LEWIS SILKIN

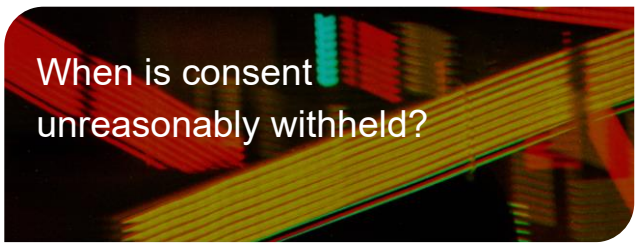
Contract interpretation guide

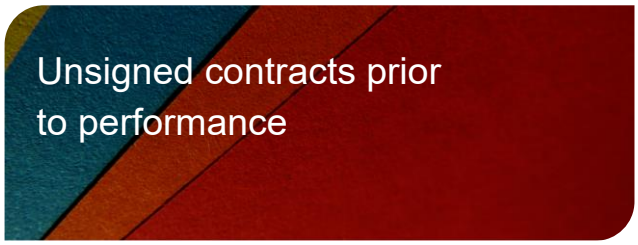
England and Wales

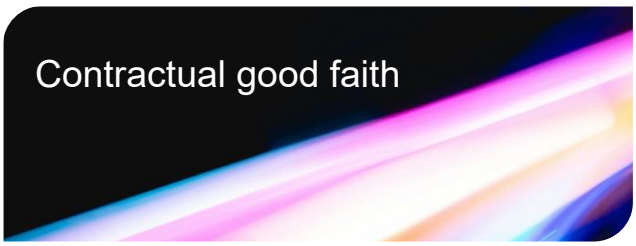
The meaning of words used in contracts is of key importance. The choice of certain words or phrases can significantly impact upon the obligations of one party to another and using them in contracts without thought to their meaning and implications can result in uncertainty, unintended consequences, a mismatch of expectations and, ultimately, legal disputes.

Our Dispute Resolution team has compiled this guide, looking at the meaning of some commonly used, but also commonly litigated, contractual terms. We also consider the likely outcomes where parties have not concluded a formal contract at all. Click on the tiles below to navigate our guide.

Our experienced team is available to discuss any questions you may have - please **contact us**.







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Meaning of ‘endeavours’

Contracts often include an obligation for a party to use ‘best endeavours’, ‘reasonable endeavours’ or ‘all reasonable endeavours’, or other variations of the same, to achieve a defined objective. It is sometimes difficult to distinguish what different drafting actually means practice. We provide guidance on how to interpret endeavours clauses below.

Endeavours clauses are a way for parties to agree to try to meet specified objectives without undertaking to be bound by an absolute contractual obligation or allowing an unenforceable ‘agreement to agree’ to make its way into the contract. This option is often useful where the completion of the relevant objective depends on matters outside of the parties’ control and remains uncertain. However, due to their nature, endeavours clauses are notoriously difficult to define with any certainty with respect to what is actually required of the relevant party. The distinction between the most common types of endeavours clauses, ‘best endeavours’, ‘reasonable endeavours’ and ‘all reasonable endeavours’, is also ambiguous.

In general, it is considered that ‘best endeavours’ will require more by way of performance of the contractual obligor than ‘reasonable endeavours’ and ‘all reasonable endeavours’ will require less than ‘best endeavours’ but more than ‘reasonable endeavours’. However, what is clear is that there is no uniform meaning for each term and that the interpretation applied will depend largely on the commercial and contractual context. The *Jet2* case (addressed below) has created some uncertainty regarding what is required from each obligation and held that “[T]*he meaning of the expression remains a question of construction not of extrapolation from other cases … the expression will not always mean the same thing*”[1]. Therefore, it is possible that the performance required by the same endeavours clause will be interpreted differently across different contracts and parties.

In construing the meaning of an endeavours clause in a particular situation, the court will apply the general rules of contractual interpretation and will have regard to (at the time that the contract is formed) the express wording of the clause, the contract as a whole, the commercial objective of the contract and the surrounding commercial context. The court will consider whether the undertaking has been satisfied at the time of performance, which may mean that the prevailing circumstances might not be quite what the parties had anticipated. Distilling an established set of rules is therefore difficult. However, the case law in this area provides some useful guidance as to how to approach the different drafting in practice.

Best endeavours

It has been held that, in order to exercise ‘best endeavours’, a party must take all steps which “*a prudent, determined and reasonable*”[2] obligee would take when acting in his own interest and desiring to achieve that result. The obligor must therefore consider what a reasonable obligee would do when considering what steps it should take. In contrast to the other forms of endeavours clause, a best endeavours clause

[1] *Jet2.com v Blackpool Airport Ltd* [2011] EWHC 1529 (Comm)

[2] *IBM United Kingdom Ltd v Rockware Glass Ltd* [1980] FSR 335

may require an obligor to incur financial expenditure in meeting the defined purpose and/or act in a manner contrary to its own commercial interests, as in the *Jet2* case[3]. In this case, the effect of the endeavours clause meant that Blackpool Airport was required to operate outside of its normal hours for the Jet2 airline notwithstanding that this caused the airport to suffer a loss.

Taking guidance from case law, in order to satisfy a best endeavours clause, an obligor should do everything that they can reasonably do and ensure that it has been genuine in its attempts to carry out the desired objective.

All reasonable endeavours

It is thought that this term represents a middle ground between 'best endeavours' and 'reasonable endeavours'. This can make its interpretation in practice difficult as it will, as ever, depend on the context. Whilst there is some uncertainty in the case law, it has been suggested that an 'all reasonable endeavours' clause requires efforts very similar to that of best endeavours with the key distinction being that an obligor subject to an 'all reasonable endeavours' clause is less likely to be required to sacrifice its own commercial interests[4]. The terms of the contract will be of key relevance.

Reasonable endeavours

This is the least onerous variation of the endeavours clause. The conduct required to fulfil this obligation will largely depend on the wider context, including the underlying agreement, the factual background and the wider commercial context. However, it may suffice for the relevant party to take one of several possible courses of action, provided such course of action is deemed to be 'reasonable'. Importantly, an obligor is generally able to balance the weight of the contractual obligation against its own commercial considerations. If, however, the desired objective is clear, a reasonable endeavours obligation can still represent a demanding commitment.

The obligation for a party to use reasonable endeavours can often be seen in a force majeure clause – i.e. – a party affected by a force majeure event must use reasonable endeavours to overcome the effects of such event before it can be relied upon as a force majeure. The interpretation of 'reasonable endeavours' in this context has recently come before the Supreme Court[5] which held that a party relying on the force majeure clause and demonstrating that they have used 'reasonable endeavours' to overcome the effects of the event or state of affairs did not have to compromise by accepting an offer of non-contractual performance from the other contracting party, unless there is clear wording to that effect.

Takeaways

Whilst there is some guidance in the case law as to how to interpret the different variations of endeavours clauses, what remains clear is that in practice the meaning of a particular endeavours clause will largely depend on the precision of the desired objective, the predictability and ease of the action required, the contract as a whole and the overall commercial and factual context.

In order to advance commercial certainty and ensure enforceability, parties should add any specific steps and/or measures envisaged to satisfy the endeavours obligation and should clearly express the desired objective in the contract. In contrast, where the objective and any action required are obscure this will make the enforcement of any endeavours clause more difficult. Therefore, whilst the meaning of the clause will depend largely on the context, a defined and attainable objective and a stringent variation of the endeavours clause, such as 'best endeavours', will aid enforcement against the obligor.

An obligor seeking to comply with an endeavours clause should consider recording in detail all steps taken towards the satisfaction of the obligation, in the event of a subsequent dispute.

Georgina Fernando
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[3] *Jet2.com v Blackpool Airport Ltd* [2012] EWCA Civ 417
[4] *Rhodia International Holdings Ltd v Hunstman International LLC* [2007] EWHC 292 (Comm); *Brooke Homes (Bicester) Ltd v Portfolio Property Partners Ltd* [2021] EWHC 3015 (Ch)
[5] *RTI Ltd v MUR Shipping BV* [2024] UKSC 18

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Interpretation of exemption clauses

Parties often include provisions in their contracts that seek to exclude (in its entirety) or limit (to a particular level) a contracting party's liability in respect of certain types of liability or loss. These clauses can serve the useful purpose of allocating risk between the parties and thereby giving the parties certainty as to what their potential exposure is under the contract.

Clauses that seek to exclude or limit liability (referred to in this note as "exemption clauses") can operate in different ways. Clauses can be drafted so as to:

- prevent one party from being liable to the other in the event of what would otherwise be a breach of the contract;
- limit or remove a remedy for breach, for example by limiting the amount of compensation which would otherwise be payable upon a breach of contract;
- require one party to indemnify the other against the consequences of that other's default; or
- limit the time in which one party may bring a claim against the other.

Whilst parties are generally free to choose the terms upon which they wish to contract and to allocate risk as they see fit, exemption clauses can operate in a manner that may appear unfair or which may take advantage of an inequality of bargaining power. In order to address these concerns, various common law and statutory controls apply to exemption clauses.

Common law controls (developed in case law by the courts) include:

- Rules regarding the incorporation of the clause: the more onerous and unusual a clause is, the more that must be done to bring it to the attention of the other party.
- Restrictive interpretation of exemption clauses.
- Public policy against fraud: a party cannot limit liability for its own dishonesty (*HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6).

Statutory controls (in a business to business context) include:

- The Unfair Contract Terms Act 1977 ("UCTA"). In summary, UCTA provides:
  - For a complete bar on the exclusion of liability for death or personal injury resulting from negligence, or for the breach of statutory implied terms about title to goods;
  - That any provision seeking to restrict liability for the following types of liability must be "reasonable":
    - Breach of contract, when a party is seeking to restrict liability for such breach in its own standard terms (not in respect of a negotiated contract);
    - Loss resulting from negligence (other than death or personal injury), as defined in UCTA;
    - (Non-fraudulent) misrepresentation;
    - Breach of statutory implied terms about quality of goods

- Other statutory controls can be found in the Supply of Goods (Implied Terms) Act 1973 and the Late Payment of Commercial Debts (Interest) Act 1998.

This note deals with the second of the common law controls referred to above; namely the (restrictive) interpretation of limitation of liability clauses.

Limitation of liability clauses have traditionally been interpreted strictly. However, since the introduction of UCTA, and over more recent times, the courts' traditional hostility has diminished, and the degree of strictness applied is likely to vary depending upon the extent of the limitation (so, for example, the rules will be applied more rigorously to a clause excluding a party's liability than to a clause limiting liability).

The following general principles of interpretation have been developed in the case law over time:

- Exemption clauses will be interpreted in the context of the contract as a whole, rather than in isolation.
- A real doubt or ambiguity in an exemption clause will be resolved against the party seeking to rely on the clause (i.e. "contra proferentem").
- Clear words are necessary before the court will hold that a provision in a contract takes away rights or remedies which a party would have had at common law.
- As regards attempts to exclude or restrict liability for negligence:
    - Where a party has no liability to the other contracting party other than a liability in negligence, an exemption clause will usually be interpreted as limiting or excluding liability for negligence.
    - Where a party's liability may realistically arise otherwise than through negligence, an exemption clause will usually be interpreted as not limiting or excluding liability for negligence unless it does so by clear words (which will most likely require the use of the word "negligent" or "negligence" or some synonym for those words).
- Prior to the introduction of UCTA, and the controls on exemption clauses brought about by that Act, there used to be a presumption of interpretation that an exclusion clause was not intended to apply to a fundamental breach of contract (in other words, a breach depriving a party of substantially the whole benefit of the contract). That is no longer the case; there is no rule of law which prevents parties from excluding or limiting liability for fundamental breach. Whether the contract does so is a question of interpretation.
- The court will be reluctant to interpret an exemption clause in a manner which effectively absolves one party from all duties and responsibilities, leaving no remedy, as "to do so would be to reduce the contract to a mere declaration of intent".
- As noted above, on grounds of public policy a contract may not exempt a party from liability for fraud. It is possible for a provision to exclude liability for the fraud of a party's agent, but it must do so in clear and unmistakable terms.
- Where a contract contains a provision excluding liability for "consequential losses", "consequential losses" will normally be interpreted as referring to losses under the second limb of the rule in Hadley v Baxendale (i.e. losses that result from special circumstances, which will only be recoverable if the other party knows of those circumstances). This means that losses under the first limb of the rule in Hadley v Baxendale (i.e. losses which arise naturally, or in the usual course of things, or that may reasonably be in the contemplation of the parties when the contract was made) will not be excluded by virtue of this wording, even if a layperson may consider those losses to be "consequential".
- The following types of clauses will be subject to the same principles of interpretation as an exemption clause:
    - Time bar clauses.
    - Clauses pursuant to which one party agrees to indemnify another party against the consequences of that other's liability to third parties.

In conclusion, a party looking to exclude or limit its liability should use clear and unambiguous words, and should not attempt to exclude its liability under the contract entirely or seek to exclude its liability for fraud. Doing otherwise opens the door to challenge and uncertainty.

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LEWIS SILKIN

What type of breach?

Contractual breaches can come in many forms. Some are serious, giving the wronged party the right to terminate the contract. Others will be more minor, and might be easily remediable. It can be useful to think of contractual breaches as a sliding scale, with repudiatory breaches at one end, and minor, remediable breaches at the other.

When a counterparty commits a breach of contract, it is necessary to assess the severity of the breach, alongside the wording of the particular contract in question, before acting. Getting things wrong can have very serious consequences.

Conditions, warranties and innominate terms

Contracts are made up of different types of terms:

- Conditions are essential contract terms, of key importance to the parties. Most terms are not conditions. Any breach of a condition will justify an immediate termination of the contract at common law on the basis that the breach is repudiatory.
- Warranties carry the least weight. No breach of a warranty can constitute a repudiatory breach and trigger a right to terminate.
- Innominate terms are the most common types of term. The worst breaches can trigger a right to terminate for repudiatory breach at common law, less serious breaches will not.

Repudiatory breach

Parties to a contract normally retain their common law rights to accept a counterparty's repudiatory breach and terminate the contract. The parties are able to exclude that right, but express clear wording has to be used – unless they do so, it will be presumed they wanted to retain it.

Absent any guidance in the applicable contract as to what constitutes a repudiatory breach, a breach will be repudiatory at common law if it deprives the innocent party of the substantial benefit of the contract. A repudiatory breach will often be referred to as striking at the root of the contract. When faced with a breach one should step back and consider whether it meets this relatively high bar; if not, it won't be repudiatory.

In the event of a repudiatory breach, the innocent party has the right to choose whether to accept the breach, terminate the contract and claim damages, or affirm the contract (so it continues) and claim damages.

Substantial breach

Contract terms referring to 'substantial breach' are not that common, but do come up from time-to-time.

The Court of Appeal has held that a clause in a contract giving rise to a right to terminate for 'substantial breach' was no different to repudiatory breach (in *Crane Co. v Wittenborg* [1999] All ER (D) 1487).

Material or serious breach

'Material' or 'serious' breach are much more commonly found expressions within contracts. Contracts often include an express right to terminate if a party is in either material or serious breach.

If you're drafting a contract and considering including a 'material' or 'serious' breach provision, it can be useful to provide a list of potential examples of what actions or omissions would constitute a breach of that standard, along with the consequences of such breach. The list doesn't have to be exhaustive or to cover every given eventuality, but the provision of a few examples of breaches which meet the standard will allow comparison with the listed breaches by analogy.

If the contract doesn't include a list of examples, then you'll need to

consider what constitutes a material breach. Judges have provided guidance, but those guiding principles can only go so far.

In *Compass Group UK and Ireland Ltd v Mid Essex Hospital Services NHS Trust* [2013] EWCA Civ 200, Lord Justice Jackson stated that a material breach was one which "*connotes a breach of contract which is more than trivial, but need not be repudiatory*", relating to a "*serious matter, rather than a matter of little consequence.*"

Later in *Mears v Costplan* [2019] Civ 502, the High Court held that the meaning of 'material' could range from "*not trivial*" to "*serious enough to justify termination at common law*".

Context and the exact circumstances and the detail of your contract will be key in making your assessment as to whether a breach is material and whether that justifies termination.

Persistent breach

Although less common, contracts may refer to 'persistent' or 'repeated' breaches. An LLP agreement containing such a term was recently considered in the case of *THJ Systems Ltd & Anor v Daniel Sheridan & Anor* [2023] EWHC 927 (Ch). In respect of allegations of persistent breaches, the court found that repeated breaches need to have some gravity to them, and that taken together they must amount collectively to something serious in all the circumstances, taking into account the nature of the contract and the obligation breached, in order to give rise to a right to terminate.

Remediable breach

Often contracts will set out that a party which is in breach of contract be given a period to remedy the breach concerned, commonly known as a 'cure period'.

If your counterparty has committed such a remediable breach, you'll need to comply with the express terms set out. This will normally involve you serving a notice on the counterparty informing them that they are in breach and specifying the period in which they must remedy the breach. Once you've served your notice, you'll need to wait the full cure period to see if the breach is remedied before taking further action. Not all remediable breaches will be sufficiently serious to give rise to a right to terminate if they remain unremedied – so consider, in advance, the impact of the breach if it remains unremedied.

Any breach

Contractual terms giving parties a right to terminate an agreement for 'any breach' are uncommon, and are not widely used, as they are seen as uncommercial.

Such provisions have received some judicial attention, with 'any breach' having been interpreted as meaning a breach which is non-trivial (*Vivienne Westwood Ltd v Conduit Street Development Ltd* [2017] EWHC 350 (Ch). In other decisions, the court has interpreted a provision giving right to terminate for any breach, as meaning any repudiatory breach, i.e. as per the position at common law (as in *Rice v Great Yarmouth Borough Council* [2003] TCLR 1).

Why does it matter?

Put simply, the consequences of getting things wrong can be serious. If you don't act quickly when faced with a repudiatory breach, then you might be taken to have affirmed the contract. And if you seek to terminate on the wrong grounds or when you don't have a basis to do so, this is likely to constitute a repudiatory breach in itself.

When terminating for breach of contract, you want to be sure you've considered the position, and set this out correctly in any termination notice you serve. Once a termination notice has been sent, it can't be withdrawn. Once you've made your election, and set out the grounds on which you're terminating, you can't change course.

What should I do?

When faced with a breach of contract, you need to consider and assess the position. Go back to the wording of the contract, but don't forget your common law rights. Take advice if necessary to make sure you're acting appropriately. Don't wait too long before deciding on what action to take, or you may be taken to have affirmed the contract. If you're seeking to terminate the contract as a result of the breach, make sure you consider all possible grounds for termination you may have, and what damages each ground might give rise to – different types of damages may well be available for different types of breach. If the consequences of the different breaches aren't inconsistent or contradictory, then you could consider setting out alternative grounds for termination in your termination notice.

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When is consent unreasonably withheld?

The phrase 'consent not to be unreasonably withheld' is often seen in commercial contracts. However when is withholding consent actually unreasonable and how can this be determined?

The phase 'consent not to be unreasonably withheld' can be used in a number of different situations, for example, in commercial and financial contracts, and in leases. Other variations, such as, "such consent not to be unreasonably conditioned, withheld or delayed", can arguably make the obligation stricter as it adds the requirements that consent must also not have unreasonable conditions attached or be unreasonably delayed.

Interpretation

So when is consent unreasonably withheld? This will be a question to be determined in the context of the relevant facts and the answer will differ depending on the context.

In a 2011 case, *Porton Capital Technology Funds and others v 3M UK Holdings Limited and others* [2011] EWHC 2895 (Comm), this phrase was interpreted in the context of a commercial agreement between two parties for the acquisition of the shareholding of a company. One of the Defendants had agreed that it would not cease the business of the development or marketing of a product, "*without the written consent of the vendors, which shall not be unreasonably withheld*". Consent was sought several times pursuant to that clause but was refused. The Defendants considered that such consent was unreasonably withheld. The court disagreed and sided with the Claimants, finding that refusal of content had not been unreasonable. The court found that principles developed mainly in the context of landlord and tenant cases were of assistance and that the following approach was appropriate:

1. The burden is on the party alleging unreasonableness to prove this;
2. The party refusing consent simply needs to show that it was reasonable in the circumstances, not that the refusal was right or justified;
3. In determining what is reasonable, a party deciding whether to consent can have regard to their own interests; and
4. There was no requirement to balance interests or have regard to costs which may be incurred by the requesting party.

The court considered all the particular circumstances and concluded that consent was not unreasonably withheld.

Some more recent cases have also considered the issue of whether consent had been unreasonably withheld:

- *Barclays Bank plc v UniCredit Bank AG and another* [2012] EWHC 3655 (Comm) - The case concerned a dispute as to whether the Claimant exercised its discretion in a "*commercially reasonable manner*" in respect of its refusal to consent to the early termination of certain finance transactions. In this case, the court acknowledged that it is difficult to define detailed objective criteria as to whether consent has been exercised in a commercially reasonable manner or if consent has been unreasonably withheld, but noted that, "*the question is not whether the decision is justified but whether the decision is one which might be reached by a reasonable man in the circumstances; and the decision maker is entitled to take into account his own commercial interests, in preference to those of the other party, and normally to their exclusion*." The decision

was upheld on appeal ([2014] EWCA Civ 302).

- Refusal of consent is likely to be unreasonable if the purpose of the provision in question is to preserve the contractual rights of the party needing to consent, but the basis of the refusal is that that party is seeking to enhance such rights. The background and purpose of the provision will need to be taken into account when considering the matter objectively. This was considered in the *Barclays* case above and in *Crowther and another v Arbuthnot Latham & Co Ltd* [2018] EWHC 504 (Comm), in which a lender was found to have unreasonably withheld consent to the sale of a property valued at €4m in satisfaction of a €5.9m debt for reason that it did not have security for the balance, which its contractual rights did not extend to.
- Similar considerations arose in *Apache North Sea Limited v Ineos FPS Limited* [2020] EWHC 2081 (Comm). The court, determining preliminary issues, decided that the defendant could not, under the terms of the contract, make its consent (not to be unreasonably withheld) to the claimant's request to revise its estimated production profile conditional on the agreement of a new tariff. It found, however, that "*it may well be legitimate for the consent-provider to impose a condition intended to protect or compensate for a benefit it enjoyed under the contract which the course for which consent is sought would impair. However, that is obviously very different from imposing a condition which would impair a right which the party seeking consent enjoys under the contract.*" The terms of the contract as a whole must be taken into account in the objective assessment.
- In *Gama Aviation (UK) Limited and another v MWWMMWM Limited* [2022] EWHC 1191 (Comm), the court considered (on an application for summary judgment) issues including whether consent had been unreasonably withheld in the context of a contract for the management and operation of an aircraft. The court noted the following when looking at whether consent was unreasonably withheld (in this case, in relation to an assignment):
  - If a party unreasonably withholds consent, the party seeking that consent can treat it as no longer being required.
  - Reasonableness has to be given a broad, common sense meaning.
  - It involves both a reasonable process and a rational outcome.
  - A reasonable process means "*one which takes into account considerations which have a legitimate purpose and disregard irrelevant considerations*".
  - The refusal of consent can't be based on "*extraneous or disassociated matters*" or to achieve a collateral purpose.
  - Reasons relied upon to justify refusal of consent must be those which were relied upon at the time, rather than afterthoughts.

Conclusion

We can extrapolate from these cases, but each case will turn on its own facts.Therefore, a court will decide, objectively, whether consent was unreasonably held or not, taking into account the type of contract and all the relevant circumstances. Therefore, whether a decision to withhold consent is reasonable or not could differ in different contexts.

How can uncertainty be avoided? Parties should carefully consider what each provision is designed to achieve. Where possible, clearly agree and set out each parties' rights and obligations in the relevant contract, and if there are particular steps which a party should take to satisfy its contractual obligations, detail these to avoid later argument.

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LEWIS SILKIN

Unsigned contracts prior to performance

Though not best practice, it is not uncommon for parties to begin to perform duties under a contract before it is signed. When this situation arises, the question is what terms, if any, are the parties bound by?

The starting point when considering the answer to this question will be clarifying the stage which the contract or negotiations reached before the parties began performance. This is of course, a highly fact specific question and will vary in each instance. Below we run through the principles to consider and apply them to some different, though not exhaustive, examples of parties proceeding without signed terms.

A recap of the law

The starting point is that until a contract is concluded (in accordance with the principles of English law) the English courts will maintain that either party is free to decide not to contract or to withdraw without incurring liability.

English law requires that for a contract to be formed there must be an offer, that is accepted, with consideration passing, an intention to create legal relations and on certain terms. In the event of a dispute as to when a contract was formed, or if it was formed at all, the court is concerned with finding out if those elements are satisfied. A signed document may be good evidence of that, but it's by no means the only way terms can be found to bind.

In fact, a written document is not (with some limited exceptions) a pre-requisite to a legal binding contract at all. It's merely one way a contract can be formed under English law, which also recognises contracts formed orally or via conduct.

We will now turn to several scenarios to assess the likely legal position and the considerations of the courts.

Contract terms are final and parties begin performance without having signed

If the only thing missing from a fully negotiated contract is the signature and date but the parties begin to work together in accordance with the terms, the court may well conclude that the contract applies in full and is binding. From the contract, the court should have everything it needs to identify the offer, consideration and certainty of terms. The two points that might be challenged are the fact of acceptance and an intention to create legal relations.

English law permits acceptance either expressly or via conduct. That is a wide remit and a pragmatic approach will be taken by the court, looking at all the evidence. So, if the parties fulfil their duties under the contract and in accordance with the agreed terms, that is likely to suffice for acceptance. Such conduct will also satisfy the requirement for intention to create legal relations. Of course, one party cannot typically use its own performance to bind the other, without more. Acceptance is the final and unqualified expression of assent to the terms of the offer. For the offeree to have accepted, it must therefore be clear that the offeree acted as it did in response with the intention of accepting the offer. Generally an offeree will not be bound by an offer if they do nothing in response, although if the silence of the offeree demonstrates unambiguously, in the circumstances, an intention to be bound, this could be sufficient.

Both sides have put forward their own contracts, with neither signed

A more adversarial scenario than the above, if the parties didn't negotiate terms and end up with a final draft but instead put forward their own respective terms, which neither signed or otherwise expressly

accepted, you'll be in the remit of the "last shot" doctrine. Here, if conflicting terms have been exchanged, each is considered a counteroffer. If, following receipt of the last set of terms exchanged, the parties started performing the contract then, absent any subsequent negotiation on terms or conduct indicating that they intended other terms to apply, that performance may be considered acceptance by conduct of the final set of terms in the series. It could also be the case, depending on the facts, that a contract is formed, but neither party's terms apply. Of course, if there is no evidence of any acceptance, then no contract will be formed.

As indicated, the last shot doctrine can be displaced by the evidence of the parties' objective intention that the "last shot" shouldn't prevail – for example, if the parties' performance follows the terms of the earlier document in the series. It is also possible that the terms of an earlier contract may expressly prevent the possibility of it being varied or overruled by later terms unless a variation is expressly agreed by both parties in writing and signed – for example, a master services agreement that is signed by both parties, which clearly states its terms will prevail will likely bind in place of general wording at the bottom of an invoice that says, "delivery based on our general conditions of sale".

Heads of Terms ("HoTs") / Memorandum of Understanding ("MoU")

A more nuanced situation is where parties exchange HoTs, a MoU, letter of intent, heads of agreement, etc, but failed to further negotiate the details of those terms or finalise the anticipated contract. In the event of a dispute, the court will strive to determine what terms apply, if any.

The legal effect of these types of document will depend on their content and on the intention of the parties. The principles above governing whether or not a contract has been concluded will apply. As above, if the parties start performing in accordance with the HOTs/MOU, a court may be able to find a contract has been concluded via conduct on the terms set out. Markings such as "subject to contract" will provide a strong indication that the parties did not intend to be bound. However, the court will look at all of the circumstances and the relevant context to assess the actual content of any agreement and can still conclude that the parties intended to be bound if there is evidence of such and all of the contractual formation requirements are satisfied.

Whether terms in these types of 'interim' documents are binding is highly fact specific. A consistent factor is that a party takes on significant risk by commencing performance on the basis of HoT/a MoU alone.

What if no terms are apparent?

Though it might appear there are no terms, the reality is parties will not have begun performance in a complete vacuum and, therefore, there will be some frame of reference for the court to start from in the event of a dispute - even if it's as simple as oral commitments, email communications or a limited HoT. If the court is satisfied that all the requirements for contractual formation are present from those references then there can still be a binding agreement.

As stated at the start, these situations are not exhaustive – there are many other scenarios where parties engage with each other without the applicable terms being clear. Each situation will need to be considered on its facts and in the relevant context to evaluate whether or not a contract has been formed and, if so, on what terms.

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Contractual good faith

The concept of good faith is something of a problem child in contract law. English law has no general doctrine of good faith in contracts. The law has traditionally prized party autonomy in contract formation. That being the case, contracting parties are free to agree to include duties and obligations of good faith in their agreements. This is frequently done, and so despite the absence of a good faith doctrine, the English courts have nevertheless grappled with the question of what is meant by a duty of good faith when interpreting contracts containing such provisions.

This section offers a high level overview of the interpretation of express terms of good faith in contracts, the related duty of rationality in cases of contractual discretion (sometimes called the *Braganza* duty[6]), and finishes with a discussion of situations where good faith obligations have been implied into contracts.

Express terms of good faith

As stated, contracting parties can include terms under which they agree to act in good faith or to owe a duty of good faith. It is not easy to discern an overall pattern from the cases interpreting such provisions, except that the more sophisticated and detailed the contract, the less onerous the obligation of good faith is likely to be.

In *Re Compound Photonics Group*[7], the Court of Appeal emphasised that a clause requiring a party to act in good faith must take its meaning from the context in which it is used. A shareholders' agreement contained an obligation on each shareholder to *"at all times act in good faith in all dealings with the other Shareholders"*. The majority shareholders removed two directors (who were also shareholders), who then issued proceedings for unfair prejudice. The Court of Appeal held that the majority shareholders had not acted contrary to the good faith obligation. If the contractual intention had been to prevent them from exercising their powers under company law to remove the directors, this would have been expressed in the shareholders' agreement. The Court of Appeal placed weight on the fact that the shareholders' agreement had been professionally drafted. Overall, in the context of the case, the duty of good faith clause imposed a core requirement that the parties should act honestly towards each other and the company, and not to act in bad faith towards each other. The court, however, declined to describe what conduct might fall into the category of bad faith.

The courts have interpreted good faith obligations narrowly in complex commercial settings, in which it may be expected that contracting parties will have looked after their own interests and to have included all matters that they wish to. In *Phones 4u Limited (in administration) v EE Limited and others*[8], Phones 4u claimed that a notice by EE not to extend or renew a major contract had no legitimate commercial reason, and was designed to cause Phones 4u to go into administration. Phones 4u alleged that EE's conduct had been in breach of its contractual obligation to *"in good faith observe and perform the term and conditions of this Agreement*". The court disagreed, and held that there had been no breach by EE of the

[6] After the case of *Braganza v BP Shipping Limited* [2015] UKSC 17

[7] [2022] EWCA 1371

[8] [2023] EWHC 2826 (Ch)

provision to act in good faith. The contract was detailed and professionally drafted, and the obligation was limited to fairly narrow aspects of the relevant clause and did not give rise to a general duty. An indication of this was that the contract contained no corresponding good faith obligation on Phones 4u.

Rationality in cases where there is contractual discretion (the *Braganza* duty)

Contracts often give one party the power to exercise a discretion which will affect the rights of both parties. Generally, such a discretion must be exercised in good faith and not arbitrarily or capriciously. In its modern form, this duty is sometimes called the *Braganza* duty, after a Supreme Court case relating to an employer's contractual discretion to pay death in service benefit.

The duty includes an obligation to take relevant considerations into account, to exclude extraneous considerations, and to be consistent with the purpose of the contract. There are, therefore, similarities with the public law *Wednesbury* test.

The duty will not, however, apply to so-called "absolute" contractual rights, such as the right to terminate a contract or to call in a loan.

Implying a term of good faith

The test for the implication of terms into contracts, focusing on necessity and obviousness, is not easy to satisfy. The area in which good faith obligations have been most readily implied are so-called "relational" contracts. The foundational case of *Yam Seng*[9] involved a wholesaler and distributor. The distribution agreement was short and was not drawn up by lawyers. The wholesaler stated that it intended to use another distributor in part of the relevant market, and knowingly gave the distributor false pricing information. The contract did not deal with these issues, and the court considered whether these actions were in breach of an implied duty of good faith. The court found that the contract could be classified as "relational", by which was meant that a high degree of co-operation based on mutual trust and confidence, and expectations of loyalty, were implicit in the contract, and that the wholesaler had been in breach.

A further example of the implication of a good faith term is *Al Nehayan v Kent*[10]. In a long-term joint venture with little contractual detail, the court found there to have been breaches of a duty of good faith where one party had (a) secretly negotiated to sell jointly owned property without informing the other, and (b) used its position as a shareholder to obtain a financial benefit at the other party's expense.

In summary, an implied term of good faith will likely mean that the parties must avoid conduct that reasonable people would regard as commercially unacceptable and must not act to undermine the benefit of the agreed bargain.

Conclusion

Given the uncertainties surrounding good faith in English law, it is legitimate to ask whether including a good faith duty is worthwhile. It may seem desirable to have such an agreement, in particular if a long-term commercial relationship is envisaged, but bear in mind that doubts about what constitutes good faith conduct mean that the problem child status of the concept is likely to continue for some time.

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[9] *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB

[10] [2018] EWHC 333 (Comm)

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Glossary

Our glossary of key terms referenced in this guide

For ease of reference, we have summarised some key terms referenced in this guide. Click on the links to where these terms are discussed for context and guidance.

Term	Meaning	Link to content
All reasonable endeavours	No uniform meaning, but this term is thought to represent a middle ground between 'best endeavours' and 'reasonable endeavours'.	Page 4
Affirmation	A party can affirm a contract following a repudiatory breach expressly or by way of conduct (including delay). If a party affirms the contract (so it continues) it can also claim damages. (See further, Repudiatory breach, below.)	Page 7
Any breach	A contractual provision giving a right to terminate for 'any breach', are uncommon. This term has been interpreted as meaning a breach which is non-trivial. In other decisions, the court has interpreted a provision giving right to terminate for any breach, as meaning any repudiatory breach, i.e. as per the position at common law.	Page 8
Best endeavours	No uniform meaning, but it has been held that, in order to exercise 'best endeavours', a party must take all steps which "*a prudent, determined and reasonable*" obligee would take when acting in his own interest and desiring to achieve that result.	Page 3
***Braganza* duty**	If, pursuant to a contract, one party has the power to exercise a discretion which will affect the rights of both parties, generally, such a discretion must be exercised in good faith and not arbitrarily or capriciously.	Page 14
Common law	Law developed in case law by the courts.	Page 5

Condition	An essential contract term, of key importance to the parties. Any breach of a condition will justify an immediate termination of the contract at common law, should the innocent party so elect, on the basis that the breach is repudiatory, together with the right to claim damages.	Page 7
Consent not to be unreasonably withheld	Whether or not consent has been unreasonably withheld will be a question to be determined in the context of the relevant facts and the answer will differ depending on the context.	Page 9
Consequential loss (or indirect loss)	This term will normally be interpreted as referring to losses under the second limb of the rule in *Hadley v Baxendale* (i.e. losses that result from special circumstances, which will only be recoverable if the other party knows of those circumstances).	Page 6
Contra proferentem	A doctrine which provides that in the event of doubt or ambiguity in the interpretation of a contract, there is a presumption against the party which put the words forward.	Page 6
Exemption clause	A clause which seeks to exclude (in its entirety) or limit (to a particular level) a contracting party's liability under a contract in respect of certain types of liability or loss.	Page 5
Good faith	There is no general doctrine of good faith (generally, acting honestly and fairly) in English contract law. However, contracting parties are free to agree to include duties and obligations of good faith in their agreements.	Page 13
Heads of terms	(Also referred to as letters of intent, memorandum of understanding or heads of agreement.) Usually a short document setting out the main terms of a transaction, the details of which is then negotiated between the parties. Heads of terms can be fully or partially binding, or not legally binding at all.	Page 12
Innominate term (or intermediate term)	Neither a condition, nor a warranty. The worst breaches of an innominate term can trigger a right to terminate for repudiatory breach at common law, less serious breaches will not.	Page 7
Material or serious breach	A matter of contractual interpretation and construction. In case law, this term has been interpreted as a breach that is "*more than trivial, but need not be repudiatory*", but also that the meaning of 'material' could range from "*not trivial*" to "*serious enough to justify termination at common law*" (i.e., repudiatory).	Page 7

Persistent breach	**In respect of allegations of persistent breaches, the court has found that repeated breaches need to have some gravity to them, and that taken together they must amount collectively to something serious in all the circumstances, taking into account the nature of the contract and the obligation breached, in order to give rise to a right to terminate.**	Page 8
Reasonable endeavours	No uniform meaning, but this is thought to be the least onerous variation of the endeavours clause. It may suffice for the relevant party to take one of several possible courses of action, provided such course of action is deemed to be 'reasonable'. Generally the weight of the contractual obligation can be balanced against the performing party's own commercial considerations.	Page 4
Remediable breach	Often contracts will set out that a party which is in breach of contract be given a period to remedy the breach concerned, commonly known as a 'cure period'. Not all remediable breaches will be sufficiently serious to give rise to a right to terminate if they remain unremedied.	Page 8
Repudiatory breach	A breach will be repudiatory at common law if it deprives the innocent party of the substantial benefit of the contract. A repudiatory breach will often be referred to as striking at the root of the contract. In the event of a repudiatory breach, the innocent party has the right to choose whether to accept the breach, terminate the contract and claim damages, or affirm the contract (so it continues) and claim damages.	Page 7
Substantial breach	The Court of Appeal has held that a clause in a contract giving rise to a right to terminate for 'substantial breach' was no different to repudiatory breach.	Page 7
UCTA	Unfair Contract Terms Act 1977 – a statute which imposes limits on which exclusion clauses can be used to avoid liability.	Page 5
Warranty	In the context of classification of contractual terms: A contract term which does not give the innocent party the right to treat the contract as repudiated in the event of breach, but entitles that party to claim damages.	Page 7

Contact our team

We have a wealth of experience handling commercial disputes across a broad spectrum.

Our highly experienced team consisting of 16 partners and 34 fee-earners specialise in all forms of dispute resolution, including litigation, arbitration (international and domestic) and mediation. We have litigated cases at every level in the English courts through to the Supreme Court and the European Court of Justice. We are frequently involved in ground-breaking and high profile cases where the context requires significant expertise and industry knowledge. Nonetheless much of our work concerns resolving problems efficiently and effectively with the minimum of fuss.

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If you would like to discuss any of the issues covered in this document with one of our experts, please reach out to a member of the team listed below.

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