

# Commercial Thinking

Welcome to the 4<sup>th</sup> edition of Commercial Thinking, the first for 2011. We have selected some of the most topical UK commercial law developments over the last quarter to update you on. From case studies to changes in regulation, Commercial Thinking aims to keep you alert of the legal updates that may impact your business.

## *\*Featured article*

### Might your contracts soon be governed by EU contract law?

The responses to the European Commission's July 2010 green paper containing proposals for some form of EU-wide contract law have now been submitted. The UK responses show little appetite for the more radical proposals but the response from mainland Europe appears somewhat warmer. So now seems a good time to recap on the significance of the proposals and what they might mean for you.

### The proposals

Research commissioned by the Commission has suggested that the differences between national contract laws may be creating additional transaction costs, legal uncertainty and a lack of consumer confidence, and that consumers and businesses have expressed support for some form of EU-wide contract law. The Commission is considering various different solutions ranging from (i) a "toolbox" for EU lawmakers when they adopt new legislation to (ii) an optional EU Contract Law which could be chosen as an alternative to the existing national contract laws to (iii) creating a European Civil Code which would not only establish a European Contract Law but would also cover other non-contractual type obligations.

One major source for the terms of any EU contract law will be the Principles of European Contract Law developed by European academics on the basis

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of the Draft Common Frame of Reference which covers principles, definitions and model rules of civil law, including contract law. Any EU contract law is likely to contain overarching principles of good faith and fair dealing such as already exist in civil law jurisdictions, but not in general English contract law. Of course, the UK has for many years incorporated European law into domestic legislation, including some that is based on legal traditions from other EU states – the Commercial Agents Regulations 1993 are an example of this. However, until now this has been limited to discrete areas of law. The possibility of wholesale change to an entire area of law is unprecedented. This is particularly significant for laws such as English law and Dutch law which are frequently chosen to govern commercial contracts between parties who do not themselves have any connection with those jurisdictions.

## UK response to the proposals

The suggestion of replacing national contract law with an EU alternative, even on an optional basis, has met with a negative response from parties within the UK. The OFT's response makes the point that the significant time and costs needed to implement the proposals will not necessarily be proportionate to the benefits to be gained from the process. It also notes that there is existing EU consumer protection legislation which applies to both domestic and cross-border transactions, and it is hard to see the benefit of developing a further set of relevant principles which might only apply to cross-border transactions. A further widely-made objection is that each Member State will interpret European contract law in its own way so differences will soon appear at a national level in any event. Indeed, the UK government's position is that the availability of different contract laws across Europe is a strength rather than a weakness.

In fact, there is some scepticism about the way the EC research was framed in the first place, and about the suggestion that businesses and consumers would be more likely to trade across borders if there was a European Contract Law in place. The prevailing view in the UK is that the difficulties are more practical, and will always exist whether or not contract law is standardised across the EU. These difficulties arise from cultural, language and regulatory barriers. The real issues are such matters as accessibility for redress of problems in a cross-border contract, and the differences in procedures, available remedies, time taken and costs which apply at national level within the EU Member States. That said, surveys have revealed a marked preference amongst consumers in certain other

EU member states (Italy, for example) for some kind of EU-wide contract law.

## What might this mean for you?

There are many variables to consider. Even after a particular option has been chosen, there will be other issues to be resolved such as (i) whether any EU contract law should cover both business-to-consumer and business-to-business contracts; (ii) whether online transactions should be covered; (iii) whether EU contract law should be restricted to cross-border transactions or whether it could be adopted for domestic transactions, and so forth. This will all take time. However, the European Commission has indicated it intends to prepare its proposals before 2012. The idea of an optional EU contract law has been more warmly received in mainland Europe.

Such a proposal could mean that businesses will need to:

- review their existing terms and conditions to determine whether they could or indeed should adopt the optional EU contract law;
- consider whether there is a commercial case for offering customers contracts under the optional EU contract law;
- face the possibility that another party (perhaps with stronger bargaining power) will insist on its use;
- bear in mind that the optional EU contract law will almost certainly contain overarching principles unfamiliar to general English contract law which could have a significant impact on UK-based businesses' approach to their business-to-business dealings;

all of which will mean that in-house lawyers will in due course need to be trained in the resulting EU contract law legislation.

Significant change is not imminent but it appears to be on its way.

## 1. Data protection security policies – how secure are you?

Recent action taken by the Information Commissioner's Office ("ICO") continues to highlight the importance of ensuring businesses and public bodies have robust security in place, particularly when it comes to the use of laptops, memory sticks and emails. Breaches may have severe consequences.

Since 6 April 2010, the ICO has had the power to issue monetary penalty notices, requiring organisations to pay up to £500,000 for serious breaches of the data protection principles under Data Protection Act 1998 (the "DPA"), where the breach was of a kind likely to cause substantial damage or distress and either the contravention was deliberate or the data controller ought to have known the risk of contravention likely to have those effects but failed to take reasonable steps to prevent it. In February this year, the ICO fined the Councils of Ealing and Hounslow £80,000 and £70,000 respectively, in connection with the theft of two laptops from an employee's home. The laptops contained details of around 1,700 individuals. There was no evidence to suggest the data held on the computers had been accessed and no complaints had been received to date but there was significant risk to the individuals' privacy. The data on the laptops were password protected but were unencrypted, in breach of the Councils' own policies. This brings the number of cases of monetary penalties to four, three of which relate to unencrypted data on laptops. Deputy Commissioner David Smith commented "*where personal information is involved, password protection for portable devices is simply not enough*". This is a clear message from the ICO, that such practices will not be tolerated and firm action will be taken.

The use of undertakings continues to be an important tool available to the ICO. February saw six such undertakings, two of which related to the loss or theft of unencrypted data on laptops and a memory stick. Similarly, Gwent Police was found to have breached the DPA when an email containing a spreadsheet of the results of around 10,000 Criminal Records Bureau enquiries was mistakenly sent to a website journalist. A staff member at Gwent Police inadvertently copied the wrong person into the email. This was a breach of the force's IT security policies.

Establishing a Data Protection Security Policy is only the first step in the

compliance chain. Effective implementation, training, regular monitoring and auditing are vital to ensure breaches of the kind described above do not occur. The ICO is clearly willing and able to take action and organisations processing personal data would be wise to take on board the trend in enforcement action.

## 2. Data protection legal framework under review

In January this year, the European Data Protection Supervisor (the “EDPS”) issued an opinion in response to the Commission’s communication “A comprehensive approach on personal data protection in the European Union” (the “Communication”). The Communication sets out the Commission’s approach to the review of the EU legal system for the protection of personal data in all areas of the EU’s activities. The overall view of the EDPS is positive. In formulating his comments, he highlights certain aspects of the current regime which require updating and makes a number of important recommendations.

Harmonisation of the current legal framework receives significant attention. There is consensus that too much discretion is left to Member States and this is having negative consequences. There is a strong desire to ensure a level playing field. With increased globalisation, many pan-European businesses find themselves obliged to comply with (possibly diverging) requirements of national data protection laws. However, the Communication, whilst advocating the importance of harmonisation, does not put forward any concrete options. The EDPS; therefore, presents proposals where greater convergence is urgent. These include:

- definitions: they should be uniformly interpreted in all Member States
- lawfulness of processing: the core elements determining the lawfulness of processing should be defined more precisely
- grounds for data processing: a more precise and robust method for determining consent and a more detailed specification of the grounds based on the legitimate interests of the data controller, which has thus far given way to widely diverging interpretations
- data subjects’ rights: a more uniform approach

- international transfers: the current system has been widely criticised for a lack of uniform practice, with the rules on adequacy in particular being interpreted and implemented very differently across the Member States.

There is general support for a more simplified notification system subject to consideration of certain alternatives and possibly a standard pan-European notification form. The EDPS further supports the extension to all data controllers of the obligation to notify personal data breaches. He considers that a notification obligation is not just a useful information tool to make individuals aware of the risks they face when their personal data are compromised, but it also incentivises data controllers to implement stronger security measures to prevent breaches, enhances accountability and serves as a useful tool in enforcement.

The EDPS supports the concepts of data portability (i.e. the explicit right for an individual to withdraw his/her data from an application or service so it can be transferred) and the right to be forgotten, (i.e. the right of an individual to have his/her data no longer processed and deleted when they are no longer needed for legitimate purposes) as strengthening a data subject's rights, but considers these should probably be limited to the electronic environment.

The EDPS considers that if steps are taken to strengthen a data subject's rights, there must be effective procedural mechanisms to enforce such rights. In this regard, he espouses the introduction of collective redress, empowering groups of citizens to combine their claims in a single action. He does note, however, that there is an ongoing debate at European level on the introduction of such collective redress mechanisms.

Few would disagree that in the 15 or so years since the adoption of Directive 95/46/EC, with technological development, the rapid growth of globalisation and divergent interpretation, the current regime is in need of an update. There are clear benefits in many of the suggestions set out in the Opinion, but the extent to which the Commission will take up the challenges raised by the EDPS remains to be seen.

### **3. The Second Electronic Money Directive (“2EMD”) requires all EU States to implement it on 30 April 2011. What does it mean to you?**

The regulatory regime for prepaid products across Europe changes on 30 April 2011 (at least in those Member States which are on time with implementation, which includes the UK). The new regime may make it easier to break into the prepaid market place.

The €1m initial capital requirement of the current regime has stifled the taking up of Electronic Money Issuer licences in Europe. The lowering of the initial capital requirement to €350,000 under 2EMD is therefore hoped and expected to lead to a flood of new applications. The market has been further stifled by the fact that many gift card programmes, which were never intended to be regulated, became caught by the definition of e-money. Under the current regime, if a gift card is issued and can be redeemed against a different legal entity to the one that issued it, then it is e-money. This catches out franchise operations like pizza parlours, coffee bars and fast food chains where loyalty cards were an obvious opportunity (taking away the clumsy paper and stamp set ups) as well as retailers with concessions and those with a group company structure. As a consequence, many of the prepaid product programmes that would have opened in this space never saw the light of day because the costs associated with launching a full e-money product were far in excess of the likely returns.

Under 2EMD the regulators have created the limited network/limited goods and services exemption for exactly this purpose. Under this, provided the prepaid product can only be used to acquire goods or services and it is “under a commercial agreement with the electronic money issuer, either within a limited network of service providers or for a limited range of goods or services” then it is excluded from regulation.

On the downside, however, 2EMD has brought in a regulation that says e-money must be able to be redeemed at par at any time and that, tied in with the restrictions on charging redemption fees and the ring-fencing provisions, will cause a number of operational issues for the e-money issuers. In the UK, HM Treasury have taken a look at the UK’s limitation periods and seen that contractual rights are 6 years. On this basis they

have put in an end-stop of 6 years for the expiry of e-money in the Electronic Money Regulations 2011. In other European countries they are also looking at this but some have prescription periods in excess of 20 years so it may be difficult in those countries. Prepaid product terms and conditions will need some careful drafting in light of this regulation to allow for dormancy fees (in lieu of 'breakage') to be taken and accounts closed off.

In addition 2EMD, which follows in form the Payment Services Directive ("PSD") (and indeed will be reviewed with PSD in 2012), has brought in the registration of agents. On the one hand this is good because agents are carrying out a regulated activity (under PSD) and by being an agent (under 2EMD) they are exempt from having to register (under PSD) as a Payment Institution. On the other hand, under the current e-money regime there is no requirement to register agents and so it is an additional burden on the issuers and will potentially slow down the process of getting new prepaid programmes up and running.

There are many other changes such as restrictions on redemption, a revised licence application process, the way in which passporting will be done, the way in which the ongoing capital requirements are calculated, detailed rules on the safeguarding of e-money funds held by the issuer, complaints procedures, offences and of course the detailed transitional provisions. There is no doubt that 2EMD is very good for the prepaid industry but now is the time to work with it to develop exciting and needed programmes that will deliver the potential that is prepaid.

#### 4. Copyright in databases

Databases may incorporate database rights or copyright. In order for database rights to subsist, there must have been substantial investment in the obtaining, verifying or presenting the contents of the database. In order for copyright to subsist, the database must constitute the author's intellectual creation, by reason of the selection and arrangement of the contents of the database. Database rights were created further to the Database Directive (Council Directive No. 96/9/EC), which also made provision for database copyright. Certain questions concerning these rights have been referred to the CJEU by the Court of Appeal in the case of *Football Dataco Ltd & 5 Ors v (1) Yahoo! UK Ltd (2) Stan James (Abingdon) Ltd (3) Stan James Plc (4) Enetpulse APS* [2010] EWCA Civ

1380.

The case concerned the use data compiled by Football Dataco from the Football League's fixtures. The defendants used those data for providing betting services, without having obtained a licence from Football Dataco. The court of first instance had found that no database rights subsisted in the databases, because there had been no substantial investment in the obtaining, verifying or presenting the contents; rather, the effort had gone into the creation of the contents. The court found, however, that database copyright subsisted, since the creation of the database had required significant creative input, labour and skill in determining how certain requirements must be met, which could be addressed in more than one way and not mechanistically.

The case went to the Court of Appeal, which was asked to consider referring questions to the CJEU concerning the subsistence in the fixture databases of: (i) database rights; (ii) database copyright under the Database Directive; and (iii) copyright under English statute.

The Court of Appeal declined to refer (i) to the CJEU as the issue had been recently decided by the CJEU, and the court at first instance has applied that decision.

The Court of Appeal did not consider that (ii) created any additional rights to (iii), but, to cover off any lingering doubt, asked the CJEU if the Database Directive precluded national rights in databases other than those described in the Directive.

As regards the nature of (ii), the parties' rival contentions were as follows. The claimants contended that the intellectually creative effort fell within the description of database copyright in the Database Directive, because the authors arranged data of all the matches to be played into the fixture list; alternatively, because the authors selected which matches were to be played on which days. But the defendants contended that this construction was; what the authors did was to create the data, while the Directive required the selection and arrangement of pre-existing data. The Court saw force in both contentions. It has asked the CJEU what is meant by "databases which, by reason of the selection and arrangement of their contents, constitute the author's own intellectual creation", in particular, whether this excludes the creation of data, whether "selection or

arrangement” includes adding significance to pre-existing data (e.g. fixing the date of a football match), and whether more than significant labour and skill is required from the author and, if so, what.

The CJEU will need to resolve the possibility that, where the effort and skill is in the creation of the data, in the words of the Court of Appeal, the requirements applicable to the subsistence of database rights may be bypassed. The CJEU’s determination will be of particular interest to gaming companies, publishers and other media and any business that “creates” data.

## 5. Can copyright in computer programs be infringed by non-literal copying?

Copyright protects the form in which ideas are expressed, not the ideas themselves. Literal copying of source code without authorisation will be copyright infringement. But the English courts have been reluctant to protect the functionality of computer programs, as falling on the wrong side of the expression/ideas dichotomy.

The question of infringement of a computer program by non-literal copying has again been considered in *SAS Institute Inc v World Programming Limited* [2010] ECHC 1829 (Ch). SAS Institute developed financial software which performed statistical analysis. The software’s core component enabled users to write applications or scripts in a programming language devised by SAS, which would then be run on the SAS programs which those users would have to license from SAS. The defendant acquired a licence for SAS’s software and studied it. The defendant had no access to the source code of the SAS software; nor had it decompiled it. The defendant developed its own programs, which were intended to emulate the functionality of SAS’s programs, and could be used to execute applications written with SAS’s core software. SAS Institute claimed that the defendant had infringed its copyrights by (among other things) indirectly copying the SAS programs, by copying the SAS manuals, and breaching the terms of the SAS licence.

Justice Arnold’s preferred view was that copyright in computer programs did not protect the SAS programming language, data files (which he found were interfaces), or functions. He agreed with the decision in *Navitaire Inc v*

*Easyjet Airline Company and Bulletproof Technologies Inc* [2004] EWHC 1725 (Ch), that there was no infringement by copying of the functions of airline reservation software, where there was no internal similarity; or by copying the syntax of commands, screen displays and reports, or business logic.

However, despite giving his preferred view, Justice Arnold referred certain questions to the CJEU, since the law on the protection of UK copyright is based on the EU Software Directive. (Note that Justice Arnold represented the defendants in the *Navitaire* case and may have wished to avoid any implication of bias.) In broad terms, the questions are:

- Does the Software Directive mean that copyright in a computer program is not infringed by:
  - ▶ Replicating its functions, where there is no access to source code and no decompilation? Is the answer affected by the nature/extent of that program's functionality; the skill, judgment and labour expended on devising the functionality; the level of detail reproduced; or whether what is reproduced goes beyond strictly what was needed for the same functionality?
  - ▶ Writing a second program so as to interpret and execute applications using the same words and syntax as used by the programming language of the first program?
  - ▶ Writing a second program so as to read from and write to data files in same format as devised for that first program?
- Does it make any difference to the answers, that the author of the second program has studied the first program, or the related manual?
- What is the scope of the statutory permission to observe, study or test the functioning of a computer program (relevant to the breach of licence claim)?

In cases concerning the non-literal copying of financial or business software, it may be difficult to conceive of non-literal copying other than of ideas or pure functions. What about games? *Nova Productions Ltd v Mazooma Games Ltd and Others*, *Nova Productions Ltd v Bell Fruit Games*

*Ltd* [2007] EWCA Civ 219 concerned a claim for copyright infringement of a computer game simulating pool. There, the court stated that if the “idea” is sufficiently detailed, so that the author’s skill and labour is in the expression of that idea, then infringement is possible. In the particular case, the court found, with regard to textual copying of the program, that the similarities between the parties’ games were at such a level of abstraction that there could not be infringement.

One wonders, however, if there might be more specific aspects of gameplay which could fall on the protected side of the expression/ideas dichotomy, say, a particular way of handling a weapon.

Note that the above cases were concerned with program copying. The copyright and protection of the artworks comprised in games is a different story.

This article also appeared in *Develop*, the computer game developers’ publication.

## 6. Copyright in GUIs

The CJEU has found that Software Directive (91/250/EEC) does not confer protection on a graphical user interface (GUI), because it is not a computer program, but copyright may subsist in a GUI, where it is the author’s own intellectual creation – see *Bezpečnostní softwarová asociace – Svaz softwarové ochrany v Ministerstvo kultury*, Case C-393/09, 22 December 2010.

As indicated above, under the Software Directive, the ideas and principles which underlie a computer program, including those which underlie its interfaces, are not protected by copyright under that Directive. Indeed, generally speaking, it is the expression of ideas and principles, not the ideas and principles *per se*, which attract protection. Moreover, under the Information Society Directive (2001/29/EC), subject to certain exceptions, copyright entitles the holder to prohibit reproduction of their works, whether in transient or permanent form, and including by communicating those works to the public.

The Czech Ministry of Culture rejected an application by the claimant, BSA, for authorisation for the collective administration of copyrights in computer programs, on the grounds that copyright did not protect the display of those

programs on the computer screen. Litigation ensued, and the Czech Supreme Administrative Court asked the CJEU whether (i) a GUI is a form of expression of a computer program and thus protected by copyright, and (ii) television broadcasting constitutes making the GUI available to the public.

The CJEU answered both questions in the negative. It said that the source and object code were the forms of expression of a computer program under the Software Directive; the object of the protection was the form of the program which allowed reproduction in different languages. Also protected under the Directive was the design work leading to the creation of the program. The Court said that any form of expression of a computer program attracts protection when its reproduction would engender the reproduction of the program itself. A GUI, however, was simply one element of a program by means of which a user could use the program. The Court then said that, although the question was not referred to it, it was appropriate to determine whether a GUI could be capable of protection under the ordinary law of copyright. The Court found that it could, but not as regards those components differentiated only by their technical function.

The Court then said that a GUI was not communicated to the public by a television broadcast, because the viewer would not have access to its essential element of providing interaction.

It is difficult to reconcile the Court's findings that GUI could be protected by ordinary copyright with its findings that a GUI is not communicated to the public by a television broadcast. In other words, what kinds of elements could be comprised in a GUI, that are not purely functional in nature?

## **7. Standard terms of business upheld**

Standard terms and conditions of business govern the majority of routine commercial transactions. Mostly they are the seller's or supplier's terms although larger corporations will often seek to impose their own terms to apply to their procurement contracts. The customer, however, rarely concerns itself about the "small print" in its supplier's standard terms until something has gone wrong. The frequent reaction will then be to scrutinise and attack the wording and the effect of the standard terms and to claim that they offend the reasonableness test under the Unfair Contract Terms

Act 1977.

A recent example of how effective the “small print” can be in protecting a seller or supplier is the case of *Röhlig (UK) Ltd v Rock Unique Ltd* [2011] EWCA Civ 18. This involved a dispute between the customer who was an importer of sandstone paving and Röhlig UK, a freight forwarding company. They had been doing business together for a number of years and, by the time that the case came to the Court of Appeal, it was accepted by the customer that Röhlig’s standard terms of business were incorporated into the contracts between them.

The dispute arose after the customer had become aware that it had been overcharged on various invoices. It appears that this overcharging had arisen from honest errors made by Röhlig in its accounting entries or in its understanding of the basis upon which it had been agreed that it would charge the customer. These allegations arose both in respect of current invoices which, as yet, remained unpaid but also in respect of earlier invoices which had previously been paid.

Röhlig’s standard terms of business incorporated the terms of the British International Freight Association (BIFA). These standard conditions included two clauses in particular which Röhlig relied upon in contesting liability to the customer. The first was a clause which provided that the customer must pay *“all sums when due, immediately and without reduction..., counterclaim or set-off”*. The second provision was that Röhlig should be *“discharged of all liability whatsoever and howsoever... unless suit be brought and written notice thereof given to [Röhlig] within nine months from the date of the event or occurrence alleged to give rise to a cause of action”*. Both the lower court and the Court of Appeal had no difficulty in deciding that the clause which prohibited set-off was both clear and effective. The words used should be given their ordinary and natural meaning and this had the result that the customer would not be entitled to make any deduction or set-off against the current invoices which had not yet been paid. The customer was obliged to pay these invoices in full. This did not, however, prevent the customer from pursuing a separate claim against Röhlig both for any amount overcharged and included within the current unpaid invoices and also in respect of earlier invoices which had been previously paid by the customer.

The difficulty which the customer faced in respect of this separate claim

was that it had served the legal proceedings on Röhlig on 2 March 2009 but the claim included amounts which the customer had paid to Röhlig more than nine months earlier, i.e. prior to 2 June 2008. Röhlig relied upon the clause in its standard terms which provided that it was “discharged” from liability arising from events or occurrences more than nine months before the customer had brought the proceedings and notified Röhlig of them.

The Court of Appeal agreed with the lower court that this clause was effective. It seems that it was accepted that the customer had, indeed, overpaid Röhlig on earlier invoices but the court held that the customer’s claim simply ceased to exist in respect of overpayments more than nine months prior to the service of the proceedings. It made no difference that the customer may not have known that it had been overcharged and could not have brought the claim earlier although, clearly, the clause would not have protected Röhlig if the overcharging had been a consequence of fraud rather than honest error.

As all transactions between the customer and Röhlig were on Röhlig’s standard terms of business, section 3 of the Unfair Contract Terms Act 1977 applied. Section 3 provides that Röhlig could not exclude or restrict its liability in respect of a breach of contract except in so far as the contract term satisfied the “requirement of reasonableness”. The decision in the lower court was that both clauses did, in all the circumstances, satisfy the reasonableness test. The Court of Appeal considered these findings but upheld the original decision. Although the customer was a small business, the court found that it was an experienced commercial enterprise. There were many businesses offering freight forwarding services which the customer could have chosen instead of Röhlig and, in all the circumstances, the customer had notice of the BIFA terms. The Court of Appeal considered that where standard terms have been negotiated between representatives of suppliers and customers as is the case with the BIFA conditions then they are likely to represent a fair balance of competing interests. The Court of Appeal acknowledged that the requirement of reasonableness must be considered separately in each case in the light of the circumstances of the case but it was nonetheless relevant that the BIFA clause imposing the nine month time bar on the claims had been upheld in an earlier case.

Both the lower court and the Court of Appeal robustly upheld standard terms designed to provide protection to the supplier even though it was not

disputed that the customer had been overcharged. From a supplier's perspective, it must clearly make sense to incorporate reasonable exclusions and limitations of liability in its standard terms and also to make sure that those standard terms are drawn to the attention of its customers. From the customer's perspective, if it cannot negotiate any amendment, then the alternative indicated by the Court of Appeal seems to be to shop around for other suppliers.

## 8. To be a contract or not to be a contract?...

That was the question before the court of appeal in *Immingham Storage Company Ltd v Clear Plc* [2011] EWCA Civ 89 where it was held that, following a series of email exchanges concerning the provision of fuel storage facilities by the claimant (Immingham) to the defendant (Clear), the statement that a "formal contract will then follow in due course" in the claimant's quotation did not indicate that the claimant's acceptance of the quotation (once signed and returned by the defendant) was merely an agreement subject to contract but instead was an expression of the desire of the parties as to the manner in which the transaction already agreed to, would in fact go through.

The case is a good example to businesses of why it is important to have clear contract wording, processes and procedures and an understanding of what amounts to pre-contract negotiations and what amounts to a contract.

A quotation was emailed by the claimant to the defendant headed "*subject to board approval and tankage availability*". It contained the main details of the proposed arrangement, including capacity and type of storage facilities, the commencement date and minimum storage period and the monthly charge, a statement that "*all other terms will be as per our General Storage Conditions Version 2008...*" and that "*a formal contract will then follow in due course*". The quotation was signed by the defendant under the pre-printed words "*we hereby accept the terms of your quotation subject to your Board approval*" and faxed back to the claimant. A few days later the claimant sent an email entitled "*contract confirmation*" to the defendant stating:

*"We are delighted to be able to accept your offer...from no later than 01 May 2009 you are assured of [the storage space] and can now proceed to source your product accordingly. In further confirmation of the above, our*

*full contract for this business will now be raised over the next few days by our Head Office and sent for your signature and return.”*

A ‘full contract’ was sent but the defendant did not return it. The storage space was made available to the defendant but the defendant was unable to source the appropriate product to make use of it. The claimant raised invoices for monthly storage charges on 1 May and 1 June. Neither was paid and the defendant denied the existence of any contract on the basis that it did not sign and return the ‘full contract’.

The court decided that the quotation dealt with all the terms of any significance to a contract of the type proposed, with matters of detail covered off in the General Storage Conditions Version 2008. It was subject to two conditions only: (i) board approval, (ii) tank availability, both of which were satisfied. Attention was drawn to the absence of the condition ‘subject to contract’. These factors pointed “overwhelmingly” to an intention to create a contract if the claimant accepted the defendant’s offer. The provision that “*a formal contract will then follow in due course*” did not, therefore, indicate that the claimant’s acceptance of the signed quotation was no more than an agreement subject to contract. The “*contract confirmation*” email from claimant to defendant, although referring to a “*full contract*” to be sent at a later date, read in its entirety, strongly supported the conclusion of a contract at that stage. The “*full contract*” reference did no more than repeat the provision in the quotation that a “*formal contract*” would follow in due course, it did not introduce a variation to the terms of the offer, but corresponded with them. The “formal contract” was essentially a formality, as the substance had already been agreed.

When negotiating a contract (particularly where the negotiations have an audit trail, e.g. email) parties should include wording to make it clear if they do not want to be bound until a formal document is signed and that any prior agreement on the main terms is only a non-binding pre-agreement. This could be done by using the phrase “subject to contract” which creates a strong (but not conclusive) presumption that the parties do not yet want to be bound.

A lot of time and money (going to court) could have been saved by the parties in the case discussed if the contract documentation, procedure and processes were clearer and the relevant staff were trained in contract law.

## 9. Repudiation of a contract - tread carefully

In *De Beers UK Ltd (Formerly The Diamond Trading Co Ltd) V Atos Origin It Services UK Ltd* [2010] EWHC 3276 (TCC), the court had to determine which party had ended a contract, upon which rested the question of the other party's damages resulting from an unlawful repudiation.

De Beers had entered into an agreement with the government of Botswana to move De Beers' aggregation process to Botswana. De Beers therefore decided to procure supply chain management software to support the transfer, and to take the opportunity to upgrade its existing, out-moded systems. De Beers entered into a fixed price contract with Atos for this project. The project fell behind. The parties entered into lengthy discussions of a revised programme. Meanwhile, Atos issued an invoice, which De Beers refused to pay, citing delay and inadequate quality of work. Atos then claimed that De Beers had caused delay, and threatened to suspend work unless the contract could be renegotiated, and also unless De Beers paid its invoice. Atos was concerned about making losses on the contract. No agreement was reached and work did not resume. The 100 page judgment describes what transpired, who said what about the events, and who was responsible for the difficulties with the project. The judge found that major causes of the delays were change requests, additional work resulting from the elaboration of original high level requirements, De Beers' delays in finalising requirements, shortcomings in the system design and, possibly, lack of effective communication between the parties. The judgment also describes the contract in detail.

The judge cites a number of cases formulating the test for repudiation of a contract. In essence, the breach must go to the root of the contract; the party breaking the contract must have clearly shown an intention to abandon or refuse to perform the contract. Whether this has happened will be highly fact sensitive.

At the end of the day, the judge found that Atos had repudiated the contract, essentially by refusing to resume work until the contract was renegotiated.

The judgment then contains a detailed analysis of the parties' claims and losses, as a result of which it states that De Beers had a net claim of £1.4 million (£4.4 million reduced by Atos's claims against De Beers).

The judge added an afternote that the damages awarded against Atos may well have been less than the losses it would have incurred had it performed the contract to completion. The judge may have awarded higher damages against Atos had the court been provided with evidence that De Beers would, in fact, procure a replacement system and not abandon the project.

It may be that each party was both winner and loser, but the case does illustrate the trickiness of choosing tactics when exiting a contract without a clear contractual basis, as well as of carefully managing delays, performance issues and scope changes.

## 10. Other Hot Topics

**Severance clauses** – We had a reminder in *Francotyp-Postalia Ltd v Kvin Whitehead and others* [2011] EWHC 367 (Ch) of the test of when such clauses are effective. The parties had entered into franchise agreements containing restrictive covenants post-termination, and also a severance clause. One of the restrictions was invalid for restraint of trade. The court refused to apply the blue pencil test, citing the three fold test for severance: (i) that the unenforceable provision can be removed without adding or changing what remains; (ii) the remaining terms are supported by adequate consideration; (iii) and the severance does not change the essential character of the contract. The difficulty was that the severance from the restriction in question affected the other restrictions and so requirement (i) was not met, and also the court would have to make a new contract. Careful with your drafting!

**Anti-bribery** - The Bribery Act 2010 requires the Secretary of State to publish guidance on the procedures which companies can put in place to prevent bribery by their staff and by any third parties while performing services for or on behalf of the company. This guidance, if followed, would assist a company in proving that it had in place "adequate procedures" designed to prevent bribery, which is the only defence available to the corporate criminal offence of failing to prevent bribery under the Act. The guidance is expected to be published in final form very shortly, and there will then be a period of three months before the Act itself comes into effect.

Salans will be hosting an Anti-bribery and Corruption seminar on 7<sup>th</sup> April 2011. To find out more, or register your interest to attend, please visit our website.

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