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Recent contract law developments

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Today’s speakers

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Improving your contract drafting

Blue Pencil Test

CASE: *Egon Zehnder Ltd v Tillman [2019] UKSC 32 (Supreme Court)*

BACKGROUND LAW:

- A restrictive covenant will be void for being in restraint of trade unless the employer has a legitimate proprietary interest to protect and the protection sought is no more than is reasonable having regard to the interests of the parties and the public interest

- In assessing the reasonableness of a non-compete restriction, the court should consider whether some lesser form of protection, such as non-solicitation, non-dealing or confidentiality provisions, would give adequate protection

KEY ISSUES:

- If one part of a restrictive covenant is unenforceable does it taint the rest of the clause and make it wholly unenforceable?

- Can a tainted clause be severed, using the so-called “Blue Pencil Test "?

- Do the words "*interested in*" prohibit any shareholding in a company, rendering them an unreasonably wide restraint of trade?

Blue Pencil Test

KEY FACTS:

- Egon Zehnder employed a business executive, Ms Tillman, pursuant to a written agreement
- Ms Tillman was rapidly promoted
- Following the termination of her employment with Egon Zehnder wanted to become employed by a firm whose business is in competition with that of Egon Zehnder
- Egon Zehnder contended that her proposed employment would breach a restrictive post-termination covenant in her employment agreement with Egon Zehnder
- There was no dispute that she was bound by the non-solicitation, non-dealing and confidentiality terms in her contract, **BUT,** Ms Tillman answered that the covenant, in its entirety, is void at common law because part of it is in unreasonable restraint of trade

Blue Pencil Test

The Disputed Restrictive Covenants:

CLAUSE 4.5 (during employment restriction)	CLAUSE 13 (post-termination restriction)
"*You shall not, during the course of your employment, directly or indirectly, hold or have any interest in, any shares or other securities in any company whose business is carried on in competition with any business of the Company or any Group Company, except that you may hold or have an interest in, for investment only, shares or other securities in a publicly quoted company of up to a maximum of 5 per cent of the total equity in issue of that company*" *Compare with clause 13.2.3 which is much wider in scope.	"13.2 *You shall not without the prior written consent of the Company directly or indirectly, either alone or jointly with or on behalf of any third party and whether as principal, manager, employee, contractor, consultant, agent or otherwise howsoever at any time within the period of six months from the Termination Date: […]*" "13.2.3 *directly or indirectly engage or be concerned or interested in any business carried on in competition with any of the businesses of the Company or any Group Company which were carried on at the Termination Date or during the period of twelve months prior to that date and with which you were materially concerned during such period.*" "13.4 *If any of the restrictions or obligations contained in this clause 13 is held not to be valid as going beyond what is reasonable for the protection of the goodwill and interest of the Company … but would be valid if part of the wording were deleted, then such restriction or obligation shall apply with such modifications as may be necessary to make it enforceable.*"

Blue Pencil Test

JUDGMENT:

- **The offending words, "[…] interested in" were unreasonably wide, BUT they could be severed from the rest of the covenant (which were reasonable and enforceable)**
- **Overruled Attwood (Attwood v Lamont [1920] 3 KB 571):** The Court of Appeal held that severance can only take place where there are several distinct covenants:

  "The learned judges of the Divisional Court, I think, took the view that such severance always was permissible when it could be effectively accomplished by the action of a blue pencil. I do not agree. The doctrine of severance has not, I think, gone further than to make it permissible in a case where the covenant is not really a single covenant but is in effect a combination of several distinct covenants. In that case and where the severance can be carried out without the addition or alteration of a word, it is permissible. But in that case only." (Younger LJ, at page 593)

- **Approved Beckett (Beckett Investment Management Group Ltd v Hall [2007] EWCA Civ 61):**
  - **First:** the so-called **"blue pencil"** test must be applied: the unenforceable provision must be capable of being removed without the necessity of adding to or modifying the wording which remains; and
  - **Second:** the remaining terms (after the offending words have been severed) must continue to be supported by adequate consideration; and
  - **Third:** the removal of the offending provision must not generate any major change in the overall effect of all the post-employment restraints in the contract.

DRAFTING TIPS

- Avoid broad phrases other than as a sweeper
- Update restrictive covenants to reflect changing circumstances if practical
- Draft to allow for severance

Force Majeure

CASE: *Classic Maritime Inc v Limbungan Makmur SDN BHD& Anor [2019] EWCA Civ 1102 (Court of Appeal)*

BACKGROUND LAW:

- *Force majeure* clauses will be interpreted according to the language used rather than the parties' intention

- The extent to which an event must make contractual performance impossible for a claim to succeed depends on how the clause is drafted

- The **position has been** that, in the case of *force majeure* clauses, there is **no requirement for an intervening event to be the sole cause for failing to perform**, i.e. "but for" the intervening event, performance under the contract would have taken place

- **However**, given the judgment in *Seadrill Ghana Operations Limited v Tullow Ghana Limited [2018] EWHC 1640 Comm*, is this still the case?

Force Majeure

KEY FACTS:

- Long-term contract between Classic Maritime (shipowner) and Limbungan Makmur (charterer) – Limbungan chartered Classic Maritime's ships to ship iron from Brazil to Malaysia. Contractual force majeure/exceptions clause was:
  - *"Neither the vessel, her master or owners, nor the charterers, shippers or receivers shall be responsible for loss or damage to, or failure to supply, load, discharge or deliver the cargo resulting from accidents at the mine or production facility or any other causes beyond the owners', charterers', shippers' or receivers' control; always provided that any such events directly affect the performance of either party under this charterparty."*

- Two Brazilian suppliers of iron, Vale and Samarco. A burst dam at their plant rendered Samarco unable to supply iron. Following the dam burst, Vale refused to continue supplying iron

- Limbungan claimed force majeure under the contract, stating that the burst dam had rendered it impossible for it to continue shipping iron to Malaysia; Classic Maritime claimed that Limbungan remained liable under the contract, because had the dam not burst, Limbungan would not have been either willing or able to perform their contractual obligation for the supply of iron, and therefore Classic was entitled to substantive damages

Force Majeure

FIRST INSTANCE:

LIABILITY:

- At first instance, Teare J in the High Court found that Limbungan could not rely on the *force majeure* clause. To rely on the clause, the charterer had to show that "but for" the dam bursting, it could and would have performed under the contract

- Even if the dam had not burst, Limbungan would not have been either willing or able to deliver the cargoes of iron

DAMAGES:

- Teare J ruled however that Classic Maritime was not entitled to substantial compensatory damages because the burst dam meant that the cargoes would not in any case have been delivered, and as a result, substantial damages would render Classic in a better off position than it would otherwise have been.

Force Majeure

C OURT OF APPEAL:

LIABILITY:

- "*Undoubtedly the question is one of construction of clause 32 in this contract, and the answer to that question* ***is determined by the language of the clause*** *which the parties have chosen, having regard to the* ***context*** *and* ***purpose*** *of the clause.*" (Males LJ, paragraph 32)

- Lord Justice Males did not consider past case law dealing with causation, such as *Bremer Handels GmbH v Vanden-Avenne Izegem PVBA [1978]* to be relevant – such cases concerned "*differently drafted*" clauses to the provision in the contract between Classic Maritime and Limbungan (paragraph 37)

- The clause included a "but for" test in the way that it was constructed, and only excused non-performance under the contract if Limbungan could prove that, but for the dam bursting, the delivery of the iron cargo to Malaysia would have taken place.

Force Majeure

COURT OF APPEAL:

DAMAGES:

- *Robinson v Harman (1848) 1 Exch 850*
  - *"The rule of the common law is, where a party sustains a loss by reason of the common law, by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed."*

- The breach was not Limbungan's unwillingness to supply the cargo, but the fact that they failed to do so. As a result, given that Limbungan could not rely on the force majeure clause the appropriate level of compensation was to place Classic Maritime in the position it would have been in had the contract been performed

- *"If the shipper cannot rely on clause 32 to avoid liability for breach, he cannot rely on it either to reduce the value of the shipowner's contractual rights flowing from the breach."* (Rose LJ, paragraph 93)

Force Majeure

PRACTICAL IMPLICATIONS

- **A force majeure clause will be construed as it is drafted, and it will not be construed according to its title**

- **Use of causative language e.g. "caused by", "resulting from" will require a direct causal link and the application of the "but for" test which must be satisfied for the clause to apply – irrespective of whether it is a force majeure clause or an "exceptions clause"**

Law Governing Arbitration Agreements

CASE: *Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait) [2020] EWCA Civ 6 (Court of Appeal)*

BACKGROUND LAW: Doctrine of separability

- The law governing the **seat of arbitration**, the **overall contract** and the **arbitration agreement** can be different from each other
- If law of seat and governing law of overall contract are express but different, may lead to dispute about which law governs the arbitration agreement. In such cases, three-stage test is applied, set out in *Sulamerica CIA Nacional de Seguros SA v Enesa Engenharia SA [2012] EWCA Civ 638*:

    1. Did the parties expressly choose the proper law of the arbitration agreement?
    2. Did the parties make an implied choice of the proper law of the arbitration agreement? The starting point to address this question is that unless there are reasons to depart from it, the choice of substantive law ought to be an implied choice of proper law of the arbitration agreement
    3. In the absence of an express or implied choice by the parties, what is the system of law with the closest and most real connection with the arbitration agreement?

Law Governing Arbitration Agreements

KEY ISSUES:

- Absent any express provision, what is the appropriate method for determining the governing law of an arbitration agreement?

- In what circumstances should the governing law of a contract also govern the law of an arbitration agreement?

- What is the effect of the construction of relevant provisions in the contract on how the governing law of an arbitration agreement should be determined (absent any express provision)?

Law Governing Arbitration Agreements

KEY FACTS:

- In 2001, Kabab-JI SAL (a Lebanese company) entered into a franchise development agreement with Al Homaizi Foodstuff Company (a Kuwaiti company) which was the licensee under the FDA. Al Homaizi became a subsidiary of a Kout Food Group in 2005

- The contract provided for arbitration seated in Paris but did not specifically stipulate the governing law of the arbitration agreement. It contained a trio of relevant provisions:
  - a governing law clause providing that "*This Agreement shall be governed by and construed in accordance with the laws of England*";
  - general provisions as to its interpretation: "*This Agreement consists of… the terms of agreement set forth herein below… It shall be construed as a whole*"; and
  - a provision stating that "*The arbitrator(s) shall apply the provisions contained in the Agreement*"

- Arbitral award issued in Paris in September 2017 – the award creditor obtained permission to enforce in England, but the debtor challenged, stating that the creditor had never become party to the agreement.

Law Governing Arbitration Agreements

COMMERCIAL COURT JUDGMENT:

- On 21 December 2017, Kabab Ji issued enforcement proceedings in the Commercial Court in London. On 7 February 2018, Popplewell J made **an order *ex parte* for the Award to be enforced** as a judgment. However on 1 March 2018, Kout Food applied for the Order to be overturned

- Sir Michael Burton in the Commercial Court concluded that there had been an **express choice of English law as proper law of the arbitration agreement** on the clear construction of the provisions. He also determined that Kout Food did not become a party to the arbitration agreement but declined to make a final determination on this point and adjourned the matter until after the decision of the Cour d'Appel de Paris

Law Governing Arbitration Agreements

COURT OF APPEAL JUDGMENT :

- According to the construction of the provision, English law was the proper law of the arbitration agreement

- **Flaux LJ:** the **purpose** of the doctrine of separability is to ensure that the chosen dispute resolution procedure survives the main agreement becoming unenforceable due to factors such as misrepresentation or fraud:
  - *"As Moore-Bick LJ said in* Sulamerica *at [26]: "Its purpose is to give legal effect to that intention, not to insulate the arbitration agreement from the substantive contract for all purposes." In other words, it does not preclude the arbitration agreement being construed with the remainder of the agreement as a whole, a fortiori where the clear intention is that the main agreement should be construed as a whole and where, as here,* ***there is nothing in the wording of the arbitration agreement which suggests that it is intended to be construed in isolation from the remainder of the main agreement***" (paragraph 66)

Law Governing Arbitration Agreements

PRACTICAL IMPLICATIONS

- It is advisable expressly to stipulate the law applicable to the arbitration agreement
- The law that is chosen may depend on the specific circumstances of the transaction/contract, with the obvious choices are to make the law governing the arbitration agreement consistent with the law:
  - Governing the underlying transaction/contract We recommend including wording in the governing law clause as follows: "This agreement, including the arbitration agreement contained within it, and any dispute or claim arising out of or in connection with it or its subject matter or formation (including all non-contractual disputes or claims) shall be governed by and construed in accordance with the law of [insert law of the transaction/contract]."); or
  - Of the seat of arbitration (if different from the contract law). We recommend including the reference to the law governing the arbitration agreement in the arbitration agreement itself, separately from and notwithstanding the governing law of the contract (i.e. wording to the effect that " This arbitration agreement shall be governed by and construed in accordance with the law of [insert law of the seat of arbitration]."

Improving your contract conduct and management

Good Faith

CASE: *TAQA Bratani Ltd v Rockrose UKCS8 LLC [2020] EWHC 58 (Comm) (High Court)*

BACKGROUND LAW:

- Historically, there is no implied "good faith" obligation under English law, however:
  - *Yam Seng Pte Limited v International Trade Corporation Limited [2013] EWHC 111 (QB)* - "relational contracts" between parties
  - *Braganza v BP Shipping [2015] UKSC 17* – "*duty of* rationality", defined as the exercise of contractual discretion in good faith, in a way which is not "*arbitrary or capricious*".

Good Faith

KEY ISSUES:

- Under English law, is there an implied duty of "good faith" which applies to the exercising of termination rights under a contract?

- Do long-term "relational contracts" automatically give rise to "good faith" obligations between parties?

- Does the *Braganza* duty of rationality apply?

Good Faith

KEY FACTS:

- The parties operated the Brae Fields as a joint venture - five oil and gas field blocks in the North Sea, under a number of Joint Operating Agreements. Under the JOAs, the operator (one JV party) could be removed following a majority vote by the operating committee supervising its activities, giving 90 days' notice

- Following serious concerns that the defendant (the operator) was not able to perform its role, the claimants unanimously voted to remove the defendant as operator, replacing them with the first claimant

- The defendant was given 365 days' notice of termination of its role as operator

- The defendant argued that the claimants were under an implied obligation to act in "good faith"

Good Faith

JUDGMENT:

- The claimants had complied with their contractual requirements

- There was no implied term of "good faith" (arising out of the contract between the parties) or express provisions in the contract which qualified this or placed any additional requirements on the claimants as part of the termination procedure – the drafting was clear and unambiguous

- Despite the parties collaborating in a joint venture – the parties had expressly agreed not to act as a partnership

- HH Judge Pelling QC: "*the starting point and in all probability the end point in the construction exercise will be (a) the* ***natural and ordinary meaning*** *of the provision construed (b)* ***any other relevant provisions*** *of the contract being construed and (c) the* ***overall purpose of the provision being construed*** *and the contract in which it is contained.*" (paragraph 33)

- Given the construction of the agreements, and the agreed commercial relationship between the parties, the *Braganza* principle did not apply, and it was doubtful that it should apply to unqualified termination agreements between sophisticated commercial parties

Executing Documents

CASE: *Wood v Commercial First Business Ltd (In Liquidation) [2019] EWHC 2205 (Ch) (High Court)*

- **BACKGROUND LAW:** Individuals executing deeds must comply with Section 1(3) of the Law of Property (Miscellaneous Provisions) Act 1989

(3) An instrument is validly executed as a deed by an individual if, and only if—
(a) it is signed—
(i) by him in the presence of a witness who attests the signature; or
[…]

- **KEY ISSUE:** The court had to consider various issues, including whether or not the execution of a mortgage deed had been correctly witnessed

- **KEY FACTS:**
  - A borrower signed two commercial mortgages as deeds
  - The first mortgage was signed by the borrower, as a deed, in the presence of an attesting witness
  - The attesting witness did not sign the deed at the same time as the borrower in the borrower's presence, instead the attesting witness signed the deed later

Executing Documents

JUDGMENT:

- The court accepted that the witness had not signed the mortgage deed in the borrower's presence **BUT** this did not invalidate the execution of the deed

- The proper interpretation of section 1(3) is that while it is necessary for the person executing the deed to sign in the presence of a witness, there is no additional requirement for the witness to sign in the presence of the executing party

- If those drafting section 1(3) had intended it to be a requirement that the witness should sign in the presence of the executing party, it would have been very easy for that to be expressed – it was not a drafting accident that this was not included as a statutory requirement

Leave to Appeal granted on 23 January 2020 with the Appeal due to be heard by 1 March 2021.

Executing Documents

CASE: *Neocleous v Rees [2019] EWHC 2462 (Ch) (High Court)*

BACKGROUND LAW:

- A contract for the sale or other disposal of an interest in land must satisfy the specific requirements of section 2 of the Law of Property (Miscellaneous Provisions) Act 1989

- Whether or an electronic signature will satisfy the signature requirement in section 2 for land contracts is not addressed in statute and this specific issue has not been previously tested in the English courts

- In other contexts, e.g. guarantees, courts have taken a pragmatic approach such allowing an exchange of emails to satisfy the requirement that a guarantee be made in writing

2.— Contracts for sale etc. of land to be made by signed writing.

[…]

(3) The document incorporating the terms or, where contracts are exchanged, one of the documents incorporating them (but not necessarily the same one) must be signed by or on behalf of each party to the contract.

[…]

Executing Documents

KEY FACTS:

- Dispute over a right of way over land
- The claimant offered to buy part of the disputed land to settle the problem
- Lawyers agreed the terms of the settlement **by an exchange of emails**
- Defendant subsequently claimed that the dispute had not been settled
- Claimant sought specific performance for the sale of land
- Common ground that contract of compromise would need to satisfy the formality requirements set out in section 2

Executing Documents

JUDGMENT:

- Meaning of "signed" had been developing over time to incorporate electronic signatures

- In this instance an email footer, even though applied automatically, was sufficient act of signing for section 2:
  - the footer could only be present by reason of a conscious decision to include it, - even though the subject of a general rule that automatically applied the footer in all cases. The recipient would therefore naturally conclude that the sender's details had been included as a means of identifying the sender with the contents of the email
  - the sender of the email was aware that their name was being applied as a footer. The recipient had no reason to think that the presence of the name as a signature was unknown to the sender
  - the fact that the defendant's lawyer had used the words "Many Thanks" before the footer showed an intention to connect his name in the footer with the contents of the email
  - the defendant's lawyer's name and contact details in the footer was positioned at the end of the document, in the conventional style of a signature

Executing Documents

- **ELECTRONIC SIGNATURES:** On 4 September 2019, the Law Commission published a report on the electronic execution of documents. It found that the law does accommodate the use of electronic signatures, but that as this is not contained in a single source it is inaccessible to many
- **The findings of the report included:**
  - An electronic signature is capable in law of being used to execute a document (including a deed) provided that the person signing the document intends to authenticate the document and any formalities relating to execution of that document are satisfied
  - Save where the contrary is provided for in relevant legislation or contractual arrangements, or where case law specific to the document in question leads to a contrary conclusion, the common law adopts a pragmatic approach and does not prescribe any particular form or type of signature
  - Electronic equivalents of the familiar non-electronic forms of signature are likely to be recognised by a court as legally valid - there is no reason in principle to think otherwise
  - The requirement under the current law that a deed must be signed "in the presence of a witness" requires the physical presence of that witness - this is the case even where both the person executing the deed and the witness are executing / attesting the document using an electronic signature

Executing Documents

PRACTICAL IMPLICATIONS

- Electronic signatures are part of every day for contracting parties and their effectiveness and enforceability have been recognised even for deeds
- Current law requires witness to be in the physical presence of the signatory when the signatory signs. BUT the witness can sign later
- Beware of emails. Consider:
  - use of "subject to contract" or equivalent wording in negotiating communications to avoid inadvertently entering into a legally binding relationship; and
  - wording in automatic signature saying that no contract is intended to be formed

Inducing a Breach of Contract

CASE: *Beans Group Ltd v Myunidays Ltd [2019] EWHC 320 (Comm) (High Court)*

- **BACKGROUND LAW:** One of the "economic torts" - inducing or procuring a breach of contract occurs where:
  - The defendant intentionally induces or procures a breach of a contract between the claimant and a third party without reasonable justification; and, as a result
  - The claimant suffers economic loss

KEY ELEMENTS OF THE TORT

- **Breach of contract**
- **Knowledge and intention:**
  - Assessed subjectively: The defendant has to have the requisite knowledge of inducing or procuring a breach of contract
  - Includes turning a blind eye: This could still be intention if there has been a conscious decision not to enquire into whether the relevant act would amount to a breach
  - Needs more than foreseeability: If the breach of contract is neither a desired end, nor a means to an end, but merely a foreseeable consequence of the defendant's actions, then it cannot for this purpose be said to have been intended

Inducing a Breach of Contract

KEY FACTS:

- Shein was an online retailer who offered discounts to students
- Contract with Student Beans for verification technology
- Shein then entered into contracts with Myunidays for similar technology from Myunidays – breached Student Beans' exclusivity
- Myunidays was not aware of the pre-existing exclusive contracts between Shein and Student Beans - despite Myunidays making enquiries about exclusivity with other providers
- Student Beans found out about the contracts between Myunidays and Shein and notified Myunidays
- It appeared that Myunidays did not subsequently terminate its contracts with Shein, despite being informed of the Student Beans contracts
- Student Beans sought injunction preventing Myunidays from continuing to provide services to Shein, based on inducing or procuring breach of Student Beans' pre-existing contract

KEY ISSUES:

The High Court had to answer the following questions:

- **Q1:** Did the defendant (Myunidays) tortiously procure or induce the breach of the contract the claimant (Student Beans) already had with a third party (Shein) by entering into inconsistent contracts with Shein?
- **Q2:** Did ongoing performance after notice from Student Beans mean that Myunidays had tortiously procured or induced Shein to breach the Shein's contracts?

Inducing a Breach of Contract

JUDGMENT:

- **Q1: Before being put on notice – No**:
  - Myunidays had not had sufficient knowledge of Student Bean's contracts with Shein, or the requisite intention of interfering with their performance, when it entered into contracts with Shein which were inconsistent with exclusivity clauses in these pre-existing contracts
  - Myunidays had not turned a blind eye to the Student Beans contracts – it had asked about the possibility of them, but had not been told about them
- **Q2: After being put on notice - Yes**:
  - Liability arises where an inconsistent transaction is continued knowingly and actively, and damage is proven
  - Once Myunidays became aware of the terms of the pre-existing contracts between Student Beans and Shein and did not desist from providing the SVT services to Shein, it had committed the tort of procuring or inducing breach of contract
  - On the balance of probabilities, Shein would have returned to Student Beans' SVT services if prevented from using Myunidays' services and so Student Beans suffered loss while the SVT services were being provided to Shein by Myunidays
- The injunction was granted to Student Beans

PRACTICAL IMPLICATIONS

- Be wary when dealing with someone already under contract – you can't just turn a blind eye.
- Particular care should be taken when dealing with competitors.
- Seek representations that there is no breach of contract.
- Also take care when undertaking group reorganisations.

Conclusions

Contracting Considerations

- Always draft for blue pencil test where any concerns over enforceability
- Beware risk of forming contract by email exchange
- Take care when negotiating with a counter-party that is already in an exclusive contract
- A force majeure clause will be construed as it is drafted, and it will not be construed according to its title
- It is advisable expressly to stipulate the law applicable to the arbitration agreement - the law that is chosen may depend on the specific circumstances of the transaction/contract
- There is no generally implied duty of good faith in English Law, but there are circumstances where the duty could be implied and the duty can be imposed expressly by the contract

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