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COVID-19 and the Common Law I: English Contract Law

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COVID-19 and the Common Law I

English Contract Law:

- Formation
- Interpretation / Implication of Terms
- Variation / Rectification
- Frustration

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Preliminary question – English law is often preferred because it provides certainty to the parties. But how certain can it really be if appellate judges have to repeatedly restate what the law is?

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FORMATION

Mr Ivanov and Mr Borisov are friends and successful businessmen. They go for dinner together at an expensive restaurant in London where they drink wine and tell stories. Before the coffee, Mr Borisov's tone changes. He tells Mr Ivanov that because of Covid-19 his business is short of cash at the moment and asks if his friend can help him out.

"Of course my dear Borisov!" comes the reply. How much do you need"

"Oh, say $3.5m?"

""Not a problem my friend!"

They reach for a menu and sketch the repayment terms on the back: (1) Quarterly repayments; (2) year term; (3) 3% interest.

Later, they drink brandies and toast their friendship. Mr Borisov picks up the menu, puts it in his jacket pocket, and bids his friend good night. Mr Ivanov wakes up the next morning with a horrible headache and a text message from his friend asking that the money be paid into his bank account within the next 24 hours.

- Is there a valid contract?

- Can Mr Borisov seek performance? What defences (if any) does Mr Ivanov have?

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FORMATION

- What are formality requirements for a valid contract under English law?

- *MacInnes v Gross* [2017] EWHC 46 (QB) at [81]. Starting point is that:

  "A contract can be made anywhere, in any circumstances."

- See also Lord Clarke on contractual formation in *RTS Ltd v Molkerei Alois Muller GmbH and Co KG* [2010] UKSC 14; [2010] 1WLR 753;

  "45. The general principles are not in doubt. Whether there is a binding contract between the parties and, if so, upon what terms depends upon what they have agreed. It depends not upon their subjective state of mind, but upon a consideration of what was communicated between them by words or conduct, and whether that leads objectively to a conclusion that they intended to create legal relations and had agreed upon all the terms which they regarded or the law requires as essential for the formation of legally binding relations. Even if certain terms of economic or other significance to the parties have not been finalised, an objective appraisal of their words and conduct may lead to the conclusion that they did not intend agreement of such terms to be a pre-condition to a concluded and legally binding agreement."

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FORMATION

- Abstract statements of principle are fine, but how do we apply them here?
- Let's look at the case of Mr Blue and Mr Ashley…

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THE TIMES

Mike Ashley: Sports Direct boss 'drank 12 pints and vomited at meeting'

Deirdre Hipwell, Retail Editor

Tuesday July 04 2017, 12.01am BST, The Times

Mike Ashley "took naps under the tables in meetings if he grew bored"
SIMON ASHTON

The sportswear tycoon and Newcastle United owner Mike Ashley vomited into a pub fireplace during a management meeting in which he drank 12 pints with vodka chasers, according to a finance expert's statement made public in the High Court yesterday.

Jeffrey Blue, a former investment banker, is suing the billionaire retailer over a contested agreement allegedly struck during a drinking session in 2013. Mr Blue, who claims that Mr Ashley promised him £15 million to raise the share price of his Sports Direct chain from £4 to £8, said meetings of senior management were often held in informal settings, such as the Green Dragon pub in Alfreton, Derbyshire.

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FORMATION

- Case reported at *Blue v Ashley (Rev 1)* [2017] EWHC 1928 (Comm):

  "The question in this case is whether, as a result of a conversation in the Horse & Groom public house in Great Portland Street, London W1, on the evening of 24 January 2013, a contract was made between the claimant, Mr Jeffrey Blue, and the defendant, Mr Michael Ashley, under which Mr Ashley owes Mr Blue £14 million."

- Background facts of "agreement" set out at [10] to [18]

- Good review of law as to contractual formation at [49] to [62], objective intention vs subjective belief at [63] and [64]

- No contract as no intention to create legal relations…

- But what about Messrs Ivanov and Borisov?

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FORMATION

Key points:

1. Few formality requirements as a matter of English law.

2. But context is important to determining whether there was an intention to create legal relations, see for e.g. *MacInnes v Gross* [2017] EWHC 46 (QB) at [77] and [78]

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INTERPRETATION / IMPLICATION OF TERMS

- Rewind to the restaurant: Mr Borisov and Mr Ivanov are having dinner.

- Assume that they agreed a loan, but this time they got their lawyers to draft a detailed loan agreement between two businesses, BB (Cyprus) Ltd and II Holdings Ltd, of which Borisov and Ivanov respectively are the ultimate beneficial owners.

- One clause contains a provision that BB will be in default, and II will be entitled to sue for the whole debt, if more than 14 days elapses after a payment is due and the payment is not made.

- However, the clause further provides that BB **will not be in default** in circumstances where it fails to make a payment in order to comply with a mandatory provision of law.

- Some months after the loan is agreed, and after repayments commence, Mr Ivanov is added to the list of Specially Designated Nationals list as part of the US sanctions regime.

- Mr Borisov's business is still suffering as a result of Covid-19 and he wants to know if he can stop repaying the loan as this will help his cash flow.

- Can he?

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INTERPRETATION / IMPLICATION OF TERMS

- Most recent Supreme Court case on contractual interpretation, *Wood v Capita Insurance Services Ltd* [2017] UKSC 24. There it was argued that the Supreme Court in an earlier case *Arnold v Britton* [2015] AC 1619 had "rowed back" from the guidance on contractual interpretation given by the Supreme Court in *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900

- Lord Hodge (giving judgment of the Court) was not moved:

  "The recent history of the common law of contractual interpretation is one of continuity rather than change."

- But is that true? The judge's themselves are not convinced…

- Lord Sumption's Harris Society Lecture, May 2017: time to reassert *"the primacy of language"*, *Wood v Capita* indicates *"new direction of travel"*

- Sir Geoffrey Vos (Chancellor of the High Court):

  (1) *"Contractual Interpretation: Do judges sometime say one thing and do another?"* [2018] Canterbury Law Review 1

  (2) Chancery Bar Association Lecture, April 2018, [42]*ff: Wood v Capita* was *"somewhat surprising"* in stating that the law had not changed.

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INTERPRETATION / IMPLICATION OF TERMS

- So how do we actually interpret contracts?

- Best guidance is that laid out by Lord Neuberger in *Arnold v Britton* [2015] AC 1619 at [15]:

> *"When interpreting a written contract, the court is concerned to identify the intention of the parties by reference to "what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean", to quote Lord Hoffmann in Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38, [2009] 1 AC 1101, para 14. And it does so by focussing on the meaning of the relevant words, in this case clause 3(2) of each of the 25 leases, in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions."*

- In essence, look to the words in their context…

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INTERPRETATION / IMPLICATION OF TERMS

- Back to Borisov and Ivanov…
- Basis to refuse payment and not default?
- Similar to recent case of *Lamesa Investments Ltd v Cynergy Bank Ltd* [2019] EWHC 1877 (Comm)
- Relevant background at [2] to [9]
- Law at [12]
- Judge's approach to interpretation at [15]*ff*
- Cynergy entitled to withhold payment and would not be in default.

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INTERPRETATION / IMPLICATION OF TERMS

- What if no term like in *Lamesa*? Could Borisov argue that there was an implied term he could avoid payment?
- Again, there has been a tension as between what the basis of implying terms is – is it part of interpretation process or separate to it?
- See Lord Neuberger lecture, August 2016 to School of Law at Singapore Management University at [21] to [31].
- See also Lord Sumption Harris lecture.
- Leading case now *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd & Anor (Rev 1)* [2015] UKSC 72
- Test set out at [14] to [32], in particular at [21]…

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VARIATION / RECTIFICATION

- Returning to the restaurant...
- Let's now assume there is now a pre-existing loan, and the meeting at the restaurant instead involves Mr Borisov seeking to change the terms to reduce his payment amounts and extend the term.
- The notes on the menu therefore record what Mr Borisov and Mr Ivanov understand as the variation to the loan agreement.
- Mr Ivanov again wakes up with a headache – too much brandy! He regrets the variation as II is also short of cash and wants to get out of it. Can he? Does it matter whether there is a clause that requires variations to be signed by the parties and agreed in writing?
- Borisov is not happy with Ivanov's change of position. He states that what was on the menu was in fact what was always agreed. He wants to change the loan agreements to reflect that the notes on the menu were always the terms of the loan. Can he?

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VARIATION / RECTIFICATION

- Variation – leading case is *Rock Advertising Ltd v MWB Business Exchange Centres Ltd* [2018] UKSC 24. Lord Sumption

> *"10. In my opinion the law should and does give effect to a contractual provision requiring specified formalities to be observed for a variation.*
>
> *[…]*
>
> *16. The enforcement of No Oral Modification clauses carries with it the risk that a party may act on the contract as varied, for example by performing it, and then find itself unable to enforce it. It will be recalled that both the Vienna Convention and the UNIDROIT model code qualify the principle that effect is given to No Oral Modification clauses, by stating that a party may be precluded by his conduct from relying on such a provision to the extent that the other party has relied (or reasonably relied) on that conduct. In some legal systems this result would follow from the concepts of contractual good faith or abuse of rights. In England, the safeguard against injustice lies in the various doctrines of estoppel. This is not the place to explore the circumstances in which a person can be estopped from relying on a contractual provision laying down conditions for the formal validity of a variation. The courts below rightly held that the minimal steps taken by Rock Advertising were not enough to support any estoppel defences. I would merely point out that the scope of estoppel cannot be so broad as to destroy the whole advantage of certainty for which the parties stipulated when they agreed upon terms including the No Oral Modification clause. At the very least, (i) there would have to be some words or conduct unequivocally representing that the variation was valid notwithstanding its informality; and (ii) something more would be required for this purpose than the informal promise itself..."*

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VARIATION / RECTIFICATION

- Rectification, see Lord Neuberger lecture, August 2016 to School of Law at Singapore Management University at [32] to [39]. Very high threshold.

- There is a view that Lord Hoffmann in *Rainy Sky* and *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38 blurred the lines as between interpretation, implication and rectification.

- Court of Appeal in *FSHC Group Holdings Ltd v Glas Trust Corporation Ltd (Rev 1)* [2019] EWCA Civ 1361 recognises uncertainty and unsatisfactory nature of law as it stands.

- Very long review of the law at [46] to [175].

- Test stated at [176]. In order to establish a claim for rectification, a party must prove that the document failed to give effect to either:

  (1) a prior concluded contract, in which case the terms of the prior contract must be objectively determined; or

  (2) a common intention shared by (and communicated between) the parties, such that it can be shown that as a result of the communication between them, the parties understood each other to share the common intention.

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FRUSTRATION

- Finally, Covid-19 has caused BB to shut down its business. It has no income at the moment and cannot service its debt to II.
- Is there any scope to say that it is impossible for II to perform the loan agreement any more?
- Frustration as a matter of English law is also very hard to prove – and the remedy not necessarily desirable.
- Basis for frustration:

  (1) Destruction of subject matter

  (2) Supervening illegality

  (3) Incapacity / death

  (4) Delay

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QUESTIONS?

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