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September 2011

Recent Developments in English Contract Law

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This Stay Current focuses on four significant recent cases in England which may have implications for those looking to enter into any English law contracts and agreements, particularly in the context of mergers and acquisitions.

The first case considers some of the issues with clauses providing that a party must use "best" or "reasonable" endeavours, which are terms used in many agreements of all kinds, whilst the second case deals with the enforceability of certain restrictive covenants, such as those that might be given by a seller of a business. Another case, Barbudev, demonstrates the danger of relying on side letters or similar documents which do not contain all of the terms which will apply to a transaction. Finally, the case of Erlson deals with the buyer's right to rescind a share purchase for fraudulent misrepresentation.

Meaning Of "Best Endeavours" And "Reasonable Endeavours" - Jet2.Com Ltd V Blackpool Airport Ltd

Contractual obligations to use "best endeavours" or "reasonable endeavours" are used in a wide variety of contexts in English law contracts and agreements (and are similar to the US concepts of "best/reasonable efforts"). Given the prevalence of these terms, it is unsurprising that there has been a number of previous cases providing judicial interpretation in relation to the standard which they each require. The concept of "best endeavours" has attracted the most consideration and has been defined, for example, by the Court of Appeal in IBM v Rockware as requiring a party "to take all those steps in their power which are capable of achieving the desired approach [...] which a prudent, determined and reasonable [person] acting in his own interests and desiring to achieve that result would take". By contrast, "reasonable endeavours" is a less clearly defined concept, but is considered less stringent than best endeavours and generally requires parties to balance their contractual obligation against relevant commercial considerations. "All reasonable endeavours", a third term often used, is generally thought to lie somewhere between the two, although there is some authority to suggest that (at least in some respects) it may be equivalent to best endeavours.

In this case, Jet2.com ("Jet2"), a budget airline, had entered into a letter agreement with Blackpool Airport Limited (the "Airport") in relation to the provision of low cost services to and from Blackpool Airport for a period of 15 years. The letter agreement contained an obligation on Jet2 and the Airport to each use their best endeavours to promote Jet2's services and on the Airport to use all reasonable endeavours to provide a low cost base that will facilitate Jet2's low cost pricing. The agreement between the parties did not include an express provision as to opening hours. For four and a half years, Jet2 operated some flights outside the Airport's published opening hours (6 a.m. to 8 p.m. during summer and 7 a.m. to 9 p.m. at other times). Flights outside these times incurred significant costs for the Airport and, in an attempt to stem its losses, the Airport notified Jet2 that it would no longer allow Jet2 to operate outside the published hours of operation. Jet2 argued that operating outside these hours was necessary for it to maintain low cost pricing and that the Airport's refusal to allow it to continue to do so was a breach of its contractual obligations to use its best endeavours to promote Jet2's services and to use all its reasonable

endeavours to provide a cost base to facilitate Jet2's low cost pricing. The Airport argued that it had been losing money by allowing Jet2 to do so, and its duties under the contract did not require it to go against its own commercial interests.

In his decision, the judge noted that a court will interpret a contract by considering what a reasonable person with all of the relevant background knowledge of the parties at the time when the contract was made would have understood those parties to mean by reference to the language they have used. "All reasonable endeavours" and "best endeavours" are ordinary English words and it is a question of fact what is required by each in any given circumstance, and as such the expression will not always mean the same thing. The judge was of the opinion that even comparatively minor changes in facts could result in a different decision as to whether a party has discharged its obligation to use best or all reasonable endeavours. On the basis of the facts, the court found that the provision of access outside of the published opening hours was entirely within the Airport's control and held that it could not have been intended that the Airport would be free to pick and choose which obligations to comply with on the basis of what suited it financially.

It is generally accepted that contractual obligations imposed by a "best endeavours" or an "all reasonable endeavours" clause falls somewhere between an absolute procurement obligation and a "reasonable endeavours" obligation. However, the key lesson of this case is that, given the uncertainty as to what is actually required by a "best endeavours" or "all reasonable endeavours" clause, the parties should consider setting out in the contract exactly what steps or measures each party is expected to take, particularly where an obligation goes to the heart of the contract.

Restrictive Covenants – Baldwins (Ashby) Limited v Andrew John Maidstone

This case related to a claim for damages being sought by Baldwins (Ashby) Limited ("Baldwins") against Andrew John Maidstone ("Mr Maidstone") arising from breaches by Mr Maidstone of certain restrictive covenants contained in a share sale agreement pursuant to which Mr Baldwin sold his accountancy business to Baldwins. The share sale agreement contained a three year covenant protecting the goodwill in the business pursuant to which Mr Maidstone agreed that he would not "canvass, solicit or endeavour to entice away" any person who had been a client of the business during the two year period prior to completion.

The judge held that, in accordance with established principles, breach of the non-solicit provision would require some action by the covenantor and a positive intention on his part. It did not matter who initiated the contact, but rather the question of solicitation depends on the substance of what passes between the parties once they are in contact with each other. A general advertisement about availability for custom at a new firm or a specific notification to a client of a departure from one firm to another would likely not cross the borderline; any activity or behaviour beyond would. The court felt that the evidence pointed to a secret agreement between Mr Maidstone and his new employer to introduce new business to the new employer, which would accordingly require him to solicit it secretly from Baldwins, and accordingly that it was highly likely that Mr Maidstone had acted in breach of his non-solicitation clause.

The decision of the High Court in Baldwins is helpful to buyers looking to protect the goodwill of a target business through negotiating contractual restrictions on the conduct of the seller after completion and the court reaffirmed the long-established principle that restrictive covenants between the vendor and the purchaser of a business are looked upon with less disfavour by the court than restrictive covenants between employer and employee. However, the principle remains that such restrictive covenants in restraint of trade (such as non-compete, non-dealing and non-solicitation clauses) are contrary to public policy and, as such, are potentially unenforceable unless they are considered to be reasonable in duration and scope.

The court noted that the clause in issue was not drafted as a "non-dealing" provision, which has a clear dividing line and is easier to police and adjudicate upon. Baldwins would probably have had an easier time proving a breach of a non-dealing covenant. The principal practice point from this

case is that it would be prudent for the buyer of a business to consider including a non-dealing covenant in any acquisition agreement. However, as non-dealing covenants are broader in scope than non-solicitation covenants, care needs to be taken that they are not found to be unreasonable and therefore unenforceable. As a drafting point, the buyer should also retain the non-solicitation covenant.

One other interesting point arising from this case is the measure of damages: in the court's view, the damages which could fairly and reasonably be considered as arising from the breach of contract amounted to the gross fees which would have been earned from the solicited customers for a one year period (being the balance of the non-solicitation period) and which amounted to £31,875. The court felt that it was more likely than not that each of the solicited clients would otherwise have placed their business with Baldwins for at least one more year, and so did not reduce the damages under the "loss of chance" doctrine. However, this sum was only a fraction of the consideration paid for the business (and presumably the consideration paid was at least in part based on a multiple of the annual fee income of the business), and as such the case highlights the limits of seeking to recover elements of the overall consideration paid for a business, rather than simply loss of revenue from an improperly solicited customer, given the calculation of damages in an action for breach of restrictive covenant.

Contract Formation – Barbudev V Eurocom Cable Management Bulgaria Eood & Others

This judgment is a High Court decision ruling that a side letter in the context of an acquisition constituted an unenforceable agreement to agree.

In this case, the claimant, Barbudev, was the CEO and 40 per cent shareholder of a Bulgarian cable television and internet company, which was sold to the defendant. At the same time as signing the definitive sale documentation, the defendant sent the claimant a side letter stating that "In consideration for you agreeing to enter into the Proposed Transaction and to sign the Transaction Documents, the Purchaser hereby agrees that, as soon as reasonably practicable after the signing of the Agreement by all Parties, we shall offer you the opportunity to invest in the Purchaser on the terms to be agreed between us which shall be set out in the Investment Agreement and we agree to negotiate the Investment Agreement in good faith with you. Such terms shall include, without limitation, the following: you shall invest an aggregate amount of not less than €1,650,000 in consideration for a combination of shareholder debt and registered shares which shall represent ten per cent of the registered share capital of the Purchaser on the date of the Investment Agreement..."

The claimant contended that the side letter evidenced a partly oral and partly written binding agreement and that he had the right to have an ongoing 10% investment in the combined entity. The court held that, as a matter of proper construction of the terms of the side letter itself which lacked certainty of terms (including as to price), the letter constituted nothing more than an agreement to agree. Accordingly, following Walford v Miles, the court held that the side letter did not constitute a legally binding contract.

In many corporate and commercial transactions side letters are proposed to allow the parties to move past difficult issues and to speed up a transaction, with the intention that the detail will be resolved at a later stage. As a practice point, this case serves as a reminder of the importance when using such documents to ensure that any agreement sought upon in the context of any investment or disposal is legally enforceable, if that is what is intended. In this regard, when drafting or reviewing side letters which seek to document key elements of an agreement, which are intended to be binding, it is of the utmost importance to ensure that (i) it is clear from the face of the document that there is an intent to form legal relations, (ii) there is sufficient certainty as to terms, and (iii) the side letter is not couched as an agreement to agree. As the judge in this case noted, the precise drafting of the side letter and construction of its terms will be critical in determining its enforceability or otherwise.

In addition, the Barbudev case also serves as a salutary reminder as to the limitations of an obligation to negotiate in good faith as a matter of English law. Ultimately, in this case the side letter was deemed unenforceable on a construction of its terms as an agreement to agree, but in so finding the judge examined and relied on academic text setting out the general proposition (which is somewhat at odds to the position in continental Europe) that an agreement to negotiate in good faith is generally not considered enforceable as a matter of English law.

Rescission for fraudulent misrepresentation – Erlson Precision Holdings Ltd. v Hampson Industries plc

This case relates to the purchase by Erlson Precision Holdings Limited ("Erlson") of Hampson Precision Automotive Limited ("the Target") from Hampson Industries plc. ("Hampson"). Following completion of the purchase, Erlson sought to rescind the sale and purchase agreement on the grounds that it was induced by a fraudulent misrepresentation.

During the sales process, Erlson was provided with significant amounts of information relating to the Target including, on a number of occasions, a breakdown of historic and forecast sales by customer. These forecasts showed that the Targets' second largest customer, Cummins, was forecast to account for approximately 34% of sales in the financial years immediately following completion. Mr Ward, the chief executive of Hampson, was aware that this information had been provided to Erlson.

On the day prior to the sale, Cummins formally notified Mr Ward that it would terminate all business with the Target. This notice was forwarded to Erlson on the day of closing (but after closing had taken place). Mr Ward had known for more than a month that this would happen, but had asked Cummins not to tell anyone until he had an opportunity to discuss the matter with his board. There was also evidence that Mr Ward knew that this information would make the Target unsaleable, yet he did not share it with his management team leading the sale process.

It was accepted by the parties that (i) although the forecasts were statements of opinion, they carried an implied representation of fact, namely that Hampson had reasonable grounds, or knew of facts, that justified the forecasts; (ii) the claimant had relied on the forecasts and the implied representations they carried; and (iii) for a period of more than six weeks before contracts were signed, the implied representation was false.

Hampson's position was that it had not given any warranties relating to the forecasts and that Erlson had carried out its own due diligence and, as such, there was no breach of contract and no entitlement to rescind the contract. Any action based on innocent or negligent misrepresentation was precluded by a number of the boilerplate exclusion clauses, including the entire agreement clause. As such, the only course of action open to Erlson was a claim for fraudulent misrepresentation, none of the exclusion clauses being effective to exclude liability for fraud.

It is well established law that to establish liability for fraudulent misrepresentation, the false representation must have been made knowingly, without belief in its truth or recklessly, careless as to whether it be true or false, with the intent that the representee should act upon it. On the facts, the court found that (i) Mr Ward was aware that the forecasts were being communicated to potential buyers; and (ii) knowing they were false and/or misleading, decided not to reveal Cummins' plan to terminate the relationship with the Target, with the intention that the forecasts should continue to be relied on.

Hampson argued that Erlson also had to show that Mr Ward knew he had an obligation to correct the implied representation and that he dishonestly decided not to correct it. However, the court found that given Mr Ward's senior position, dishonesty will be proved without it being necessary to distinctly and separately show a conscious awareness of a duty to correct the statement.

Generally speaking, under English law, where a party has been induced to enter into a contract by a fraudulent representation made by another party, the injured party has a right to rescind the contract as well as (or instead of) claiming damages. Rescission involves unwinding a contract so that the parties are placed in the position they would have been in had the contract not been made. In the context of a purchase agreement, this means the seller returning the consideration and the property being returned to the seller.

In practice, recession for fraudulent misrepresentation has been relatively uncommon (at least in the context of the sale of shares) in part because fraudulent intent is required and is difficult to prove, but also because the right to rescind may be lost where it is no longer possible for the parties to be restored to their pre-contractual position or where the injured party has affirmed the contract after discovering the breach. Previously, in relation to share acquisitions, courts have viewed even a delay of a few weeks after discovering the breach as preventing rescission. However in Erlson, the buyer had notified the seller of the misrepresentation (which was based on the failure of the seller's CEO to correct information given to the buyer by his subordinates which he knew to be false) within hours of completion, and formally indicated it wished to rescind within a week. The judge accepted that the representation was fraudulent and that the buyer was entitled to rescind. However, the parties then settled (the seller had indicated an intention to appeal) and, rather than rescind, the parties agreed that the buyer would retain the company and the seller pay the buyer damages.

It remains to be seen whether Erlson will result in additional attempts to seek rescission in M&A transactions. As noted above, fraudulent intent is difficult to prove and there will still be various practical issues. However, the case does illustrate that sellers must be very wary of implied representations and may in some circumstances be under a duty to correct representations which they know to be false. Finally, it is a useful reminder to sellers that boilerplate exclusion clauses will not be effective to exclude liability for fraudulent misrepresentation.

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