20 ESSEX STREET

BULLETIN

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In a bind? Supreme Court sets out radical new position on the law of contractual variation

Rock Advertising Limited v MWB Business Exchange Centres Limited

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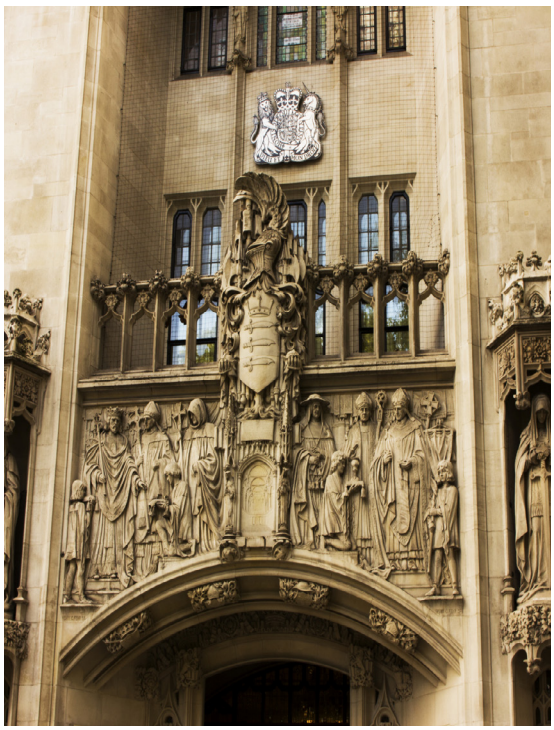


In Lord Sumption's words, the appeal resolved by the Supreme Court last week was "*exceptional*" and raised "*truly fundamental issues in the law of contract*". In a ground-breaking decision, the Supreme Court settled in a surprising way the long running debate about the effect of "no oral modification" clauses (NOM clauses), i.e. clauses which state that any contractual variation must be in writing to be effective.

NOM clauses are frequently encountered and their effect is of great commercial importance. But what did the Supreme Court say and was it right?

NOM NOM: 'Chewing the facts'

The case concerned a lease of serviced offices by the Respondent, Rock, from the Appellant, MWB. A revised schedule of payments was agreed orally on the phone between MWB's credit controller and Rock's sole director which, in financial terms, was worth slightly less to MWB. The lease contained a clause requiring all variations to be in writing and signed before they took effect. At first instance, Judge Moloney QC held that although an oral variation supported by consideration had been agreed, it was ineffective because of the NOM clause, such that MWB could claim arrears without regard to the orally agreed variation. The Court of Appeal reversed the judge's decision, differing as to the effect of the NOM clause, following the recent *obiter* decision of the same Court in *Globe Motors v TRW LucasVarity Electric Steering* [2017] 1 All ER (Comm) 601 (CA).

The main event: Sumption surprise

Whether NOM clauses have any effect, and if so what, has long been controversial in English law. Prior to the Supreme Court's decision, the recent trend had been towards such clauses having limited effect. At first instance, Gloster J in *Energy Venture Partners v Malibu Oil and Gas* [2013] EWHC 2118 (Comm), and Stuart-Smith J in *Virulite v Virulite Distribution* [2015] 1 All ER (Comm), both concluded that NOM clauses did not prevent oral variations; their existence was just one evidential factor in the factual matrix when considering whether an oral variation had been concluded. The Court of Appeal's decision below and in *Globe Motors* followed that view. Our experience is that such clauses have often been relied on, yet rarely proven decisive. That is set to change.

Lord Sumption's judgment, which had the support of the majority in the Supreme Court, reflects a startling rejection of previous thinking. He held that a NOM clause was absolutely effective to prevent the parties agreeing a subsequent variation save in accordance with its requirements, subject only to a party being able to establish an estoppel specifically preventing reliance upon the NOM clause. He rightly drew attention to the commercial advantages of NOM clauses, such as certainty and preventing attempts to undermine agreements by informal means, which may be open to abuse. These are reasons why NOM clauses are popular and so often encountered.

The principal reason why it had previously been thought a NOM clause could be overridden by oral agreement was party autonomy. Conceptually, parties with freedom of contract cannot bind themselves as to their future agreements. This is pithily encapsulated in Cardozo J's well-known judgment in the New York Court of Appeals in *Beatty v Guggenheim Exploration Co* (1919) 225 NY 380: "*Those who make a contract, may unmake it.*"

Lord Sumption's equally crisp riposte to the Cardoso J logic was: "*The real offence against party autonomy is the suggestion that they cannot bind themselves as to the form of any variation, even if that is what they have agreed.*" He noted that it was perfectly possible for a legal system to give effect to NOM clauses despite the perceived conceptual difficulty. He found support for his view in an analogy with entire agreement provisions, which are often found combined with NOM clauses. In his (not uncontroversial) analysis of existing authority in this sphere, Lord Sumption concluded that if an alleged collateral agreement is not independent, but relied on as modifying the effect of the agreement containing the entire agreement provision, that provision will work to prevent the collateral agreement operating. If entire agreement provisions can prevent contractual modifications, why not NOM clauses?

A recipe for conflict: Sumption versus Briggs

Lord Briggs agreed with the result, but for different reasons, which he was on his own in advancing. He did not accept that Lord Sumption had successfully overcome the conceptual hurdle that had troubled so many judges before him, and we would respectfully agree. The fact it is possible to have a legal rule permitting parties to bind themselves as to the method of reaching future agreement does not mean that such rule is truly giving effect to freedom of contract. Such a rule permits a current freedom to sacrifice some future freedom. On one view, Lord Sumption's approach must be an exception to freedom of contract. Lord Sumption's analogy with entire agreement clauses is also questionable. As Lord Briggs observed, entire agreement clauses are backwards looking, and so do not give rise to the same conceptual problem as to whether parties may bind themselves as to their future conduct. Entire agreement clauses nullify *prior* collateral agreements, as Lord Sumption observed, so give effect to the *latest* expression of the parties' intentions. NOM clauses seek to nullify *later* agreement, by giving effect to an *earlier* manifestation of the parties' intentions as to formal requirements.

Whilst Lord Briggs considered that NOM clauses should generally bind, by contrast with Lord Sumption's hard line view, he thought there should be an exception where the parties have expressly, or by necessary implication, orally agreed to do away with the NOM clause. This represents something of an intermediate position between Lord Sumption's stark position, and previous more liberal authority, and we think it is the preferable view.

Prior authorities gave unclear evidential weight to a NOM clause, and a rather arid debate arose about the standard of proof necessary to establish an oral variation where there was a NOM clause (as compared to when there was no such clause), which appeared to have little practical impact on outcomes. Lord Briggs' approach has the welcome merit of focusing on the NOM clause, and whether the parties are consciously overriding it, rather than assuming they are implicitly doing so if they, in fact, agree some other variation. This approach recognises a need also to find an agreed variation to the NOM clause itself, which seems a better fit with the existence of the NOM clause as part of the relevant factual matrix. Lord Brigg's analogy with "subject to contract" provisions in this regard appears apt.

However, unlike the majority decision, Lord Briggs' more cautious approach has the flexibility to allow that parties can orally override their own agreed clause in the (perhaps rare) case where they really intend to do so. Take the example of a case in which there is a recorded telephone conversation. The transcript proves that not only was an alleged variation agreed, but the NOM clause was specifically discussed, and it was agreed to depart from the clause by varying the contract without reducing the variation to writing (possibly even conscious that the conversation was being recorded). Lord Briggs' approach would uphold the agreed variation, which seems right to us. Lord Sumption's approach would not.

We recognise the commercial desirability of giving effect to NOM clauses to discourage unscrupulous assertions of informal agreements to escape contractual bargains, but the realistic possibility of escaping a NOM clause seems scarcely any wider under the formulation of Lord Briggs than of Lord Sumption, save in truly deserving cases.

Comment: Proof in the pudding

It remains to be seen how the Supreme Court's radical decision will be received in the market. As Lord Briggs observed, it represents a break with

the law in other common law jurisdictions on a fundamental contractual issue. It is likely to give rise to renewed focus by lawyers on what constitutes "writing" or "signed in writing", and on estoppel arguments. For instance, if the NOM clause requires the formality of a signed written document, will an exchange of emails suffice? There may be room for argument about forms of electronic signature, with possible resort by analogy to cases on the *Statute of Frauds* raising a similar issue, such as *Golden Ocean Group v Salgaocar Mining Industries* [2012] 1 WLR 3674.

Whilst the harshness of the Lord Sumption approach may sometimes be mitigated by the availability of estoppel, that may be a blunt tool (as the failure of the estoppel argument in this case illustrates). It will not be effective where one party resiles from the oral agreement before the other has any opportunity to rely on it, and where estoppel does operate, in some cases it could prove only temporary in effect. Lord Sumption also appears to have limited the scope for estoppel to mitigate this new approach to NOM clauses, by saying that there would at the very least have to be:

1. some words or conduct unequivocally representing that the variation was valid *notwithstanding its informality,* and
2. something more would be required for this purpose than the informal promise itself.

There is also a serious question as to how far-reaching the decision might become. Does Lord Sumption's logic arguably lead to the view that parties can bind themselves so as to be unable to reach some agreements at all in the future?

For instance, would a clause agreeing the contract can *never* be varied at all be effective?

Whilst parties arguably cannot be prevented from cancelling altogether one contract and agreeing a new one, there may be external regulatory or other reasons why the difference between continuing an existing contract in amended form, and starting a new contract, matter. With this in mind, will parties in strong bargaining positions see a creative opportunity in Lord Sumption's judgment to include more adventurous strictures in their contracts in the future?

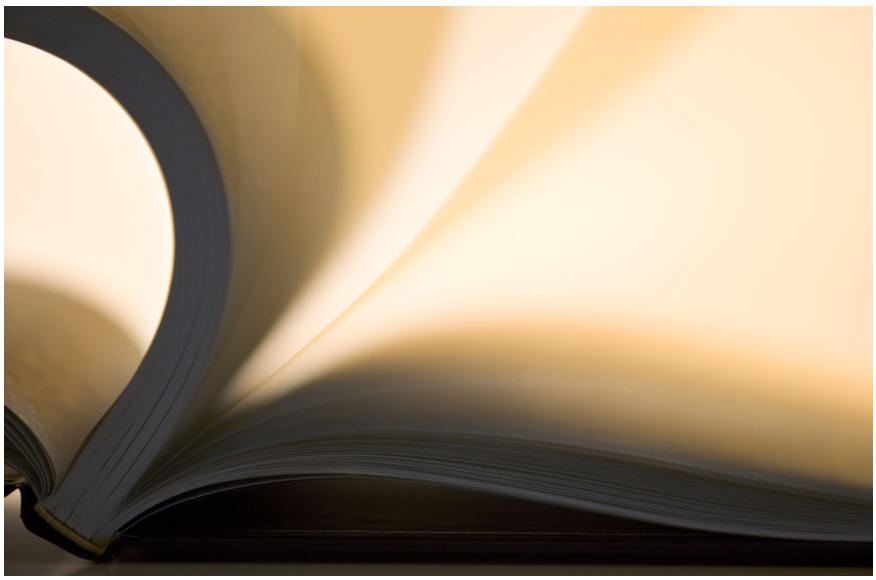
For later consideration…

The decision is almost as notable for what it did not decide as what it did. MWB also argued that there was no consideration for the variation, which argument the Court of Appeal had addressed and rejected. English law on contractual consideration has been uncertain for some considerable time because of the tension between *Foakes v Beer* (1884) 9 App Cas 605 and *Williams v Roffey Bros & Nicholls* [1991] 1 QB 1.

The facts here afforded an opportunity for the Supreme Court to grapple with this important issue (albeit *obiter*). Many interested observers will be disappointed that it passed up the opportunity to do so, by resolving the appeal on the NOM point and declining to express any view about the consideration point, despite Lord Sumption observing that the decision in *Foakes* is probably "*ripe for re-examination*" before an enlarged panel of the Supreme Court.

That may, however, be considered an open invitation to commercial parties and lawyers, so it is to be hoped that issue will reach the Supreme Court again soon.

If you require advice on any of the topics discussed in this briefing from David or Daniel, or any member of 20 Essex Street, please contact: clerks@20essexst.com



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David specialises in advocacy and advisory work across a wide range of general commercial and private international law disputes. He has a particular focus on international arbitration and has acted as sole Counsel in arbitrations in London, Singapore, Hong Kong and Dubai.

He appears in the High Court, Court of Appeal and Supreme Court and before various arbitration tribunals (including LMAA, LME, LCIA, ICC, SIAC and HKIAC), as well as in mediations. Since 2005 he has been a CEDR Accredited Mediator.

During 2009-2010 he was based in Singapore, pursuing a practice in international arbitration. While there, he was shortlisted for Young (under 40) Professional of the Year by the British Chamber of Commerce.

He regularly handles cases dealing with allegations of contractual variation.

Read his online biography

Daniel Bovensiepen

Daniel's practice covers a broad range of international commercial work, in both court and arbitration. In addition to specialist work in the fields of energy and natural resources, shipping, commodities, insurance, and banking and finance, his work has encompassed a wide range of contractual disputes concerning, for instance, substantial shareholder and joint venture disputes, exclusive distribution agreements, and claims under commercial loans and guarantees in a variety of contexts. He frequently encounters issues of contractual variation. He received the award for "Shipping Junior of the Year" at the Chambers UK Bar Awards in 2016, and was nominated for "Shipping Junior of the Year 2018" by the Legal 500. In the past few years he has appeared in the Court of Appeal and the Supreme Court, and been instructed in a number of high value arbitral proceedings, with between c.US$80 million and US$200 million at stake.

Read his online biography

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