banking relationship between an investment adviser and an allegedly "unsophisticated investor" client gave rise to fiduciary duties: *JPMorgan Chase v. Springwell* [2008] EWHC 1186 (Comm). (Fiduciary relations discussed at para. 572 onwards). (Appeal since dismissed by Court of Appeal).

## (d) Misuse of confidential information

(i) Implied contract to use information only for authorised purposes.

(ii) Tort of disclosure or misuse of 'confidential' information.

(e) Misleading implied promises

(i) Collateral Contracts.

*Walford v. Miles; Blackpool and Fylde Aero Club Ltd v. Blackpool Borough Council* [1990] 1 WLR 1195, [1990] 3 All ER 25, CA; BBF 244

(ii) Estoppel and restitution

*Walton Stores (Interstate) Ltd v. Maher* (1988) 164 CLR 387, High Ct. of Australia; BBF 158

*Crabb v. Arun DC*[1975] 3 All ER 865, CA; BBF 155

*Hoffman v. Red Owl Stores Inc* 26 Wis 2d 683, 133 NW 2d 267 (1965); BBF 281

*Drennan v Star Paving Co* 51 Cal 2d 409, 333 P 2d 757 (1958); BBF 249

*British Steel Corp v. Cleveland Bridge & Engineering Co Ltd* [1984] 1 All ER 504; BBF 39

*Regalian Properties plc v. London Docklands Development Corp* [1995] 1 WLR 212; BBF 281

***Do these 'exceptions' constitute a different principle?***

***If so, what is that principle?***

12

#### **4. Traditionally the English courts are reluctant to recognise a duty to negotiate in good faith. Why?**

- (a) The courts are wary of over-broad principles not susceptible to clear and concise application. Moreover, there is no consensus on what its content would be or how to strike a balance between the interests of parties in commercial negotiations.
- (b) The parties are free during negotiations to find the best deal the market has to offer- i.e. this is part of the operation of the free market: "the legitimate pursuit of self-interest" (Goode, p106)
- (c) Imposing obligations on parties before they voluntarily assume them is an interference with liberty and freedom of contract.
- (d) Would the remedies in respect of this duty be impossible to assess? What, if any, analogies may be drawn with other types of claims which are

allowed e.g. for loss of a chance? Would this additional means of redress add anything to the existing remedies available?

## 5. Contrast the position in English law with other legal systems.

A number of other legal systems have a requirement of good faith in negotiations, including:

(a) Principles of European Contract Law

Article 2.301- Negotiations Contrary to Good Faith

- (1) A party is free to negotiate and is not liable for failure to reach an agreement.
- (2) However, a party who has negotiated or broken off contrary to good faith is liable for the losses caused to the other party.
- (3) It is contrary to good faith, in particular, for a party to enter into or continue negotiations with no real intention of reaching an agreement with the other party.

(b) UNIDROIT (2010)

Article 2.1.15: Negotiations in bad faith

- (1) A party is free to negotiate and is not liable for failure to reach an agreement.
- (2) However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party.
- (3) It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party.

(c) Civil law jurisdictions, e.g. Germany and other common law jurisdictions e.g. US.

13

*Are the situations covered by this requirement of good faith in these legal systems resolved in a different way in this jurisdiction?*

## 6. What difference in practical results would the (open) adoption of a different principle make in English law?

Would the recognition of a different underlying principle make any difference in practice?

Would the adoption of such a general principle be too vague to be enforced?

How would it affect adversarial types of commercial relationship?

What other principles have been suggested in respect of this jurisdiction?

## 7. Conclusion

### Questions for discussion in class:

Please prepare answers to the following questions, which your class tutors may use as the basis for discussion in the class.

1. Does the law impose duties on the parties at the pre-contractual stage?
2. What justifications can be advanced for the approach taken by English law? Are they convincing?
3. Do you think that English law manages to achieve a fair balance between the interests of the parties?
4. X plc is a large UK-based manufacturing company. In each of the following scenarios, advise X as to its obligations (if any) to its prospective counterparty.

14

- (a) X is in negotiations with B, an insurance company. X's management is concerned because its in-house weather forecasting unit has predicted a wet summer, which is likely to hit sales of one of its core products, plastic garden sunloungers. X is seeking insurance to cover this eventuality.
- (b) X is in negotiations with C, a large investment bank. X intends to protect its position as regards the possible wet summer by entering a contract with C, where in return for a premium, C will pay X if certain weather events occur.

3. *The concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making representations.*

Lord Ackner in *Walford v Miles* [1992] 2 A.C. 128, 138.

Why have the courts found that imposing a duty of good faith in this context would be "repugnant"? Do you think that the general principle in *Walford v Miles* is due for reconsideration?

## Topic 3 Express Terms, Implied Terms, and Interpretation

When asked to advise on a dispute regarding a commercial contract, the first, and quite possibly the last, thing an English lawyer will do is ask to read the express terms of the written agreement and then apply them to the dispute at hand. This practice rests on the assumptions that (a) the court will almost invariably enforce the express terms of the contract because of their fidelity to the principle of freedom of contract, (b) that such terms are readily discoverable, (c) that a court will not add additional obligations (implied terms), and (d) that the meaning of the express terms is readily apparent. The following materials investigate the plausibility of the assumptions in (b), (c), and (d).

Chen Wishart, Chapter 10

### 1. Discovering the Express Terms

#### (a) Objective Test of Express Terms

'If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms. (Blackburn J. *Smith v Hughes* (1871) LR 6 QB 597, BBF 303).'

15

Rectification of inaccuracy in written agreement: *Rose v. Pim* [1953] 2 All ER 739, [1953] 2 All ER 739, CA BBF: 307

#### (b) Standard Form Contracts and Incorporation

Signature binding: *L'Estrange v F Graucob Ltd.* [1934] 2 KB 394 (BBF 345)

Requirement to take reasonable steps to give notice of terms, and the more unusual and onerous the terms, the more steps that are required:

*Interfoto Picture Library Ltd. v Stiletto Visual Programmes Ltd* [1988] 1 All ER 348, CA (BBF 336). Dillon LJ 'if one condition in a set of printed conditions is particularly onerous or unusual, the party seeking to enforce it must show that that particular condition was fairly brought to the attention of the other party.' Bingham LJ 'the plaintiffs did not do what was necessary to draw this unreasonable and extortionate clause fairly to their attention.'

*AEG (UK) Ltd v LogicResource Ltd* [1996] CLC 265, CA (BBF 339). Contract for sale of cathode ray tubes on seller's standard terms, but detailed terms not given to buyer but

only available on request. Clause 7.1 gave a warranty against defects caused by faulty materials and bad workmanship, but in 7.7 otherwise excluded implied terms under SGA, and in 7.5. required the purchaser to return goods at its own expense. CA found clause 7 contrary to UCTA. Majority also found clause 7 not included as unusual or onerous; but Hobhouse LJ dissented, saying this term was of the kind one expects to find in commercial contracts. Would it make a difference if the contract had been signed by the buyer?

(b) Forgetting the Form

What happens if the seller forgets to use the written form (containing the normal disclaimers)? Does that mean that the form is not incorporated into the contract? Not always:

- (i) course of dealing: *Henry Kendall & Sons v William Lillico & Sons Ltd* (The Hardwicke Game Farm Case) [1969] 2 AC 31 (BBF 339);
- (ii) standard terms of trade: *British Crane Hire Corporation Ltd v Ipswich Plant Hire Ltd* [1974] 1 All ER 1059, CA (BBF 340).

Would such arguments be accepted in contracts where the buyer is a consumer?

## 2. Implied Terms

16

(a) Sources of Implied Terms in the judge-made Common Law

There are several sources:

- (i) **unexpressed intention** (officious bystander/business efficacy tests of intention);

*Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10  
*Marks and Spencer plc v BNP Paribas Securities* [2015] UKSC 72

- (ii) **importation of general legal obligations** (eg duty to be careful in contracts for services (ie the duty of care/negligence liability of *Donoghue v Stevenson*));
- (iii) **model or standard types of contracts, with standard incidents.**

*Liverpool City Council v Irwin* [1977] AC 329, HL (BBF 415) (implied term that landlord owed a duty to take reasonable care to keep in reasonable repair and useability the common parts of the premises)  
*Mahmud and Malik v BCCI* [1998] AC 20 (BBF 455)

(b) Sources of Implied Terms in Statute: e.g. Sale of Goods Act 1979, s 14

**(c) General principle that implied terms cannot override express terms:**

*Johnstone v Bloomsbury Health Authority* [1991] 2 All ER 293, CA (BBF 443)

*Paragon Finance plc v Nash* [2001] EWCA Civ; [2002] 1 WLR 685, CA

But by statute this may occur (ie compulsory terms) eg term of satisfactory quality in sales of goods to consumers cannot be excluded.

**(d) Justification**

What is the justification for implied terms (ie law's insertion of additional obligations)?  
Save on transaction costs? Fairness? Risk allocation? Efficiency?

**3. Interpretation**

Chen-Wishart, Chapter 10

It is said that 99% of litigated cases concerning commercial contracts turn on questions of interpretation, construction, or meaning of contracts. Why do written contracts cause such a problem? Is the problem that the parties do not always say what they mean or do not always mean what they say? Or is the problem that lawyers write the contracts and don't know what the parties mean? Or is the problem really one derived from the indeterminacy of language in general? Or is the problem caused by the courts because they lack a consistent approach to interpretation of the express terms of contracts? Or is the problem that the courts try to secure a fair result regardless of what the contract says?  
Collins, 228-231

17

*Thake v Maurice* [1986] QB 644, [1986] 1 All ER 497, CA (BBF 330)

\**Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98 (Lord Hoffmann) (BBF 399)

*Schuler AG v Wickman Machine Tools* [1974] AC 235, HL (BBF 409, 599)

\**Bank of Credit and Commerce International v Ali* [2001] UKHL 8, [2002] 1 AC 251, HL (BBF 848)

*Arnold v Britton* [2015] AC 1619

*Wood v Capita Insurance Services Ltd.* [2017] UKSC 24

There seem to be three possible basic approaches to the interpretation of written contracts:

- (1) A search for the actual intentions of the parties to the contract;
- (2) An application of the literal meaning of the words contained in the document;
- (3) An enquiry into what a reasonable person or reasonable promisee would have understood to have been the meaning of the words.

The choice between these different approaches is usually guided by appeals to a variety of policy considerations, including:

- certainty;
- fairness;
- theories of the basis of contracts eg 'will theory', 'reliance theory';
- promoting the utility of using written documents for business planning;
- costs of litigation.

The approach in (1) ('subjective intention') seems to be condemned on various grounds:

- actual intention is often hard for a court to establish;
- the approach may merely reveal that the parties had different intentions;
- the approach does not pay sufficient attention to the actual documents, because it seems to open up the possibility of arguments that whatever the parties may have agreed in writing their actual intentions were completely different so the court can (and should) ignore the written contract.

18

The approach in (2) ('literalism' or 'formalism') is also condemned on various grounds:

- the meaning of words is not fixed, but must be understood in the context in which it is used;
- literal meanings may lead to absurd results or at least commercially improbable results in some circumstances;
- it ignores the actual intentions of the parties'

The approach in (3) ('objective promisee') is also condemned on various grounds:

- the courts may end up enforcing a contract that neither party actually wanted or intended
- it may sometimes allow the courts to ignore the literal meaning of the words completely

See Sir Christopher Stoughton, 'How Do the Courts Interpret Commercial Contracts?' (1999) *Cambridge Law Journal* 303-313?

'Canons of interpretation' are rules, guides that the courts use when interpreting

contracts:

1. The document must be construed as a whole: do not look at clauses in isolation, but interpret them in light of the whole document.
2. In construing a contract, all parts of it should be given effect where possible, and no part should be treated as inoperative.
3. Where a contract contains special provisions as well as general ones, specific provisions will be given greater weight.
4. Where a contract is a standard form contract to which the parties have added special conditions, then (unless the contract provides otherwise), greater weight will be given to the special provisions.
5. The reasonableness of the result of any particular construction is a relevant consideration when choosing between rival constructions.
6. Where there is a doubt about the meaning of a contract, the words will be construed contra proferentem.

See Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98, HL (BBF 399):

19

- (1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.
- (2) The background or 'matrix of fact' includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.
- (3) However, previous negotiations of the parties and their declarations of subjective intent are excluded for practical policy.
- (4) The meaning which a document would convey to a reasonable man is not the same thing as the literal meaning of its words as ascertained in dictionaries.
- (5) A judge may occasionally conclude that the parties have made a linguistic mistake if the ordinary meaning of the words leads to a conclusion that flouts business

common sense or suggests an intention of the parties that they plainly could not have had.

Lord Hoffmann's restatement has been much cited and on some level is regarded as authoritative. One important aspect of his approach is that he discards any precedents on the interpretation of particular terms in contracts and any general principles for interpretation other than those cited above. Lord Hoffmann asks: 'If interpretation is the quest to discover what a reasonable man would have understood specific parties to have meant by the use of specific language in a specific situation at a specific time and place, how can that be affected by authority?' It is not clear that other judges accept this implication of his position: eg *BCCI v Ali*.

Everyone seems to agree that 'certainty' is very important? Why? What does certainty mean in this context? Is it the most important consideration? If not, what is? And which approach achieves the greatest certainty?

It also seems to be agreed that the prior negotiations between the parties should not be relevant to the question of the meaning of the contract: *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38. Does that make sense? Do Stoughton LJ and Lord Hoffman give a good explanation of this exclusion? Everyone agrees that 'rectification' is a limited exception to this rule. Also Lord Hoffmann would admit evidence of the background facts including the use of 'private language' and the commercial purpose of the transaction, which may indirectly involve reference to the negotiations, if not the precise negotiating positions.

20

It also seems to be agreed that subsequent conduct by the parties in the performance of the contract should be irrelevant to the question of the meaning of the contract (see *Schuler v Wickman Tools*). Does that make sense? Goode comments: 'Very often the record of negotiations culminating in the contract is the best guide to the intention of the parties, as is their behaviour subsequently'. He suggests that these legal restrictions are 'widely ignored in practice' (though no evidence is cited).

#### Questions for Class Discussion:

1. What is the difference between express and implied terms?
2. On what basis are terms implied into contracts? Are all implied terms implied for the same reasons?
3. 'While academic commentators have welcomed Lord Hoffmann's liberal approach to interpreting contracts, practitioners are dismayed by it'.

Discuss.

4. Should judges be able to take into account the parties' pre-contractual negotiations when interpreting contracts?

## Topic 4 Commercial Contracts and Commercial Circumstances: Mistakes, Frustration and Contractual Variation.

While often business contracts produce mutual beneficial exchanges, sometimes commercial circumstances produce winners and losers. This lecture deals with how contract law responds to disparities between the commercial circumstances of the contract, and the contracting parties' expectations and intentions. Relevant facts may differ from contracting parties' assumptions on entering a contract. Facts may change during the course of the contract, requiring renegotiation or even leading one party to seek to walk away from the contract. This lecture considers how English contract law regulates such scenarios.

### A. The Doctrine of Mistake

\*Chen-Wishart, chapter 6.

#### (a) Mistakes in recording the transaction and Rectification

22

*Chartbrook v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101

#### (b) Mistakes as to the subject matter of the contract

##### (i) Cross-purpose mistakes

*Raffles v Wichelhaus* (1860) 2 H & C 906

##### (ii) Unilateral Mistake as to Subject matter

*Smith v Hughes* (1871) LR 6 QB597

##### (iii) Common Mistakes as to Subject Matter

#### **Contractual Risk Allocation and Mistake**

*McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377

***Res exticta***

*Couturier v. Hastie* (1856) 5 HLC 673.

Sale of Goods Act of 1979 s 6

***Res sua***

*Cooper v. Phibbs* (1867) LR 2 HL 149.

***Mistake of 'quality'***

*Bell v. Lever Brothers* [1932] AC 161.

- Types of actionable mistakes:
- Lord Atkin: *If mistake operates at all it operates so as to negative or in some cases to nullify consent. The parties may be mistaken in the identity of the contracting parties, or in the existence of the subject-matter of the contract at the date of the contract, or in the quality of the subject-matter of the contract. These mistakes may be by one party, or by both, and the legal effect may depend upon the class of mistake above mentioned.*
- Conditions for Actionable Mistake as to Quality:
- Lord Warrington: *The real question, therefore, is whether the erroneous assumption on the part of both parties to the agreements that the service contracts were undeterminable except by agreement was of such a fundamental character as to constitute an underlying assumption without which the parties would not have made the contract they in fact made, or whether it was only a common error as to a material element, but one not going to the root of the matter and not affecting the substance of the consideration.*
- Lord Atkin: *Mistake as to quality of the thing contracted for raises more difficult questions. In such a case a mistake will not affect assent unless it is the mistake of both parties, and is as to the existence of some quality which makes the thing without the quality essentially different from the thing as it was believed to be.*

23

*Leaf v. International Galleries* [1950] 1 All ER 693.

## ***Mistake in Equity***

*Solle v Butcher* [1950] 1 KB 671.

*Associated Japanese Bank (International) Ltd v Credit du Nord* [1988] 3 All ER 902.

### ***Common Mistake Rethought***

*Great Peace Shipping v Tsavliris* [2002] EWCA Civ 1407

## **B. The Doctrine of Frustration**

### **Chen-Wishart, chapter 7.**

#### **(i) The doctrine**

*Paradine v Jane* (1647) Aleyn 26

*Taylor v Caldwell* (1863) 3 B & S 826

*Davis Contractors Ltd v Fareham Urban District Council* [1956] A.C. 696

Lord Radcliffe: ... frustration occurs whenever the law recognizes that *without default of either party* a contractual obligation has become *incapable of being performed* because the *circumstances* in which performance is called for would render it *a thing radically different from that which was undertaken by the contract*. *Non haec in foedera veni. It was not this that I promised to do.*

24

#### **(ii) Frustrating events**

- Thing ceases to exist: *Taylor v Caldwell* (1863) 3 B & S 826
- Personal service: *Robinson v Davison* (1871) LR 6 Ex 269
- Non occurrence of event: *Krell v Henry* [1903] 2 KB 740
- Supervening illegality: *Denny, Mott v James Fraser* [1944] AC 265
- Intervening event: *Fibrosa Spolka v Fairbairn* [1943] AC 32, *B.P. Exploration (Libya) Ltd v Hunt* [1983] 2 A.C. 352
- Failed adventure: *Jackson v Union Marine Insurance* (1874) LR 10 CP 125, *The Nema* [1982] A.C. 724

(iii) Non-Frustrating events

- Failure of supply: *Blackburn Bobbin Co Ltd v T.W. Allen Ltd* [1918] 2 K.B. 467
- Increased cost: *The Eugenia* [1964] 2 Q.B. 226
- Foreseeable events: *The Eugenia* [1964] 2 Q.B. 226
- Fault: *Maritime National Fish Ltd v Ocean Trawlers Ltd* [1935] A.C. 524, *The Super Servant Two* [1990] 1 Lloyd's Rep 1

(iv) Remedies

Law Reform (Frustrated Contracts) Act 1943

*BP (Exploration) Libya v Hunt* [1982] 2 W.L.R. 253 (HL)

*Gamerco S.A. v I.C.M./Fair Warning (Agency) Ltd* [1995] 1 WLR 1226;

Law Reform (Frustrated Contracts) Act 1943 :

§1(2) All sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged (in this Act referred to as “*the time of discharge*”) shall, in the case of sums so paid, be recoverable from him as money received by him for the use of the party by whom the sums were paid, and, in the case of sums so payable, cease to be so payable:

25

Provided that, if the party to whom the sums were so paid or payable incurred expenses before the time of discharge in, or for the purpose of, the performance of the contract, the court may, if it considers it just to do so having regard to all the circumstances of the case, allow him to retain or, as the case may be, recover the whole or any part of the sums so paid or payable, not being an amount in excess of the expenses so incurred.

- §1(3) Where any party to the contract has, by reason of anything done by any other party thereto in, or for the purpose of, the performance of the contract, obtained a valuable benefit (other than a payment of money to which the last foregoing subsection applies) before the time of discharge, there shall be recoverable from him by the said other party such sum (if any), not exceeding the value of the said benefit to the party obtaining it, as the court considers just, having regard to all the circumstances of the case and, in particular,—
  - (a) the amount of any expenses incurred before the time of discharge by the benefited party in, or for the purpose of, the performance of the contract,

including any sums paid or payable by him to any other party in pursuance of the contract and retained or recoverable by that party under the last foregoing subsection, and

(b) the effect, in relation to the said benefit, of the circumstances giving rise to the frustration of the contract.

### C. Contractual Variation

Beale, Bishop and Furmston, pp. 97-174.

Chen-Wishart, chapter 3

#### (i) The problem of consideration for the variation

*Foakes v. Beer (1884)* 9 App Cas 605

*Williams v. Roffey Bros [1990]* 1 All ER 512, [1991] 1 QB 1

- Glidewell LJ:

- “(i) if A has entered into a contract with B to do work for, or to supply goods or services to B, in return for payment by B; and
- (ii) at some stage before A has completely performed his obligations under the contract B has reason to doubt whether A will, or be able to, complete his side of the bargain; and
- (iii) B thereupon promises A an additional payment in return for A’s promise to perform his contractual duties on time; and
- (iv) as a result of giving his promise, B obtains in practice a benefit, or obviates a disbenefit; and
- (v) B’s promise is not given as a result of economic duress or fraud on the part of A; then
- (vi) the benefit to B is capable of being consideration for B’s promise, so that the promise will be legally binding”

26

*Re Selectmove Ltd [1995]* 1 WLR 474, [1995] 2 All ER 531,

*Attrill & Others v. Dresdner Kleinwort Limited [2012]* EWHC 1189 QB

*MWB Business Exchange Centres Ltd v Rock Advertising Ltd [2016]* EWCA Civ 553

#### (ii) Variation and Economic Duress

*Pao On v Lao Yiu Long* [1979] 3 All ER 65

Lord Scarman: *Duress, whatever form it takes, is a coercion of the will so as to vitiate consent... in a contractual situation commercial pressure is not enough. There must be present some factor 'which could in law be regarded as a coercion of his will so as to vitiate his consent... In determining whether there was a coercion of will such that there was no true consent, it is material to inquire whether the person alleged to have been coerced did or did not protest; whether, at the time he was allegedly coerced into making the contract, he did or did not have an alternative course open to him such as an adequate legal remedy; whether he was independently advised; and whether after entering the contract he took steps to avoid it. All these matters are... relevant in determining whether he acted voluntarily or not.*

*Universe Tankships of Monrovia v International Transport Workers' Federation: 'The Universe Sentinel'* [1983] 1 AC 366

Lord Scarman: The authorities... reveal two elements in the wrong of duress:

- pressure amounting to compulsion of the will of the victim; and
  - the illegitimacy of the pressure exerted.
- *There must be pressure, the practical effect of which is compulsion or the absence of choice. Compulsion is variously described in the authorities as coercion or the vitiation of consent. The classic case of duress is, however, not the lack of will to submit but the victim's intentional submission arising from the realisation that there is no other practical choice open to him. This is the thread of principle which links the early law of duress (threat to life or limb) with later developments when the law came also to recognise as duress first the threat to property and now the threat to a man's business or trade.*

27

### (iii) Effect of Economic Duress

*North Ocean Shipping v. Hyundai : The Atlantic Baron* [1979] QB 705.

*Adam Opel GmbH v. Mitras Automotive (UK) Ltd* [2007] EWHC 3481 (QB).

### (iv) Estoppe

*Central London Property Trust v High Trees House* [1947] KB 130. *D & C Builders v. Rees* [1966] 2 QB 617. 2

*Collier v P & M J Wright (Holdings) Ltd* [2007] EWCA Civ 1329, [2008] 1 W.L.R. 643

**Questions for Class Discussion:**

1. What factors lead to uncertainty in the performance of commercial contracts? How can parties minimise the dangers of uncertainty?

2. 'The decision in The Great Peace has finally put the law of common mistake on a rational basis.'

Discuss.

3. Gemma's Gems is a company which makes high quality designer jewellery for the rich and famous. The company specialises in diamond necklaces. They contact the offices of Ciara's Carats, who are diamond merchants in London, to buy diamonds. Gemma orders £1m worth of 'Matamela' diamonds. These are unique diamonds, for they come only from one diamond mine in southern Africa. Gemma intends to make a unique 'Matamela' necklace, for which a buyer has offered her £10m. Unknown to both parties, there are no more diamonds to be found in the Matamela mine: the last of these diamonds was extracted from the mine in 2010. Gemma also agrees to buy the entire shipment of diamonds aboard the Windhoek, bound for Southampton. In fact, there are two ships called the Windhoek carrying diamonds, both of which are sailing for Southampton.

28

Advise Gemma. Does *Foakes v Beer* have any continuing practical relevance?

4. Does *Foakes v Beer* have any continuing practical relevance?

5. On 1 January, Myrtle Shipping agrees with Adam's Apples to ship for it 10,000 tons of apples on their ship the Myrtle I from Southampton to Mumbai at £2 per ton freight. On 10 January, while the ship is waiting to load, a revolution takes place in Egypt and the Suez canal is blocked. The voyage will have to be round the Cape of Good Hope and will take three times as long. During this time, the apples may

deteriorate and be suitable only as cattle feed. On 12 January, Myrtle repudiates the agreement, and hires the ship out to another client. On 14 January, the canal reopens.

Advise Adam's Apples.

6. The Green Broad Beanz are a popular rock group, made up of 12 musicians. They are on a long tour of Europe to promote their latest record. They contract with Osborne Macaroon, a famous promoter, to promote their London concert. Osborne guarantees that he will pay the group £10 million, or 85% of the profits of the tickets, whichever is greater. He pays them an advance of £2 million. When performing in Paris, the drummer commits acts of indecency on stage. Potential concert goers are offended by such acts, and ticket sales are extremely poor. The lead singer is also infuriated by this. On the night before the concert, he loses his temper and screams so loudly at the drummer that he loses his voice. The concert is cancelled. Osborne has to refund all the tickets he has sold. The Green Broad Beanz claim they have incurred great expenses in preparing for the concert. They do however have insurance to cover the loss arising from the cancellation of any concerts.

29

Advise Osborne.

## Topic 5 Remedies for Breach of Contract

Chen-Wishart, Chapters 12, 13, 14.

### I. The Aims of Remedies for Breach of Contract

#### Pacta sunt servanda?

- encourage keeping promises / deter breach
- ensure that breach does not amount to 'loss'
- encourage settlement of disputes

### II. Actions for Debt

#### (1) Claim for money owed - action for the agreed price:

Sales of Goods Act 1979 s 49(1) – Where, under a contract of sale, the property in the goods has passed to the buyer and he wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action against him for the price of the goods.

30

#### (2) Simplified procedure, leading to a court order for the debtor's assets to be seized and sold up to the value of the debt.

#### (3) Debt must be 'due' – not if:

- already been paid
- the time for payment not reached
- performance not substantially fulfilled (eg SGA s 14(2))

### III. Termination for Breach of Contract

(1) Not a 'judicial' remedy... but eventually subject to judicial control ('was repudiation wrongful?')

(2) Rule: Termination is available if

'the occurrence of the event deprive[s] the party who has further undertakings still to perform of substantially the whole benefit which it was the intention of the parties as

expressed in the contract that he should obtain as the consideration for performing those undertakings'.

*Hong Kong Fir Shipping Co Ltd v Kawasaki* [1962] 2 QB 26 per Diplock LJ

Situations:

- Repudiation: the other party treats the party as not existent or announces its total default ('anticipatory breach')
- Express termination clauses: the parties defined what kind of breach allows termination
- Breach of condition ( $\leftrightarrow$  warranty): the contract (implicitly) characterizes an obligation as such that its breach would deprive the injured party of what is substantially deprived of what is entitled to.  
→ problems of interpretation  
(e.g. *Schuler v Wickman* [1973] 2 All ER 39, HL)

(3) Exception: loss of right to terminate

- 'Affirmation of contract'
- 'Waiver of breach'

#### IV. Compensatory Damages

31

(1) If there is no agreed remedy and the claim is not a simple one for a money debt, the primary remedy offered by the courts is compensatory damages for 'loss'.

(2) The notion of 'loss' can be described in various ways:

- (a) Reliance interest: putting the injured party back in the position as if there never had been a contract;
- (b) Expectation interest: the position the injured party would have been in, if the contract had been properly performed, in so far as money can achieve that, including loss of profits

(3) Two crucial qualifications:

- (a) Personal satisfaction/non-pecuniary losses/performance interest:
  - *Jarvis v. Swans Tours* [1973] 1 All ER 71, CA
  - *Farley v Skinner* [2001] UKHL 49 HL

'If the cause is no more than disappointment that the contractual obligation has been broken, damages are not recoverable even if the disappointment has led to a complete mental breakdown. But, if the cause of the inconvenience or discomfort is a sensory

(sight, touch, hearing, smell, etc) experience, damages can, subject to the remoteness rules, be recovered.'

- (b) Remoteness of loss: Loss of profits incurred as a consequence of breach of contract sometimes not recoverable under the doctrine of 'remoteness of loss'

'The damages recoverable for a breach of contract are such as may fairly and reasonably be considered as arising naturally, ie, according to the usual course of things, from the breach of the contract itself, or such as may be reasonably supposed to have been in the contemplation of both parties at the time they made the contract as the probable result of the breach of it.'

*Hadley v Baxendale* (1854) 9 Exch 341

SGA ss.50/51: The measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the buyer's/seller's breach of contract.

But:

'Such a risk would be completely unquantifiable, because although the parties would regard it as likely that the owners would at some time during the currency of the charter enter into a forward fixture, they would have no idea when that would be done or what its length or other terms would be.'

32

*Transfield Shipping v Mercator Shipping (The Achilleas)* [2008] UKHL 48 per Lord Hoffmann

Contrast:

'The orthodox approach remains the general [*Hadley v Baxendale*] test of remoteness applicable in the great majority of cases. However, there may be "unusual" cases, such as itself, in which the context, surrounding circumstances or general understanding in the relevant market make it necessary specifically to consider whether there has been an assumption of responsibility. This is most likely to be in those relatively rare cases where the application of the general test leads or may lead to an unquantifiable, unpredictable, uncontrollable or disproportionate liability or where there is clear evidence that such a liability would be contrary to market understanding and expectations.'

*Sylvia Shipping v Progress Bulk Carriers* [2010] EWHC 542 (Comm) per Hablen J.

## VI. Specific Performance and Injunctions

(1) Specific performance is an order to perform the contract, and an injunction is an order to refrain from breaching the contract. Failure to obey the order is a contempt of court, resulting in fines and possibly imprisonment.

## RSC Order 45

## Rule 5(1) – Enforcement of judgment to do or abstain from doing any act

Where –

- (a) a person required by a judgment or order to do an act within a time specified in the judgment or order refuses or neglects to do it ...; or
- (b) a person disobeys a judgment or order requiring him to abstain from doing an act, then, subject to the provisions of these rules, the judgment or order may be enforced by one or more of the following means, that is to say –

- (i) with the permission of the court, a writ of sequestration against the property of that person;
- (ii) where that person is a body corporate, with the permission of the court, a writ of sequestration against the property of any director or other officer of the body;
- (iii) subject to the provisions of the Debtors Act 1869 and 1882, an order of committal against that person or, where that person is a body corporate, against any such officer.

## (2) Equitable orders are awarded only exceptionally where:

- (a) common law remedies (ie damages) would be ‘inadequate’ to meet the ‘justice’ of the case;
- (b) they are ‘practicable’ and not force personal service; and
- (c) it would not be unfair or oppressive to enforce the contract at the date of judgment (*Patel v. Ali* [1984] Ch 283)

33

## (3) Orders for specific performance are very rarely granted in practice for breach of contracts (other than for the transfer of interests in land)

‘No authority has been quoted to show that an injunction will be granted enjoining a person to carry on a business, nor can I think that one ever would be, certainly where the business is a losing concern.’

*A-G v Colchester Corporation* [1955] 2 QB 207, 217 per Lord Goddard CJ

‘The purpose of the law of contract is not to punish wrongdoing but to satisfy the expectations of the party entitled to performance.... The exercise of the discretion as to whether or not to grant specific performance starts from the fact that the covenant has been broken. Both landlord and tenant in this case are large sophisticated commercial organisations and I have no doubt that both were perfectly aware that the remedy for breach of the covenant was likely to be limited to an award of damages. The interests of both were purely financial: there was no element of personal breach of faith... No doubt there was an effect on the businesses of other traders in the Centre, but Argyll had made no promises to them and it is not suggested that CIS warranted to other tenants that Argyll would remain. Their departure, with or without the consent of CIS, was a

commercial risk which the tenants were able to deploy in negotiations for the next rent review.'

*Co-operative Insurance Society Limited v. Argyll Stores [1998] AC 1 per Lord Hoffmann*

**Exceptional case:**

*Sky Petroleum v. V.I.P. Petroleum [1974] 1 All ER 954*: Party suffering from breach would have to go out of business if no specific performance were granted.

(4) Usual justification for absence of specific performance as normal remedy is **efficient breach**: if a party to a contract can by breaking the contract and paying full compensation still be better off, then breach maximises wealth.

**UNIDROIT Principles (2010)**

**Article 7.2.2 (Performance of non-monetary obligation)**

Where a party who owes an obligation other than one to pay money does not perform, the other party may require performance, unless

- (a) performance is impossible in law or in fact;
- (b) performance or, where relevant, enforcement is *unreasonably burdensome or expensive*;
- (c) *the party entitled to performance may reasonably obtain performance from another source*;
- (d) performance is of an exclusively personal character; or
- (e) the party entitled to performance does not require performance within a reasonable time after it has, or ought to have, become aware of the non-performance.

34

contrast:

**Article 6.2.1 (Contract to be observed)**

Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship.

**Questions for Classes – Remedies for Breach**

1. What are the primary and secondary remedies for breach of contract in English common law and in equity? Why are English courts so reluctant to grant specific

performance? Is the principle of *pacta sunt servanda* nothing but an illusion in English law?

2. Tom and Jerry enter into a contract under which Tom promises to convey part of a tract of land to Jerry and Jerry promises to pay £ 100,000 and to build a 'first class theatre' on it. The underlying understanding of the parties, based on a report of an independent expert, was that the building of the theatre would enhance the value of A's remaining land at least by 150%, maybe up to 250%. A conveys the land to B, who pays the price but eventually refuses to build the theatre. What remedies are available to A?
3. Isn't the right to refuse payment of money owed under the contract the same as the right to terminate the contract?
4. Explain why *Hadley v Baxendale* is so important for the English law of damages? Doesn't it undermine the principle of full compensation?
5. In order to have the right to terminate the contract, the party suffering from a breach must be able to show that it was essentially deprived of what it was entitled to expect under the contract. In order to obtain specific performance, the party suffering from a breach must be able to show that the common law remedies would be inadequate to meet the equity of the case. Is there a common logic in the sense of 'if money can fix it, money it is'?

35

## Topic 6 Exclusion Clauses and Agreed Remedies

### Introduction

*General Question.* To what extent are the parties to a commercial contract free to select their remedies for breach of contract? The short answer is that the parties generally have freedom of contract. As ever, we concentrate on the scope of the exceptions.

*Policy issues.* On the one hand, freedom of contract has the advantage that the parties can plan carefully in advance the consequences of any breach, take those potential costs into account when pricing the deal, and bargain to protect any particular interests that they might have in relation to the transaction. On the other hand, a remedy provided in a contract might prove to be either oppressive in the sense that it effectively compels one party to perform a contract unwillingly or unfair in the sense that the remedy provides protection that far exceeds any losses to the injured party.

*Scope of Question.* There are a host of ways in which the parties can provide for remedies for breach of contract, e.g.:

- Security rights to ensure payment (considered elsewhere in this course)
- Termination clauses
- Exclusion of liability clauses
- Limitation of damages clauses
- Indemnity clauses
- Guarantees.

36

We consider here some of these types of terms in contracts, with a special focus on those where it is possible to challenge the validity or effectiveness of the clause.

Chen-Wishart Chapters 12 and 14.

- 1. Liquidated damages clauses: an agreement that in the event of breach of contract a fixed sum (or a sum calculable by reference to fixed criteria) will be payable**

These terms serve useful purposes: reduce uncertainties about the appropriate level of compensation, offer the quick procedure of claims for an agreed sum, determine the scale of the risk in advance, enable insurance arrangements or other kinds of guarantees/indeemnities to be comprehensive, avoid difficulties in proving speculative losses, and reduce delays in payment, and encourage settlements.

But the courts have required liquidated damages clauses to specify a level of compensation which is genuine pre-estimate of the loss, and if it is more, it will be dubbed a 'penalty' and be unenforceable (though ordinary damages for breach of contract may still be claimed).

Unclear distinction between price terms and liquidated damages clauses: eg *Interfoto v Stiletto*, but to be a penalty clause the payment must be triggered by breach of contract.

A fixed amount of damages may still be enforceable even if with hindsight it exceeds actual loss, provided that at the time of formation of contract the fixed amount was the expected likely loss or at least an average of expected likely losses: *Dunlop v New Garage*.

Many writers trained in economic analysis have questioned whether the courts should invalidate penalty clauses. One argument (eg Rea) is that the price paid reflects the advantage obtained from a penalty clause, so that by disallowing a penalty clause, the court upsets the balance of fairness in the contract.

Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd [1915] AC 79 (HL) ('genuine pre-estimate of loss')

Workers Trust v Dojap Investments [1993] AC 573 (PC) (deposits)

Andrews v Australia & New Zealand Banking Group Ltd [2012] HCA 30 (High Court of Australia) noted (2013) LQR 152

\*Makdessi v Cavendish Square Holdings BV [2015] UKSC 67

37

S Rowan, 'For the Recognition of Remedies Agreed Inter Partes' LQR (2010) 448

\*Summers, 'Unresolved Issues in the Law of Penalties' [2017] LMCLQ 95-121

## 2. Termination clauses

The general principles governing the right to terminate a contract for breach of contract are considered in: *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaishs Ltd* [1962] 2 QB 26, CA (BBF 498); *Cehave NV v Bremer Handelsgesellschaft mbH (The Hansa Nord)* [1975] 3 All ER 739 (BBF 501). Under these principles, the courts are reluctant to permit termination for breaches that have no or few adverse effects on the injured party, but nevertheless they recognise that by convention and agreement even apparently trivial breaches can justify termination of a contract. In other words, whether or not a particular breach should entitle one party to terminate the contract depends ultimately on how the court interprets the contract and the significance it attaches to breach of particular terms.

The language of condition and warranty is often used by the parties to signal that breach of a particular term (a condition) will entitle the other party to terminate the contract. But this legal convention is not always accepted by the courts: *Schuler (L) AG v. Wickman Machine Tool Sales Ltd* [1973] 2 All ER 39, HL (BBF 527). The phrase that 'time is of the

'essence' is treated as a special signal that lateness gives the right to terminate. In general in commercial contracts, where the contract specifies a particular time for performance, a court will almost certainly treat this as a condition.

But the parties can express the right to terminate in straightforward terms eg breach of clause X will entitle the other party to terminate the contract, and provided that the term is clear, it will be enforced by the courts. If there has been no breach of the relevant term yet a party purports to terminate the contract for this reason, a court will regard this termination as a repudiatory breach of contract itself. See *Woodar Investment Development Ltd v Wimpey Construction (UK) Ltd* [1980] 1 All ER 571, HL (BBF 585)

### **3. Deposits: a fixed sum of money, payable in advance, which is forfeited by breach of contract by the depositor**

An earnest of future performance in the form of a sum of money which will be forfeited on breach is a deposit. Deposits are excluded from the rule against penalties and are in general enforceable: *Union Eagle v Golden Achievements*.

However, deposits can be challenged for being excessive. The test seems to be whether the deposit is reasonable, which in turn depends upon the customs of the trade: *Workers Trust v Dojap*. An unreasonable deposit has to be returned in full, though (presumably) ordinary damages for breach of contract may still be claimed.

38

### **4. Exclusion Clauses**

\*Unfair Contract Terms Act 1997; BBF 1004-13

\**George Mitchell (Chesterhall) Ltd. v. Finney Lock Seeds Ltd.* [1983] 2 AC 803, [1983] 2 All ER 737, HL; BBF 1014

UCTA: Confined to exclusion clauses: s.13; not unfair terms generally. But extended concept of exclusion: s.3: applies to express terms that apparently entitle one party to render performance substantially different from that which was reasonably expected, or no performance at all with respect to part or all of the his obligations. Question in *Paragon Finance* was: is power to vary interest rate at bank's discretion within s.3? No – because the term does not affect the bank's performance obligations, only those of the borrowers.

Includes contracts between businesses, but special rules for contracts where one party 'deals as a consumer'.

Declares some exclusion clauses invalid, (eg. 2.(1) negligence liability for personal injury) but for others grants a judicial discretion to determine whether a term is 'fair and reasonable'.

S.11(1) 'the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.'

### Questions for Class Discussion

1. Is there a coherent set of principles behind the way in which the courts approach agreed remedies?
2. Is the approach of the courts towards penalty clauses justifiable? Should penalty clauses be enforced under English law? What do you think of the solution proposed in article 7.4.13 of the UNIDROIT Principles (<http://www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010-e.pdf>)? Is the equitable control over 'penalty clauses' justifiable and consistent with other aspects of judicial control over remedies agreed in the express terms of the contract?
3. Why is *Schuler* a controversial decision?
4. Peter a government minister, wants a large dome shaped building completed by 31<sup>st</sup> January at 12 noon for a great public event on New Years Eve 1999/2000. Peter insists in the specification for tenders that the works be completed on time and that there should be a 25% reduction of the price if the dome is not completed on time. Bob the builder bids successfully for the job (£100 m). The building is completed one day late, and as a consequence Peter suffers a nose dive in popularity ratings, threatening his chances of being re-elected and leading to his sacking by the Prime Minister. Peter and the government refuse to pay Bob more than £75m.

39

Advise Bob on his claim for £25 m.

## Topic 7 Multi-Party Projects: privity of contract and the rights of third parties

Beale, Bishop and Furmston, ch 46.

Chen Wishart, ch. 4.

### 1. The general rules

1.1. C may not enforce a contract made between A and B which was intended to confer a benefit upon C.

*Dunlop Pneumatic Tyre Co v Selfridge* [1915] AC 847

*Tweddle v Atkinson* (1861) 1 B & S 393

*Scruttons v Midland Silicones Ltd* [1962] AC 446

1.2. A contract between A and B cannot impose obligations on C, or restrict C's legal rights.

*Haseldine v Daw* [1941] 2 K.B. 343

### 2. Devices to avoid the privity rules

40

2.1 'Collateral' agreements

*Shanklin Pier Ltd v Detel Products Ltd* [1951] 2 KB 854

2.2 Agency

*The Eurymedon, New Zealand Shipping v Satterthwaite* [1975] A.C. 154

2.3 Bailment and sub-bailment

*Morris v Martin* [1966] 1 Q.B. 716

*The Pioneer Container* [1994] 2 A.C. 324

2.4 Trust

*Lloyd's v Harper* (1880) 16 Ch D 290

*Re Schebsman* [1944] Ch 43

2.5 Liability in Tort

*Grant v Australian Knitting Mills* [1936] A.C. 85

Consumer Protection Act 1987, Part I  
*Norwich CC v Harvey* [1989] 1 W.L.R. 828  
*White v Jones* [1995] 2 AC 207

### **3. Enforcement by the promisee**

#### 3.1 Enforcement of a positive promise

*Beswick v Beswick* [1966] AC 58

#### 3.2 Enforcement of a negative promise

*Gore v Van der Lann* [1967] 2 Q.B. 31

#### 3.3 Seeking damages

*Woodar v Wimpey Construction* [1980] 1 W.L.R. 227  
*Jackson v Horizon Holidays* [1975] 1 W.L.R. 1486  
*Linden Gardens Trust v Lenesta Sludge* [1993] 3 All E.R. 417; pp. 432-437; and 421- 422  
*Panatown Ltd v Alfred McAlpine Construction Ltd* [2000] 4 All ER 97  
*Rolls-Royce Power Engineering Plc v Ricardo Consulting Engineers Ltd* [2003] EWHC 2871  
(TCC), [2004] 2 All ER (Comm) 129

41

### **4. Statutory avoidance**

#### 4.1 Particular examples

Road Traffic Act 1988, s. 148(7)  
Third Parties (Rights Against Insurers) Act 1930  
Consumer Credit Act 1974, s. 56, s. 75  
Resale Prices Act 1976, s. 26

#### 4.2 The Contracts (Rights of Third Parties) Act 1999

#### **Background:**

Law Commission (1991) Consultation Paper No. 121 Privity of Contract: Contracts for the Benefit of Third Parties

Law Commission (1996), Law Com No 242, Privity of Contract: Contracts for the Benefit of Third Parties

#### 4.2.1 The third party's right to enforce the contract

's 1 (1) Subject to the provisions of this Act, a person who is not a party to a contract (a "third party") may in his own right enforce a term of the contract if—(a) the contract expressly provides that he may, or (b) subject to subsection (2), the term purports to confer a benefit on him.'

's 1 (2) 'Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.'

*Nisshin Shipping Co Ltd v Cleaves & Co Ltd* [2003] EWHC 2602, [2004] 1 Lloyds Rep 38

*Laemthong International Lines Company Ltd. v. Artis and Others*, (The Laemthong Glory) (No. 2) [2005] EWCA Civ 519

*Prudential Assurance Co Ltd v Ayres* [2007] EWHC 775

s 1 (3) 'The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into.'

*Avraamides v Colwill* [2006] EWCA Civ 1533

#### Further Reading

42

Burrows, 'The Contracts (Rights of Third Parties) Act and its Implications for Commercial Contracts' [2000] LMCLQ 540

MacMillan, 'A Birthday Present for Lord Denning: The contracts (Rights of Third Parties) Act 1999' (2000) 63 MLR 721

Stevens, 'The Contracts (Rights of Third Parties) Act 1999' (2004) 120 LQR 292

Adams and Brownsword, 'Privity of Contract—That Pestilential Nuisance' (1993) 56 MLR 722

Coote, 'The Performance Interest, Panatown, and the Problem of Loss' (2001) 117 LQR 81

Kincaid, 'Privity Reform in England' (2000) 116 LQR 43

Phang, 'Sub-bailments and Consent—The Pioneer Container' (1995) 58 MLR 422

Smith, 'Contracts for the Benefits of Third Parties: in Defence of the Third Party Rule' (1997) 17 OJLS 643.

**Topics for Class Discussion:**

1. In what ways can the benefits which parties intend to confer on third parties by their contract be recovered by them?
2. Bordeaux Bottlers export fine wines from France to the United Kingdom. They always contract with Vasily's Vessels to carry a cargo of their finest wines on board their ship, the Vasily 1. They ask Vasily's Vessels to transport two crates of expensive wine, one white and one red. Their contract of carriage includes the following term:

the carriers and any servants, agents and stevedores whom the carriers may from time to time employ shall be exempt from all liability, for any loss or damage, whether caused by negligence or otherwise, to any goods carried on the SS Vasily 1. Such exemption extends to the loading and unloading of any goods so carried.

Vasily's Vessels also tell Bordeaux Bottlers that the goods will be unloaded by their subsidiary company, Steven's Stevedores, and housed at their premises pending collection. The contract between Vasily's Vessels and Steven's Stevedores exempts the latter's servants or agents from all liability for damage to any goods unloaded.

43

When the ship reaches the port, one of the stevedore's crane operators carelessly drops one of the containers he is unloading onto the whole consignment of red wine, which is all destroyed. Later, while lifting the white wine, he allows it to fall into the water.

Bordeaux Bottlers now want to sue Steven's Stevedores.

Advise Bordeaux Bottlers.

3. What has been the effect of the Contract (Rights of Third Parties) Act 1999?

## Topic 8 Commercial Dispute Resolution and International Commercial Contracts

This lecture considers how businesses resolve disputes, and how businesses entering into contracts might (not) plan for resolving problems that arise during the course of the contractual relationship. The first part of the lecture considers methods of dispute resolution that might be used as alternatives to court litigation. The second part considers particular issues arising in international contracts, most notably the question of the law governing such a contract.

### A. Commercial Dispute Resolution

\*L. Mulcahy, *Contract Law in Perspective*, Chapter 19 “Dispute Resolution” (see Moodle): <http://lib.myilibrary.com/Open.aspx?id=175367&src=0>

E. McKendrick, *Goode on Commercial Law* (4th edn, 2010) 1-8, 1299-1343

#### 1. Models of Business Contracting

44

*Walford v Miles* [1992] 2 A.C. 128; [BBF 271]

Lord Ackner: “*The concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making representations.*”

\*S. Macaulay, “Non-Contractual Relations in Business: A Preliminary Study” (1963) 28(1) American Sociological Review 55-67

“*if something comes up, you get the other man on the telephone and deal with the problem. You don't read legalistic contract clauses at each other if you ever want to do business again. One doesn't run to lawyers if he wants to stay in business because one must behave decently.*”

L. Mulcahy, “Telling Tales about Relational Contracts: How Do Judges Learn about the Lived World of Contracts?”, in Campbell, Mulcahy and Wheeler (eds.), *Changing Concepts of Contract* (Palgrave 2013).

## 2. Litigation and Alternative Dispute Resolution Trends

L. Mulcahy, "Telling Tales about Relational Contracts: How Do Judges Learn about the Lived World of Contracts?", in Campbell, Mulcahy and Wheeler (eds.), *Changing Concepts of Contract* (Palgrave 2013).

### English Law's Support of Alternative Dispute Resolution

- Civil Procedure Rules
- Mediation:
  - o Costs Sanctions: *Thakkar v Patel* [2017] EWCA 117
  - o Interpretation of Clauses: *Cable and Wireless plc v IBM* [2002] EWHC 2059
    - "... the English courts should nowadays not be astute to accentuate uncertainty (and therefore unenforceability) in the field of dispute resolution references. There is now available a clearly recognised and well-developed process of dispute resolution involving sophisticated mediation techniques provided by trained mediators in accordance with procedures designed to achieve settlement by the means most suitable for the dispute in question..."
    - ... For the courts now to decline to enforce contractual references to ADR on the grounds of intrinsic uncertainty would be to fly in the face of public policy..."
- Arbitration
  - o *Pioneer Shipping Ltd v BTP Tioxide Ltd (The Nema)* (No.2) [1982] A.C. 724.
  - o *West Tankers Inc v Ras Riunione Adriatica di Sicurtà SpA* [2007] UKHL 4
    - Lord Hoffmann: "... it should be noted that the European Community is engaged not only with regulating commerce between Member States but also in competing with the rest of the world. If the Member States of the European Community are unable to offer a seat of arbitration capable of making orders restraining parties from acting in breach of the arbitration agreement, there is no shortage of other states which will. For example, New York, Bermuda and Singapore are also leading centres of arbitration and each of them exercises the jurisdiction

45

*which is challenged in this appeal. There seems to me to be no doctrinal necessity or practical advantage which requires the European Community handicap itself by denying its courts the right to exercise the same jurisdiction."*

### **3. Varieties of Alternative Dispute Resolution and their Respective Advantages**

L. Mulcahy, "Dispute Resolution" in Contract Law in Perspective (Routledge Cavendish 2008): <http://lib.myilibrary.com/Open.aspx?id=175367&src=0>

R. Goode, 'Litigation or Arbitration? The Influence of the Dispute Resolution Procedure on Substantive Rights' (2007) *19 Pace Int'l L Rev* 53-62

- (i) Negotiation
- (ii) Mediation (and Conciliation)
- (iii) Expert Determination
- (iv) Arbitration
- (v) Litigation

46

### **4. The Public Interest in Private Dispute Resolution**

L. Mulcahy, "The Collective Interest in Private Dispute Resolution" (2013) 33(1) *Oxford Journal of Legal Studies*

*"... despite our many claims about the dynamism of the common law its advancement remains worryingly haphazard. Moreover, claims about the development of doctrine are rendered somewhat hollow if our legal system is not facilitating the pursuit of cases with precedent-setting potential. It is contended that this situation is likely to get worse as faith in the litigation system as a vehicle for change or site of democratic practice diminishes, as has been predicted."*

Lord Thomas, "Developing Commercial Law through the Courts: Rebalancing the Relationship between the Courts and Arbitration", BAILII Lecture 2016, 9 March 2016:  
<https://www.judiciary.gov.uk/announcements/speech-by-the-lord-chief-justice-the-bailii-lecture-2016/>

## 5. Focus on Commercial Arbitration

### (i) Principles of Arbitration:

**Arbitration Act 1996, §1.**

*General principles.*

*The provisions of this Part are founded on the following principles, and shall be construed accordingly—*

- *the object of arbitration is to obtain the fair resolution of disputes by an impartial tribunal without unnecessary delay or expense;*
- *the parties should be free to agree how their disputes are resolved, subject only to such safeguards as are necessary in the public interest;*
- *in matters governed by this Part the court should not intervene except as provided by this Part.*

*Fiona Trust v Privalov [2007] UKHL 40; [2007] 4 All E.R. 951*

Lord Hoffmann: *In approaching the question of construction, it is therefore necessary to inquire into the purpose of the arbitration clause. As to this, I think there can be no doubt. The parties have entered into a relationship, an agreement or what is alleged to be an agreement or what appears on its face to be an agreement, which may give rise to disputes. They want those disputes decided by a tribunal which they have chosen, commonly on the grounds of such matters as its neutrality, expertise and privacy, the availability of legal services at the seat of the arbitration and the unobtrusive efficiency of its supervisory law. Particularly in the case of international contracts, they want a quick and efficient adjudication and do not want to take the risks of delay and, in too many cases, partiality, in proceedings before a national jurisdiction.*

47

### (ii) Advantages of Commercial Arbitration

#### • The (myth of the) traditional advantages of arbitration:

- speediness: dedicated arbitrators, single instance, swift enforcement
- costs: deriving from speediness
- competence: possibility to choose specialists, including non-lawyers (engineers, accountants)

- flexibility
- confidentiality: award, existence of and material used in arbitration
- Other reasons for opting for arbitration
  - in England: avoiding barristers
  - in the U.S.: avoiding jury trial
- Especially at the international level: an efficient regime of enforceability of arbitration agreements and awards in 146 countries
  - ***UN Convention on Recognition and Enforcement of Foreign Arbitral Awards (NY 1958)***
    - enforceability of arbitration agreements; Art II(1) and (3) NYC
    - no *double exequatur*; cf. Arts III and V(1)(e) NYC
    - presumption of validity upon presentation of agreement and award
      - burden of proof on award debtor for grounds for refusing enforcement: Art V(1) NYC
        - lack of valid arbitration agreement or non-respect for its scope; (a)&(c)
        - violation of due process or of procedure provided in agreement; (b)&(d)
        - award not yet binding on parties or set aside in country of origin; (e)
      - no review of the merits, although public policy exception; Art V(2)(b) NYC
  - importance of choice of place of arbitration
    - default regime for many legal questions (cf. s 2 AA 1996)
    - place of setting aside (cf. Art V(1)(e) NYC)
  - importance of the place of enforcement; Art V(2) NYC
  - importance of institutional rules: e.g., compare s 69(1) Arbitration Act 1996 with Art 26(9) LCIA Rules; or s 46(3) AA 1996 with Art 22(3) LCIA (see also below).

48

## (iii) Key Features of Commercial Arbitration:

- The arbitration clause:
  - LCIA recommended clause for Mediation and Arbitration:
    - *'In the event of a dispute arising out of or relating to this contract..., and if the dispute cannot be settled through negotiation, the parties shall first seek settlement of that dispute by mediation in accordance with the [...] Mediation Procedure...'*
    - *'If the dispute is not settled by mediation within [ ] days of the appointment of the mediator, or such further period as the parties shall agree in writing, the dispute shall be referred to and finally resolved by arbitration under the [...] Arbitration Rules...'*
- Court support of Arbitration:
  - Arbitration Act 1996, section 9:
    - *(1) A party to an arbitration agreement against whom legal proceedings are brought ... in respect of a matter which under the agreement is to be referred to arbitration may... apply to the court in which the proceedings have been brought to stay the proceedings as far as they concern that matter.*
    - *(4) On an application under this section the court shall grant a stay unless satisfied that the arbitration agreement is null and void, inoperative or incapable of being performed.*
- Separability
  - §7 Arbitration Act 1996
  - Fiona Trust v Privalov [2007] UKHL 40; [2007] 4 All E.R. 951
    - Lord Hoffmann: *If one accepts that this is the purpose of an arbitration clause, its construction must be influenced by whether the parties, as rational businessmen, were likely to have intended that only some of the questions arising out of their relationship were to be submitted to arbitration and others were to be decided by national courts... If, as appears to be generally accepted, there is no rational basis upon which businessmen would be likely to wish to have questions of the validity or enforceability of the contract decided by one tribunal and questions about its performance decided by another, one would need to find very clear language before deciding that they must have had such an intention.*

49

- Kompetenz-kompetenz
  - §30 Arbitration Act 1996
- Governing/applicable law
  - §46 Arbitration Act 1996
- Grounds for challenging arbitral award
  - Substantive jurisdiction: §67 Arbitration Act 1996
  - Serious irregularity: §68 Arbitration Act 1996
  - Appeal on point of law: §69 Arbitration Act 1996
    - *Pioneer Shipping Ltd v BTP Tioxide Ltd (The Nema) (No.2)* [1982] A.C. 724.
- Enforceability of arbitral award:
  - UN Convention on Recognition and Enforcement of Foreign Arbitral Awards (NY 1958), Articles III, V

## B. International Commercial Contracts

50

### 1. Party Choice of Applicable Law: the Interests at Stake

- (i) Considerations for Contracting Parties
- (ii) Public Interest Policy Concerns

#### **Regulation (EC) No 593/2008** Rome I Regulation, Recital (6):

*The proper functioning of the internal market creates a need, in order to improve the predictability of the outcome of litigation, certainty as to the law applicable and the free movement of judgments, for the conflict-of-law rules in the Member States to designate the same national law irrespective of the country of the court in which an action is brought.*

- Manuel Penadés Fons, “Commercial Choice of Law in Context: Looking Beyond Rome”, (2015) 78(2) Modern Law Review 241

- *Amiri Flight Authority v BAE Systems [2003] EWCA Civ 1447*
- Unfair Contract Terms Act 1977 (outline knowledge only required)
  - **§26.— International Supply Contracts.**
    - (1) The limits imposed by this Act on the extent to which a person may exclude or restrict liability by reference to a contract term do not apply to liability arising under such a contract as is described in subsection (3) below.
    - (2) The terms of such a contract are not subject to any requirement of reasonableness under section 3 or 4: and nothing in Part II of this Act shall require the incorporation of the terms of such a contract to be fair and reasonable for them to have effect.
    - (3) Subject to subsection (4), that description of contract is one whose characteristics are the following—
      - (a) either it is a contract of sale of goods or it is one under or in pursuance of which the possession or ownership of goods passes; and
      - (b) it is made by parties whose places of business (or, if they have none, habitual residences) are in the territories of different States (the Channel Islands and the Isle of Man being treated for this purpose as different States from the United Kingdom).
    - (4) A contract falls within subsection (3) above only if either—
      - (a) the goods in question are, at the time of the conclusion of the contract, in the course of carriage, or will be carried, from the territory of one State to the territory of another; or
      - (b) the acts constituting the offer and acceptance have been done in the territories of different States; or
      - (c) the contract provides for the goods to be delivered to the territory of a State other than that within whose territory those acts were done.
- Ministry of Justice, UK Trade & Investment, “UK Legal Services on the International Stage: Underpinning growth and stability” (2013)

- “As a government we recognise the importance of the UK’s legal services sector and the excellent reputation its legal services providers have at home and abroad. The sector contributed £20.9 billion to the UK economy in 2011 [1.8% GDP], £4bn of this derived from exports. It is important that we consolidate the UK’s international standing in what is becoming an increasingly competitive field.”

(iii) Practical Considerations

- Procedure v Substance
- Proof of Foreign Law
- *Iraqi Civilian Litigation v Ministry of Defence* [2015] EWCA Civ 1241

2. Freedom of Contract and Choice of Law

**Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations (Rome I)**

52

- **Recital (11):**
  - The parties' freedom to choose the applicable law should be one of the cornerstones of the system of conflict-of-law rules in matters of contractual obligations.
- **Article 3 Freedom of Choice**
  - 1. A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract.
  - 2. The parties may at any time agree to subject the contract to a law other than that which previously governed it, whether as a result of an earlier choice made under this Article or of other provisions of this Regulation. Any change in the law to be applied

that is made after the conclusion of the contract shall not prejudice its formal validity under Article 11 or adversely affect the rights of third parties.

- 3. Where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement.
- 4. Where all other elements relevant to the situation at the time of the choice are located in one or more Member States, the parties' choice of applicable law other than that of a Member State shall not prejudice the application of provisions of Community law, where appropriate as implemented in the Member State of the forum, which cannot be derogated from by agreement.
- 5. The existence and validity of the consent of the parties as to the choice of the applicable law shall be determined in accordance with the provisions of Articles 10, 11 and 13.

53

### 3. Limits of Freedom of Choice of Law

Choice of *national* law:

Preliminary draft of Regulation (EC) No. 593/2008 ('Rome I')

Article 3 – Freedom of choice

1. A contract shall be governed by the *law* chosen by the parties...

2. ~~The parties may also choose as the applicable law the principles and rules of the substantive law of contract recognised internationally or in the Community.~~

~~However, questions relating to matters governed by such principles or rules which are not expressly settled by them shall be governed by the general principles underlying them or, failing such principles, in accordance with the law applicable in the absence of a choice under this Regulation.~~ [original proposal, COM(2005) 650 final]

- *Beximco Pharmaceuticals Ltd v Shamil Bank of Bahrain EL* [2004] EWCA Civ 19

- “The wording of article 1(1) of the [Regulation] (“The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries”) is not on the face of it applicable to a choice between the law of a country and a non-national system of law, such as the lex mercatoria, or “general principles of law”, or as in this case, the law of Sharia. Nevertheless, that wording, taken with article 3(1)... and the reference to choice of a “foreign law” in article 3(3), makes it clear that the [Regulation] as a whole only contemplates and sanctions the choice of the law of a country...”
- *Dana Gas PJSC v Dana Gas Sukuk, Deutsche Bank, Commercial International Bank, Blackrock* [2017] EWHC 2928 (Comm)

## Arbitral Tribunals

### Arbitration Act 1996

#### 46 Rules applicable to substance of dispute

(1) The arbitral tribunal shall decide the dispute—

- (a) in accordance with the law chosen by the parties as applicable to the substance of the dispute, or
- (b) *if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal.*

54

(2) For this purpose the choice of the laws of a country shall be understood to refer to the substantive laws of that country and not its conflict of laws rules.

(3) If or to the extent that there is no such choice or agreement, the tribunal shall apply *the law determined by the conflict of laws rules* which it considers applicable.

### LCIA Arbitration Rules (1998)

#### Article 22 – Additional Powers of the Arbitral Tribunal

(3) The Arbitral Tribunal shall decide the parties’ dispute in accordance with the law(s) or *rules of law chosen by the parties* as applicable to the merits of their dispute. If and to the extent that the Arbitral Tribunal determines that the parties have made no such choice, the Arbitral Tribunal shall apply the law(s) or *rules of law which it considers appropriate*.

(4) The Arbitral Tribunal shall only apply to the merits of the dispute principles deriving from “ex aequo et bono”, “amiable composition” or “honourable engagement” where the parties have so agreed expressly in writing.

**Regulation (EC) No. 593/2008 ('Rome I')****Article 3(3)**

3. Where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement.

**Article 9 – Overriding mandatory provisions**

1. Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.

2. Nothing in this Regulation shall restrict the application of the overriding mandatory provisions of the law of the forum.

3. Effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application.

55

**Article 21 – Public policy of the forum**

The application of a provision of the law of any country specified by this Regulation may be refused only if such application is manifestly incompatible with the public policy (*ordre public*) of the forum.

**Unfair Contract Terms Act 1977****○ §27.— Choice of Law Clauses.**

- (1) Where the [law applicable to] a contract is the law of any part of the United Kingdom only by choice of the parties (and apart from that choice would be the law of some country outside the United Kingdom) sections 2 to 7 and 16 to 21 of this Act do not operate as part [of the law applicable to the contract].

- (2) This Act has effect notwithstanding any contract term which applies or purports to apply the law of some country outside the United Kingdom, where (either or both)—
  - (a) the term appears to the court, or arbitrator or arbiter to have been imposed wholly or mainly for the purpose of enabling the party imposing it to evade the operation of this Act; or
  - (b) in the making of the contract one of the parties dealt as consumer, and he was then habitually resident in the United Kingdom, and the essential steps necessary for the making of the contract were taken there, whether by him or by others on his behalf.

## Topic 9 Financial law (1): Introduction and Debt Finance

### 1. Introduction

Financial law has been defined as ‘the law and regulation of insurance, derivatives, commercial banking, capital markets and investment management sectors’ and as a subset of commercial law.<sup>1</sup> The sources of financial law are market practice, case law and legislation, though not always in that order. For example, there is little public-sector regulation of syndicated<sup>2</sup> lending with the result that, in such deals, much turns on the terms of the contracts which lenders and the borrowers negotiate for themselves. By contrast, the capital markets are heavily regulated by European and domestic legislation and individual investors will have little say about the terms and conditions of their securities.

The function of financial law is to translate risks of many kinds (for example, your house burning down) into credit risk, and then to permit the circulation of units of risk among market participants.<sup>3</sup> Valdez has described how in the financial markets ‘the money goes round and round, just like a carousel on a fairground’<sup>4</sup> but as we will see, it is in fact more helpful for lawyers to think about the movement of risk, not money.

57

The purpose of the first part of this lecture is to explore the importance of the contract law element of English financial law. The positions which parties enter into may be economically complex, and sometimes bafflingly so, but all may be understood in legal terms as contracts in one form or another. This perspective affords a number of insights which we shall explore the first part of lecture, drawing on a broad range of examples from across the markets and making reference to developments since the financial crisis broke out in 2007.

### Reading

J. Armour et al, *Principles of Financial Regulation* (Oxford: OUP, 2016), chapter 2, in particular section 2.3.2 (financial markets). This book is available as an e-book on the LSE library website.

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<sup>1</sup> Benjamin, *Financial Law* (Oxford: OUP, 2007) 4.

<sup>2</sup> This is lending by a group of lenders (usually banks) rather than by a single lender. It is typically for larger sums than any one lender is prepared to lend.

<sup>3</sup> Benjamin, 3.

<sup>4</sup> S. Valdez, *An Introduction to the Global Financial Markets* (London, Palgrave MacMillan 2007) 3.

E. Ferran and L. Chan Ho, *Principles of Corporate Finance* (Oxford: OUP, 2014), chapter 1 (introduction). This book is available as an e-book on the LSE library website.

*Hazell v Hammersmith and Fulham LBC* [1990] 2 QB 697, 739-741

*Bankers Trust International plc v PT Dharmala Sakti Sejahtera* (1995) 4 Bank LR 381 (overview of highly complex facts only, focus on the causes of action including misrepresentation brought by the claimant).

Take a look at the International Swaps and Derivatives Association's website, at <http://www.isda.org/>

**The following are not required for the course but may also be of interest:**

Lord Turner, *The Turner Review* (London: FSA, March 2009) pp. 27-28, 81-83, 108-110. This is available online:

[http://www.fsa.gov.uk/pubs/other/turner\\_review.pdf](http://www.fsa.gov.uk/pubs/other/turner_review.pdf)

G. Tett, *Fool's Gold* (London: Little Brown, 2009)

E. Ferran, *Principles of Corporate Finance Law* (2<sup>nd</sup> edition, 2014, Oxford OUP)

L. Gullifer and J. Payne, *Corporate Finance Law: Principles and Policy* (Hart, 2<sup>nd</sup> ed, 2015). N.B. You are not required to purchase these books for this course, these are included only if you would like a recommendation for your own interest.

58

## 2. Understanding financial positions as contracts

Legally speaking, the positions which market participants enter into are contracts of one form or another. These contracts may be analysed by thinking about how risk moves between the parties.

For example:

- Under a contract of insurance, the insurer assumes the insured's risk of a particular event happening. Funds move if and when the insured suffers loss. During the life of the contract, the insured has a credit risk as regards the insurance company. *Prudential Insurance Co. v IRC* [1904] 2 KB 658
- Similarly under an indemnity, the surety assumes a liability to pay if and when the principal debtor defaults. To this extent, the surety assumes the creditor's risk of the debtor defaulting but the creditor has a credit risk as regards the surety. *ILG Capital v Van Der Merwe* [2008] EWCA Civ 542

- In a syndicated loan, funds move at the outset of the transaction from a syndicate of lenders to a borrower. During the life of the loan, the lenders assume the credit risk of the borrower defaulting, which they may address, for example, through a guarantee or an indemnity. *Redwood Master Fund, Ltd and Others v TD Bank Europe Limited and Others* [2002] EWHC 2701 (Ch)
- When Eurobonds are issued, funds move from investors (initially the managers) to the issuer. Up to maturity, the bondholders assume the credit risk of the issuer defaulting on the coupon (interest) and/or principal. *Elektrim SA v Vivendi Holding Corp; Law Debenture Trust Corp v Vivendi Holdings Corp* [2008] EWCA Civ 1178

### 3. Contract law as a tool for innovation in the financial markets

The financial markets based in London have long been a site of innovation, for example the first Eurobond issue was arranged here in July 1963 for an Italian national highways authority. More recently certain innovative practices in the securitisation market have been implicated in the build-up to the financial crisis. Indeed, Lord Turner's 2009 review described part of the cause of the crisis as 'macro trends meet financial innovation' (The Turner Review, Chapter 1).

While some innovation turns on matters such as economics or tax law, other innovative practices may be understood as contract law-based responses to various problems which presented themselves in the financial markets. For example:

59

- **Markets facilitated by the standardisation of contracts.**  
**Issue:** Privately negotiated contracts, sometimes entered into in high volumes and at speed by traders, which have to address the full range of legal issues as well as the economic terms, expose parties to cost, delay and risk.  
**Response:** Standardisation of contracts driven by trade associations. e.g. ISDA's Master Agreement for the 'over-the-counter' derivatives market and the LMA's Facility Agreement for syndicated loans.
- **Contractual credit risk mitigation.**  
**Issue:** Borrowers under syndicated loan facility agreements have no statutory disclosure obligations (either on signing or during the life of the loan); the usual rule of caveat emptor applies.  
**Response:** Sophisticated contractual drafting, which is now market standard, enables the providers of capital to flush out information on signing and to monitor the borrower closely during the life of the loan.

These ‘representations’, ‘repeating representations’ and ‘covenants’ are drafted to impose a significant disclosure burden on the borrower. This gives the lender early warning of any problems which the borrower might be facing so they can take pre-emptive action as provided for in the ‘events of default’ section of the agreement. ‘Cross-default’ provisions mean that the lenders can also benefit from the protections enjoyed by other creditors of the borrower under their agreements. This is a particularly useful device if the market has become less ‘lender friendly’ over time. We will look at the drafting of such clauses in the next lecture.

- **Secondary market in loans**

**Issue:** For various reasons, lenders may wish to sell their participation in a loan to a third party, for example if the loan has many years to run and the bank wishes to free up capital for new deals. Legal techniques for the transfer of property such as novation, assignment, sub-participation, risk participation can be onerous for lenders in practice, e.g. in terms of serving notice (s. 136 Law of Property Act 1925) or obtaining consents (novation). Shopping around for a transferee may also breach a bank’s duty of confidentiality to its client. *Tournier v National Provincial and Union Bank of England* [1924] 1 KB 461

**Response:** Transfer Certificates were developed in the 1980s and it is now standard to find them appended to the facility agreement. Taking advantage of the concept of the unilateral offer, they simplify the process whereby the loan participation can be transferred to a new lender, though Borrower consent is usually still required. This has facilitated the market in secondary loans, making these positions much more liquid. This also means that new types of participants, such as hedge funds, have become involved in the loan market as transferees.

As to confidentiality, standard drafting gives the borrower’s consent to lenders making disclosures to potential transferees, though the borrower may require confidentiality agreements to be signed by the recipients of its information.

60

#### 4. Common causes of action in the financial markets.

##### The common law relationship of banker-client

- \**Foley v Hill* (1848) 2 HLC 28, 9 ER 1002 (EL)
- \**Tournier v National Provincial & Union Bank of England* [1924] 1 KB 461 (CA)
- \**Turner v Royal Bank of Scotland* [1999] 2 All ER (Comm).
- *Thomas v Triodas Bank* [2017] EWHC 314 (QB)

When borrowers become insolvent or transactions lead to losses not profit, parties may be inclined to sue either their counterparty, or a third party in better financial health. It is common for claimants in this position to launch multiple causes of action, some of which may be based on contract law. For example:

**Misrepresentation, breach of contract, breach of collateral contract claims.** When parties suffer heavy losses in the financial markets they sometimes seek remedies on the basis that they were induced into the contracts by false statements or that contractual terms were breached. For example: *JPMorgan Chase v. Springwell* [2008] EWHC 1186 (Comm) and *Springwell Navigation Corp v JPMorgan Chase and ors* [2010] EWCA (Civ) 1221; *Bankers Trust International PLC v PT Dharmala Sakti Sejahtera* [1995] HC, QBD Comm Ct. In both of these cases investors sought to avoid liability and/or seek damages in relation to investments which (in the first case) suffered heavy losses due to the Russian financial crisis in 1998 and (in the second) were extremely complex and had exposed the investor by way of a swap to \$65million losses because of a rise in interest rates. Both cases saw several different causes of action pleaded. In the first case, Springwell argued (at first instance) "*breach of contract, negligence, breach of fiduciary duty, negligent mis-statement and/or misrepresentation under s.2 of the Misrepresentation Act 1967*". In the second case, the claims included lack of authority, misrepresentation, breach of contract and breach of duty of care. These two cases offer interesting examples of the courts' approach to sophisticated investors in this position; in neither case was the investor successful in its claims.

61

**Suing Agents and Arrangers and other third parties:** When borrowers become insolvent, lenders may seek redress from other parties such as the bank that has arranged the loan, for example claiming misrepresentation or breach of contract. However, Agents and Arrangers now include extensive disclaimer language in the loan agreement itself and in the preliminary documents, which has consistently been found to be effective, eg in *IFE Fund SA v Goldman Sachs International* [2007] EWCA Civ 811.

**Penalty clauses:** Penalty clauses are void in English law: *Dunlop Pneumatic Tyre Co Ltd. v New Garage and Motor Co. Ltd* [1915] A.C. 79; *Makdessi v Cavendish, Parkingeye Ltd v Beavis* [2015] UKSC 67. Parties in the financial markets have tried to argue that various terms of their contracts are 'penal' in nature and therefore void. For example, a bank recently claimed that contractual provisions in the ISDA Master Agreement which allow the early termination and 'close out' of transactions were unenforceable for this reason. However, in this case the court found that there was no realistic prospect of this argument succeeding. *BNP Paribas v Wockhardt EU Operations (Swiss) AG* [2009] EWHC 3116 (Comm) (QBD)

**What appears to be the approach of the English courts when considering these sorts of claims brought by participants in the financial markets?**

**We will also note and contrast the ramifications for the financial markets of decisions such as:**

*Hazell v Hammersmith and Fulham LBC [1990] 2 QB 697; and Haugesund and another v Depfa ACS Bank [2009] All ER (D) 34.*

## 5. Debt finance

### 5.1. Introduction

In the previous section, we defined financial law and explored how contract law underpinned the positions that market participants enter into. The second part of this lecture looks in detail at another area of financial law, namely the law relating to debt finance. In particular, we will focus on loans and bonds. Both these types of debt finance represent important examples of how commercial contract law may work in practice.

The first part of the lecture will cover the background to the topic of debt finance, contrasting debt and equity as means of raising finance and, within debt, contrasting loans and bonds. The second part of the lecture looks at loans, in particular the facility agreement between lender(s) and borrower, in more detail. The final part of the lecture discusses bonds, explains some of the jargon associated with that market and examines the nature of the contracts in place between the different parties involved in a bond issue and in the secondary market.

62

#### **Reading**

##### **(1) Background to debt finance/ loans**

E. Ferran and L. Chan Ho, *Principles of Corporate Finance Law* (Oxford: OUP, 2014) chapter 11, page 270-295. This book is available as an e-book from the LSE library. The LMA's Guide to Syndicated Loans, especially section 3 (Parties to a syndicated loan).

[http://www.lma.eu.com/uploads/files/Introductory\\_Guides/Guide\\_to\\_Par\\_Syndicated\\_Loans.pdf](http://www.lma.eu.com/uploads/files/Introductory_Guides/Guide_to_Par_Syndicated_Loans.pdf)

*Raiffeisen Zentralbank Österreich AG v Royal Bank of Scotland Plc [2010] EWHC 1392 (Comm)* (attempt by a member of syndicate to claim that it had been induced to participate by misrepresentations made by the Arranger bank).

[For more detail on loans (not required for the course) see

L. Gullifer and J. Payne, *Corporate Finance Law: Principles and Policy* (Hart, 2<sup>nd</sup> ed, 2015), section 8.4 or A. McKnight, *The Law of International Finance*, (Oxford: Oxford University Press, 2008) , 3.1-3.14 inclusive and chapter 9 (not 9.2.5) or J. Benjamin, *Financial Law* (OUP, 2007) section 8.1.2 (bank loans) or R. Cranston, *Principles of Banking Law* (OUP, 2002) chapter 11.]

## (2) Bonds:

E. Ferran and L. Chan Ho, *Principles of Corporate Finance Law* (Oxford: OUP, 2014) chapter 15, pages 447-449.

*Bank of New York Mellon v GV Films Ltd* [2009] EWHC 3315. Case about an events of default under bond documentation, which entitled the trustee to accelerate the payment of bonds. The trustee was awarded summary judgment (i.e. judgment without a full trial).

[For further reading on bonds, (not required for the course) see:

L. Gullifer and J. Payne, *Corporate Finance Law: Principles and Policy* (Hart, 2<sup>nd</sup> ed, 2015), section 8.3 or A. McKnight, *The Law of International Finance*, (Oxford: Oxford University Press, 2008), chapter 10, with focus on sections 10.2-10.6 and 10.9. or P. Wood, *The Law and Practice of International Finance: University Edition*, (London: Sweet & Maxwell, 2008), paras 11.01- 11.32 (comparison of loans and bonds)].

63

### 5.2. Background to debt finance

The basic purpose of the financial markets is to match borrowers in need of funds with entities and individuals willing to lend them money on the promise of a return of some kind. When creditors lend capital they are assuming a risk that the borrower will not repay them, but in return they receive (usually) some sort of return, e.g. interest or a dividend.

Companies, governments, banks and public sector bodies all rely heavily on debt finance.

See Table 3 in the document below for data for 2016 ('year to date') setting out the sums raised by companies on the London Stock Exchange's Main Market through issuing equity and debt.<sup>5</sup>

<sup>5</sup> <http://www.londonstockexchange.com/statistics/historic/main-market/factsheet-archive-2016/dec-16.pdf> See table 3.

**Gearing (or leverage)** is the ratio of debt to equity. A higher level of debt than equity is regarded as desirable for companies in the interests of economic growth. However, sometimes gearing can become dangerously high. For example, before the US hedge fund LTCM crashed 1998 its gearing reached 50:1.

### 5.2.1 *Contrasting debt and equity*

- Examples
- Income
- Capital
- Ownership
- Ranking on a winding-up

However, note the convergence between debt and equity in the form of convertible bonds, bonds with warrants and 'equity' tranches of bond issues.

**You are in a position to provide funds to the following. Would you choose debt or equity?**

- A new social media website set up by two undergraduates in London.
- A large UK-based supermarket chain
- A French clothing company which is looking to raise sterling in London in order to expand into the UK.

64

### 5.2.2 *Contrasting loans and bonds*

Loans and bonds are both funded positions and types of debt finance. Some of the contract terms in loans and bonds may look similar, for example both may include a 'negative pledge'. However, legally speaking and otherwise, there are some important distinctions between them:

- Size of the potential investment pool
- Nature of potential investors
- Privacy v publicity
- Documentation
- Listing on a regulated market, e.g. the London Stock Exchange's Main Market.
- Regulatory treatment
- Transferability

### 5.2.3. *Loans*

Bank lending ranges from overdrafts to very large syndicated loans made as part of leveraged buy-outs. Because there is almost no public sector regulation which will protect a lender extending funds to a borrower, any protections need to be

negotiated and included in the contract under which funds are lent. This means that lawyers acting for banks spend a lot of time negotiating, drafting and approving the facility agreement before a deal is signed and the funds drawn down.

### 5.3.1 *Syndicated bank loans*

- Syndicated and bilateral loans. Why might a bank lend as part of a syndicate? What are the advantages for a) the banks and b) the borrower of syndicated as opposed to bilateral lending? What are the possible downsides?
- Role of the Arranger and the Agent in a syndicated loan. Why should a bank take on these roles?
- In a syndicated loan the lenders have ‘several’ liability. Where would this leave the borrower if one of the syndicate became insolvent? What protection does the borrower have if a bank becomes insolvent?
- Different types of loans reflect the needs of different borrowers, for example, term loans and revolving credit facilities.

### 5.3.2 *Facility Agreements*

**The facility agreement is the contract governing how and when the loan will be drawn down and paid back with interest.**

65

- The role of the Loan Markets Association and how documentation is prepared in practice.
- A facility agreement for a syndicated loan to a commercial borrower can be broken down into those parts (1) governing the relationship between the borrower and lenders and (2) other supporting, boilerplate provisions.
- **The borrower/ lenders relationship:**
- Operational provisions e.g. how and when money will be lend and repaid. The rate of interest may be fixed or floating and will usually reference the London Interbank Offer Rate (LIBOR) plus a margin of a certain number of ‘basis points’ (each 0.01%).
- Clauses designed to protect the lenders’ margin.
- Credit risk mitigation. This includes conditions precedents, representations, covenants and events of default (see below).
- **Supporting provisions**
- For example, there will be provisions describing how lenders can transfer their share of the loan to a new lender.
- ***Why might a lender want to transfer its share of the loan? How as a matter of law might a lender transfer its rights and its responsibilities under a contract to another party? Will the borrower have to be informed?***

### 5.3.3 *Events of default*

Events of default are designed to protect the Lenders if something goes wrong, or threatens to go wrong, with the Borrower. On the happening of an event of default, the Lenders immediately have the right to stop lending and demand the drawn down funds back. Absent events of default, the Lenders would have to rely solely on (1) their rights under contract law, for example suing for breach of contract if the Borrower did not pay interest when due, and (2) their rights under insolvency law as creditors. If this is the default position, **why might Lenders seek to improve their position?**

Events of default usually include (amongst others):

- non-payment of sums due under the agreement
- breach of a financial covenant
- breach of the facility agreement
- misrepresentation
- cross-default (which is designed to give the Lenders the same rights as other creditors of the Borrower enjoy under their contracts).
- insolvency
- unlawfulness

The consequences of an event of default are very serious for the Borrower. Usually the Lenders can cancel the Borrower's right to any sums not yet drawn down, declare that the loan plus interest is immediately repayable and/ or put the loan on demand. Notes that a Borrower in default may also lose the right to consent to a transferee to whom a lender may be moving its participation. Moreover, an event of default may trigger cross-default clauses in other contracts which could have devastating effects for the Borrower.

66

***How might an event of default be 'softened' during negotiations, i.e. drafted to give the Borrower breathing space to rectify matters before the Lenders take action.***

## Topic 10: Financial Law (2): Credit and Secured Finance

It is a truth universally acknowledged that creditors who can take security for payment will do so. Security can be resorted to when a debtor defaults, so that the creditor need not line up with unsecured creditors for a small dividend when the debtor goes into (individual) bankruptcy or (corporate) winding-up proceedings. Moreover, security can be enforced before formal insolvency proceedings run their course or even commence.

Security can take broadly two forms. One is personal security, often a personal guarantee. Directors of a company frequently give personal guarantees to a lending bank along with the security over its assets given by the company itself. Banks will often supply performance bonds and similar instruments. The other form of security is proprietary security. Our concern in these two classes lies with this latter form of security.

67

Proprietary security may be granted consensually or it may arise by operation of law (as in the case of equitable and common law liens). These two classes deal with consensual security.

Consensual security in English law takes one of three forms: the pledge, the charge and the mortgage. The distinction between charges and mortgages is largely eliminated in practice. Both are used to take non-possessory security, so that the debtor may continue dealing with its assets in the normal course of business. Pledge, which we need to note only in passing, is a form of possessory security and thus more suited to non-productive assets, like shares and bullion. (A general reference below to security interest includes these three forms of security.)

Although it is not recognised in formal legal terms as security in England, the reservation of title by an unpaid seller serves the same purpose in practical or economic terms. It commonly arises where a seller of goods reserves the so-called right of disposal under section 19 of the Sale of Goods Act 1979 until the buyer pays for the goods. Informal trade credit is frequently extended by sellers to buyers on a 30-60 day credit cycle. The reservation of title clause in a contract of sale gives the seller some protection if the buyer defaults or goes into insolvency proceedings. (Reservation of title is also seen in asset

financing, where a financial institution reserves title to equipment and capital goods under conditional sale, hire purchase or similar transactions, pending payment by instalments over a protracted period.)

**The subjects of these two classes are (a) consensual, proprietary security and (2) reservation of title.**

The central themes of these classes are the following:

- (a) the avoidance of lending risk;
- (b) contractual certainty and autonomy;
- (c) the tension between individual contractual rights and collective rights;
- (d) the existence or not of a fair balance among creditors;
- (e) the roots of security in contract (the role of equity).

## GENERAL REFERENCE

R M Goode, *Legal Problems of Credit and Security* (5th ed by L Gullifer 2013)

RM Goode, *Commercial Law* (4th ed 2010), chs 22-23, 25

H Beale, M Bridge, L Gullifer and E Lomnicka, *The Law of Security and Title-Based Financing* (2<sup>nd</sup> edn, 2012) (particularly chapter 1)

68

For a global survey of English security law for a continental readership, see M Bridge, "The English Law of Security" [2002] *European Review of Private Law* 483.

See also E Ferran, *Principles of Corporate Finance Law* (OUP 2008), ch 12 (pp347-92)

### 1. Security, title reservation and insolvency

The key point about security and reservation of title upon insolvency is that they remove assets from the debtor that would otherwise be distributed amongst all its creditors on a rateable, or *pari passu*, basis. Only property belonging to the bankrupt vests in the trustee-in-bankruptcy. A company liquidator (who will not normally need a vesting order) has powers to deal with the company's property. A seller reserving title to goods, and a creditor taking a security interest in the debtor's goods, therefore stand outside the formal insolvency processes administered by the trustee and the liquidator. This is subject, however, to encroachments made on the rights of secured creditors (and to a lesser extent those reserving title) in insolvency legislation (see below).

Insolvency Act 1986, ss 107, 145(1), 283(1)(a), Sch 4 para (6).

## 2. Freedom of contract between debtor and secured creditor

It is a particularly marked feature of the law governing the creation of security in England that debtor and creditor are free to arrive at their security bargain without considering the effect of this bargain on third parties. A creditor, in fact, can sweep up in its security all of the debtor's assets, thus leaving nothing (apart from statutory intervention: see below) for distribution to unsecured creditors in bankruptcy or corporate liquidation. Public policy is conventionally regarded as having no part to play in English law in regulating the bargain struck between secured creditor and debtor.

Nevertheless, at various intervals in the law, although parties in their contract may strive for a certain effect, their bargain may be recharacterised against their wishes. One such case concerns attempts to avoid the creation of security in the formal legal sense (the reasons for this will appear below). Another concerns the difference between fixed and floating charges (dealt with below). English courts sometimes say they look beyond the form of an agreement to its substance, but what do they mean by this? Is this public policy under another name?

*Re Curtain Dream Plc* [1990] BCLC 925  
*Welsh Development Agency v Exfincos* [1992] BCLC 148

69

Did the draftsman of the documents in *Re Curtain Dream* commit a few slips of the pen which, if avoided, would have led to a different result?

What was the draftsman trying to achieve in *Welsh Development*. Do you agree with the result?

## 3. Reservation of title

Under this head we shall examine the use of title reservation devices to protect the supplier of goods from the risk of non-payment by the buyer. The device employed by sellers in this area is the *Romalpa* clause, which builds upon the provisions of the *Sale of Goods Act 1979*. There is little that is controversial about the reservation of title in the original goods: the real difficulties have been generated by the attempts by sellers, under extended reservation of title clauses, to "reserve" title to the money proceeds of the goods supplied and to the goods manufactured from the goods supplied as well as their money proceeds. After some initial success, the attempt to characterise these extended title clauses as reservation clauses has foundered: they are now consistently regarded by the courts as giving rise to registrable charges. It is quite an impracticable proposition for the great majority of trade suppliers to comply with charge registration requirements in

the Companies Act 2006 (ss 859A *et seq*) so as to perfect their security against other creditors of the buyer.

Title retention, though not formally recognised by the law as security in the proper sense of the word, in fact functions as a security and, in those cases where it works, can be more effective than a security interest. First of all, if a buyer (or a hirer under a hire purchase transaction or a lessee under a financial lease) receives goods the property in which has been retained by the unpaid seller, then the seller's interest will always override any security claimed by a chargee (or mortgagee) who has had dealings with the buyer in the latter's capacity as chargor. The chargee is able to take security only over assets that the buyer has to charge, which excludes goods the property in which has been retained by the seller. It does not matter that the mortgage might have been given before the contract of sale was concluded. Secondly, title retention is cheap and easy to accomplish. It requires no formality and the seller need not comply with registration requirements laid down in the Companies Act 2006 (ss 859A *et seq* (the Bills of Sale Act 1878 (Amendment) Act 1882 for individuals)).

*Clough Mill Ltd v Martin* [1985] 1 WLR 111

*Armour v Thyssen Edelstahlwerke AG* [1991] 2 AC 339

*Tatung (UK) Ltd v Galex Telesure Ltd* [1989] BCC 325

*Re Peachdard Ltd* [1984] Ch 131

PST Energy 7 Shipping LLC v OW Bunker Malta Ltd [2016] UKSC 23; [2016] A.C. 1034 (SC)

70

Sale of Goods Act 1979, ss 17, 18 Rule 5, 19

MG Bridge, *The Sale of Goods* (OUP 3rd edn 2014), paras 3.85-97

Louise Gullifer, “Sales” on Retention of Title Terms: Is the English Law Analysis Broken?’ [2017] Law Quarterly Review 244.

Do you agree with Robert Goff LJ in *Clough Mill* that a properly drafted clause will allow a seller to “reserve” title to new goods manufactured with those supplied by the seller? How might it be done? Do you also agree with him that a seller exercising its rights should, one way or another, have to account for any surplus (over and above the price owed by the buyer) realised after the goods have been repossessed and sold?

Apart from any extended reservation of title clause, do you think that sellers should have the right to trace into the proceeds (new goods or money) deriving from the goods they supplied?

#### 4. Types of consensual security

We shall deal with mortgages and charges. Unlike land, it is still possible to grant a mortgage over personalty, so that title passes to the mortgagee subject to a cesser

on redemption (that is, an automatic reversion to the mortgagor) when the mortgage debt is repaid. The practical difference between a mortgage and a charge is that, at law, a broader range of remedies is available for mortgages than for charges. Drafting practice, however, has eliminated this distinction, as chargees have successfully bargained for the further remedies of mortgagees. Even judges in the House of Lords (Lord Hoffmann, for example) speak of mortgage and charge as though they were the same thing and legislation also follows the same trend (Law of Property Act 1926, s 205(1)(xvi) (mortgage includes a charge); Companies Act 2006, s 861(5) (charge includes a mortgage)).

Whereas a mortgage (of personality) involves a defeasible transfer of ownership to the mortgagee, a charge does not involve a transfer. Instead, it is an encumbrance affecting the property charged until the charged debt has been repaid. A mortgage can be either a legal or an equitable mortgage, but a charge exists only in equity. (Although the common recognised co-ownership, it did not recognise undifferentiated rights in a bulk.)

The existence of a charge depends upon an intention to create a charge. When is that intention present?

*Swiss Bank Corpn v Lloyds Bank Ltd* [1982] AC 584 (read the judgment of Buckley LJ in the Court of Appeal)

*Re Cosslett Contractors Ltd* [1998] Ch 495

71

## 5. Fixed and floating charges

The modern bank debenture (loan instrument) typically recites a series of fixed charges over identified types of property, before concluding with a floating charge that sweeps up all remaining property. Very broadly, a fixed charge requires the specific consent of the chargee if the chargor is to dispose of the charged property. A floating charge involves the grant of an authority by the chargee to the chargor to deal with, and even dispose of, the charged property in the ordinary course of business.

The distinction between a fixed and a floating charge has been a battleground in recent years. At stake, is the position of the chargee bank upon the chargor company's liquidation. If a charge is a floating charge, the chargee has been to a degree expropriated by legislation in favour of certain creditors (preferential creditors) and unsecured creditors (to a limited financial extent). The battle has centred on debts owed to the chargor company by its trading partners, which (like stock-in-trade and work in progress) are part of a company's circulating as opposed to fixed capital. For a time, banks were able to take a fixed charge over the chargor's debts but recent decisions of the

Privy Council and House of Lords mean that such attempts to take a fixed charge will be recharacterised as a floating charge.

*Evans v Rival Granite Quarries Ltd [1910] 2 KB 979*

*Agnew v Inland Revenue Commissioner [2001] 2 AC 710*

*Re Spectrum Plus Ltd [2005] 2 AC 680*

Insolvency Act 1986, ss 29(2), 175, 386 and Sch 6 (as amended by the Enterprise Act 2002) and s 176A and Sched B1 para 65 (both as added by the Enterprise Act 2002)

E Kendrick Goode on *Commercial Law* (4<sup>th</sup> 2010), ch 25

S Worthington, "Floating Charges: The Use and Abuse of Doctrinal Analysis", in J Getzler and J Payne, "Company Charges: *Spectrum* and Beyond" (Oxford University Press 2006), ch 3

What is "crystallisation" of a floating charge and why if at all is it significant?

## 6. Publicity (the Companies Act scheme)

The registration of company charges was introduced in England in 1900. A clear motivation behind the duty to register from the outset was the belief that the concealment of secured credit was an evil calculated to mislead those dealing with the company. Registration was designed for the protection of those doing business with the company so that they might see how much of a company's assets would be available for distribution in an insolvent liquidation. Registration would also do much to clarify the rights of secured creditors if the company debtor went into liquidation, and the rights of those purchasing the company's property, since it would avoid the evils of backdated documents and provide the charge with a badge of authenticity. Registration has also proved useful to those interested in the affairs of the company, such as financial analysts, credit reference agencies and potential investors. Credit reference agencies, in particular, may be seen as substitutes for unsecured creditors in the examination of a company charges register. Major changes were introduced to the registration system with effect from April 2013.

72

Companies Act 2006, ss 859A, 859D-F, 859H-I, 859K-O

The 2013 changes moved from requiring identified types of charge that had to be registered to requiring all charges, with minor exceptions, to be registered. Should they also have required the registration of reservation of title clauses, whether in short-term sales or longer-term finance leases and hire purchase contracts? How reliable is the information available from Companies House about the state of a company's affairs? Note that the instrument of charge is available for public inspection on line.

## 7. Enforcing the security

A defining feature of the English law of security is the way that it permits secured creditors to enforce their security without going to court and without having to await the outcome of

insolvency proceedings. Before changes wrought by the Enterprise Act 2002, this was done by means of the ability, granted by contract, to appoint a so-called administrative receiver. (This right remains for pre-2002 debentures and for designated capital markets and private finance initiative transactions.) The debenture would grant the creditor an irrevocable power of attorney to appoint, in the name of the debtor company, an administrative receiver who was the agent of the company chargor with the primary task of paying down the debenture. (Technically, the company did it to itself.) This same procedure, under another name ("administration" – extended in meaning under the 2002 Act) is still available, though subject to certain checks and balances in the cause of those modern goals, transparency and accountability.

Insolvency Act 1986, s 29(2), Sched B1 (as added by the Enterprise Act 2002) (in outline).

Do you see why banks still need to take floating charges (apart from the recent decisions of the Privy Council and House of Lords on fixed charges over debts)?

73

Should secured creditors have so much control over the enforcement of their security?

## 8. The Future

There have been numerous calls over the last 30-40 years for a thorough reform of the English law of security. Most recently, the Law Commission has issued two consultative documents and a report which, for all practical purposes, are defunct. At the heart of this intensive debate has been the question whether English law should adopt the approach of Article 9 of the American Uniform Commercial Code. The main features of Article 9, for present purposes, are the following. (1) It adopts a functional, rather than a technical legal, definition of security. So reservation of title is treated like security, which affects registration, priority rules (which we do not cover in these lectures) and remedies. (2) It bases priority among competing security interests on (this is a simplification) on the date of registration ("filing", to use the technical expression). (3) Only barebones details of a security interest are filed ("notice filing"), and there is nothing corresponding to the former (English) Registrar's conclusive certificate. There are various reasons for the rejection by the practising profession of these reform proposals, including a sentimental attachment to the floating charge, a belief in the principle that something not broken does not need to be fixed and a genuine concern that reform would have an upsetting

effect on the capital markets, where title-based transactions (such as so-called “repos”) are in common use. The consultative documents and report are worth consulting to gain a fuller understanding of the existing law. For those who are interested, here are the citations:

*Registration of Company Charges: Property other than Land* (Consultation Paper No 164, 2002)

*Company Security Interests* (Consultation Paper No 176, 2004)

*Company Security Interests* (Report No 296, Cm 6654, 2005)

RM Goode, “The Modernisation of Personal Property Security Law” (1984) 100 LQR 234

Secured Transactions Law Reform Project, *STLR Project General Policy Paper*, April 2016:

<https://securedtransactionslawreformproject.org/draft-policy-paper/>

## Topic 11 Sale of Goods (1): Implied Terms & Damages for Defective Goods

This part of the course studies problems arising in sales of goods between businesses. Our focus will be on disputes between buyers and sellers in cases where the buyer is dissatisfied with the seller's performance.

### A. Freedom of Contract and *Caveat Emptor* v Implied Terms (Common Law Principles and Statutory Rules)

M.G. Bridge, 'The Evolution of Modern Sales Law' [1991] Lloyds Maritime and Comparative LQR 52;

Peden, 'Policy Concerns Behind Implication of Terms in Law' (2001) 117 LQR 459.

*Smith v Hughes* (1871) LR 6 QB 597

- Cockburn LJ: *'The general rule, both of law and equity, in respect to concealment, is that mere silence with regard to a material fact, which there is no legal obligation to divulge, will not avoid a contract, although it operate as an injury to the party from whom it is concealed... although a vendor is bound to employ no artifice or disguise for the purpose of concealing defects in the article sold, since that would amount to a positive fraud on the vendee; yet, under the general doctrine of caveat emptor, he is not, ordinarily, bound to disclose every defect of which he may be cognizant, although his silence may operate virtually to deceive the vendee.'*

75

### B. The Seller's Obligations (and Buyer's Rights)

- (i) Sales by Description: Implied Term of Conformity with Description

McKendrick, *Goode on Commercial Law*, 4th edn (Penguin 2010), 317–25

Bridge, *The Sale of Goods*, 3<sup>rd</sup> edn (OUP 2014), 7.04–32

In many sales of goods by reference to written documents, the seller provides a description of the goods. This express term is legally binding like any other express term

of the contract. But the Sale of Goods Act 1979 s. 13 makes special provision about such terms.

#### \*SGA section 13: Sale by Description

*Where there is a contract for the sale of goods by description, there is an implied term that the goods will correspond with the description.*

*(1A) As regards England and Wales and Northern Ireland, the term implied by subsection (1) above is a condition.*

A sale of goods by description (under s.13) occurs where in the terms of the contract descriptive words are used for the purpose of identifying or defining the goods and these terms are relied upon by the buyer. The effect of the application of s.13 is that breach of a descriptive term of the contract always triggers the buyer's right to reject the goods (no matter how minor the breach) – though that effect has now been modified by a new statutory provision SGA s.15A: BBF 594.

\**Arcos Ltd v EA Ronaasen & Son* [1933] AC 470; BBF: 428.

\**Harlingdon & Leinster Enterprises Ltd v Christopher Hull Fine Art Ltd* [1990] 1 All ER 737; BBF: 429

76

*Brewer v Mann* [2012] EWCA Civ 246, [2012] RTR 28.

Further reading: Goode: pp. 290-298.

#### (ii) Implied Terms of Quality

\*Sale of Goods Act 1979, s.14 (as amended). BBF 427

Bridge, 7.35-7.40, 7.60-7.87, 7.88–7.89, 7.96–7.135

Goode, 343–352

**Sale of Goods Act 1979 s.14**

(1) Except as provided by this section and section 15 below and subject to any other enactment, there is no implied term about the quality or fitness for any particular purpose of goods supplied under a contract of sale.

(2) Where the seller sells goods in the course of a business, there is an implied term that the goods supplied under the contract are of satisfactory quality.

(2A) For the purposes of this Act, goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price (if relevant) and all the other relevant circumstances.

(2B) For the purposes of this Act, the quality of the goods includes their state and condition and the following (among others) are in appropriate cases aspects of the quality of the goods -

- fitness for all purposes for which goods of the kind in question are commonly supplied,
- appearance and finish,
- freedom from minor defects,
- safety, and
- durability.

77

2(C) The term implied by subsection (2) above does not extend to any matter making the quality of goods unsatisfactory-

- which is specifically drawn to the buyer's attention before the contract is made,
- where the buyer examines the goods before the contract is made, which that examination ought to reveal, or
- in the case of a contract for sale by sample, which would have been apparent on a reasonable examination of the sample.

(3) Where ...the buyer, expressly or by implication, makes known...to the seller...any particular purpose for which the goods are being bought, there is an implied condition that the goods supplied under the contract are reasonably fit for that purpose...except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the skill or judgment of the seller...

(6)...the terms implied by subsections (2) and (3) are conditions.

\**Slater v. Finning* [1996] 3 All ER 398 [1997] AC 473, HL.

*Kendall v Lillico* [1969] 2 AC 31 (discussed in Bridge, 7.51–7.54)

*Ashington Piggeries v Christopher Hill* [1972] AC 441 (discussed in Bridge, 7.103–7.108)

(iii) Excluding Implied Terms and the Seller's Liability

The SGA 1979 provides that in principle the parties can agree to exclude the statutory implied terms, and the general principle of freedom of contract permits exclusion or limitation of liabilities arising under other express terms. But these principles are all now subject to Unfair Contract Terms Act 1977, ss. 6, 11, 12, Sched 2; BBF: 982, 983, 997, which in effect requires in a commercial contract the exclusion clause to be 'fair and reasonable'. E.g. *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 2 AC 803, [1983] 2 All ER 737, HL: BBF: 1000

**C. The Buyer's Remedies: Damages for Defective Goods**

If the seller is in breach of the contract of sale by having supplied sub-standard goods, what remedies are available to the buyer? In the next lecture, we will consider the buyer's ability to reject the goods. If the buyer does not reject the goods or is unable to do so, how should the damages be calculated? In a commercial context, should the damages always include 'loss of profits', or should some losses of this kind be regarded as too remote? What is the purpose of the doctrine of 'remoteness in the law of damages'? Do the legal sanctions for breach of contract in this context provide adequate incentives for the seller to conform to the expected quality standard?

78

Bridge, paras 12-98-102

**Sale of Goods Act 1979 s. 53. Remedy for Breach of Warranty**

*(1) Where there is a breach of warranty by the seller, or where the buyer elects (or is compelled) to treat any breach of a condition on the part of the seller as a breach of warranty, the buyer is not by reason only of such breach of warranty entitled to reject the goods; but he may—*

- *(a) set up against the seller the breach of warranty in diminution or extinction of the price, or*
- *(b) maintain an action against the seller for damages for the breach of warranty.*

(2) The measure of damages for breach of warranty is the estimated loss directly and naturally resulting, in the ordinary course of events, from the breach of warranty.

(3) In the case of breach of warranty of quality such loss is *prima facie* the difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had fulfilled the warranty.

(4) The fact that the buyer has set up the breach of warranty in diminution or extinction of the price does not prevent him from maintaining an action for the same breach of warranty if he has suffered further damage.

\**Slater v Hoyle & Smith Ltd* [1920] 2 KB 11, CA. BBF 654

\**Bence Graphics International Ltd v Fasson UK Ltd* [1997] 1 All ER 979, CA, BBF 657.: restriction on recovery for difference in value if no actual loss due to successful resales.

Does the law provide sufficient incentives to perform contracts and conform to quality standards in sales? Is the law in fact aimed at encouraging efficient breach of quality standards?

#### Questions for Class Discussion:

79

1. Does the requirement that goods be of satisfactory quality mean that they must be free from defect?
  2. Are goods unsatisfactory if they are below average in quality?
1. Heuristic Devices plc is a manufacturer of widgets. Advise it in respect of its liability under the following two contracts:
- (i) Heuristic agrees to sell 20,000 widgets to Jetson plc, delivery as required by Jetson but no later than three months after the contract date, which is July 1. On August 15, on a rising market, Heuristic advises Jetson by letter that it has no intention of performing the contract. Jetson takes no action in response to this letter but, on 2 October, it issues proceedings against Heuristic claiming damages.
  - (ii) Heuristic supplies 10,000 widgets to Turbo plc on March 1. The widgets are all defective and Heuristic is in breach of its obligations under s 14(2) and s 14(3) of the Sale of Goods Act. Turbo uses the widgets in its manufacturing process to make atomic smashers. Some of these atomic smashers are bought by Rutherford plc, which suffers extensive losses of profit when they break

down in service. This breakdown is due to the defective widget components in the atomic smashers. Rutherford complains about the atomic smashers to Turbo on May 1 and is threatening legal proceedings.

3. Do you agree with the result in *Bence Graphics*? Can you think of a principled way of reaching the opposite result?

## Topic 12 Sales of Goods (2): Termination and Acceptance

### A. General Law Governing Termination of Contracts

Chen-Wishart, Chapter 12

Bridge, 10.01–43

Goode, 137–43, 305–09

\**Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26, [1962] 1 All ER 474, CA; BBF 563.

\**Bunge Corp v Tradax Export SA* [1981] 2 All ER 513, HL. BBF: 571

*Schuler AG v Wickman Machine Tools* [1974] AC 235, [1973] 2 All ER 39, HL. BBF: 409, 595.

Under the general law of contract, a party may only terminate a contract for a serious breach of contract, sometimes called a fundamental breach or a repudiatory breach.

The general test for whether or not a breach is serious looks at the effects of the breach on the injured party. The question is 'does the occurrence of the event deprive the party who has further undertakings still to perform of substantially the whole benefit which was the intention of the parties as expressed in the contract that he should obtain as the consideration for performing those undertakings?' (Lord Diplock: *Hong Kong Fir v KKK*). 81

In their contract, however, the parties may specify that breach of a particular term should entitle the other party to terminate the contract.

Certain phrases have conventionally been regarded as indicating that breach of a term amounts to a fundamental breach eg 'time of the essence'; 'condition'. time clauses for delivery of goods in *Bunge v. Tradax*, even though the breach may cause no loss whatsoever.

Should the courts always respect such terms? In *Schuler v Wickman Tools* the court treats breach of a term labelled as a 'condition' as not giving a right to terminate. Does this destroy the one possible beneficial use of the distinction between conditions and warranties (ie the saving of transaction costs)?

## B. Termination, Conditions, and Warranties under the Sale of Goods Act.

Goode, 367–90

Bridge, 10.44–79 & 10.129–140

A buyer who terminates a contract for the seller's breach is usually described as having 'rejected' the goods. The right to reject the goods arises normally either for breach of s.13 implied term (lack of conformity with express terms of description) or s.14 implied terms. These implied terms are described as 'conditions' and under the statutory scheme, breach of condition gives rise to the right to rejection.

This statutory scheme sometimes creates the problem that the buyer rejects for breach of condition when the effects of breach are not especially significant. Compare:

*Arcos Ltd v EA Ronaasen & Son* [1933] AC 470; BBF: 428.

\**Cehave NV v Bremer Handelsgesellschaft mbH, The Hansa Nord* [1975] 3 All ER 739, CA BBF: 566

\* SGA 1979 s.15A: BBF 594. This provision – added in response to concerns that the Sale of Goods Act was too generous in giving rejection rights to buyers – states that a breach of condition under ss.13 and 14 will not be regarded as giving the right to reject the goods if 'the breach is so slight that it would be unreasonable' for the buyer to reject.

82

### SGA s. 15A.— Modification of remedies for breach of condition in non-consumer cases.

(1) *Where in the case of a contract of sale—*

- *(a) the buyer would, apart from this subsection, have the right to reject goods by reason of a breach on the part of the seller of a term implied by section 13, 14 or 15 above, but*
- *(b) the breach is so slight that it would be unreasonable for him to reject them,*

*then, if the buyer does not deal as consumer, the breach is not to be treated as a breach of condition but may be treated as a breach of warranty.*

(2) *This section applies unless a contrary intention appears in, or is to be implied from, the contract.*

(3) *It is for the seller to show that a breach fell within subsection (1)(b) above.*

### C. Rejection and Acceptance

The right to reject goods confers a power on the buyer. The buyer may choose to accept the goods if it prefers to do so. Under the Sale of Goods Act 1979 s. 11(2); BBF 560, the buyer may 'elect to treat the breach of the condition as a breach of warranty and not as a ground for treating the contract as repudiated.' Difficult questions arise when the buyer has not explicitly chosen to give up the right to reject, but has not immediately rejected them either. When can a buyer be said to have 'accepted' goods such that it loses the right to reject?

#### SGA s.35

- (1) *The buyer is deemed to have accepted the goods subject to subsection (2) below*
- *(a) when he intimates to the seller that he has accepted them, or*
  - *(b) when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller.*
- (2) *Where the goods are delivered to the buyer, and he has not previously examined them, he is not deemed to have accepted them under subsection (1) above until he has had a reasonable opportunity of examining them for the purpose-*
- *(a) of ascertaining whether they are in conformity with the contract...*

83

The right to reject the goods is typically lost by (a) doing something inconsistent with the ownership of the seller (eg eating them, using them, selling them), or (b) lapse of reasonable time. Asking for 'repair of goods' or reselling the goods, however, are not necessarily regarded as 'acceptance' (s.35(6)). It is possible to accept the part of the goods which reach the quality standard and reject the remainder, but all the satisfactory goods are then deemed to have been accepted (s. 35A).

#### SGA s.30

- (1) *Where the seller delivers to the buyer a quantity of goods less than he contract to sell, the buyer may reject them, but if the buyer accepts the goods so delivered he must pay for them at the contract rate.*
- (2A) *A buyer who does not deal as consumer may not - (a) where the seller delivers a quantity of goods less than he contracted to sell, reject the goods under subsection (1) above ...if the shortfall ... is so slight that it would be unreasonable for him to do so.*

## Questions for Class Discussion

1. What is the problem with being too generous with the right to terminate sale of goods contracts? What is the problem with being insufficiently generous?
2. How effective, in your opinion, is section 15A of the Sale of Goods Act 1979 in controlling excessive use of the right to terminate a contract?
3. Under what circumstances will a buyer be found to have lost the right to terminate a sale of goods contract?

84

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