Comply or Face the Consequences! Contractual Compliance Required to Vary a Contract.

May 18, 2018 James Brown

PRACTICES Commercial Real Estate Leasing, Corporate, Employee Benefits and Executive Compensation, Energy, Power and Natural Resources, Private Equity, Finance, Project Finance and Development, Food, Beverage and Restaurant, Franchise and Distribution, International, Litigation, Real Estate, Shipping

As Lord Sumption's leading judgment of the Supreme Court in *Rock Advertising Limited v MWB Business Exchange Centres Limited* [2018] UKSC 24 states, it is rare that modern litigation raises truly fundamental issues in the law of contract. This case, however, raised *two* such issues, although as a result of the Court's decision on the first issue, it was not necessary to decide the "difficult" second issue.[1]

The case, however, has laid to rest a longstanding question as to whether "No Oral Modification" or "NOM" clauses - which are often contained in written contracts and provide that the contract may not be varied other than by written variation signed by the parties - are effective to render ineffective a subsequent variation orally agreed by the parties.

A. The facts

The issue arose from a licence to occupy office premises. The occupier, Rock Advertising, had fallen into arrears with the licence fee that was due. After the operator of the premises, MWB Business Exchange Centres, had locked-out the occupier and asserted that arrears were due, the occupier contended that an oral agreement had been reached that varied the payment schedule under the licence, and that the variation was contractually binding despite clause 7.6 of the licence which provided:

> *"all variations to this Licence must be agreed, set out in writing and signed on behalf of both parties before they take effect."*

The judge at first instance found that the NOM clause did render ineffective the informally agreed variation to the payment schedule.

The Court of Appeal, however, disagreed, holding that clause 7.6 did not prevent the informally agreed variation from being effective. To hold otherwise would be to impinge on the principle that parties have autonomy to contract as they wish.

B. The judgment of the Supreme Court

In delivering the leading judgment of the Supreme Court (all of the Lords agreeing with the reasoning save for Lord Briggs) Lord Sumption, however, held differently ruling that that English law should and does give effect to a contractual provision requiring specified formalities to be observed for a variation. In this regard he:

> i. Held that the typically-cited reason for regarding such clauses as not being effective – *i.e.* that there is a conceptual impossibility between a doctrine of freedom of contract (such as

exists in English law) and the notion that parties can by agreement limit that freedom – is simply not correct.

Other codes of law - namely the Vienna Convention on Contracts for the International Sale of Goods (1980) and the UNIDROIT Principles of International Commercial Contracts - had *"squared the circle"*, by providing that parties are free to contract as they wish yet may nevertheless by agreement bind themselves such that variations to their contract are only effective if agreed in a specified manner.

ii. Observed that to hold that NOM clauses do not operate to prevent informal variations would itself be to deny party autonomy since this would be to disregard the parties' intentions in agreeing the clause.

iii. Recognised that there are good commercial reasons for recognising such clauses as being effective including: discouraging parties from seeking to undermine written agreements by alleging that they have been informally varied (which claims can be difficult to resolve); avoiding disputes not only about whether a variation was intended but also about its exact terms (which can be difficult to discern from negotiations); and by making it easier for corporations to police internal rules restricting the authority to agree them.

He considered also whether the fact that the parties had disregarded the NOM clause and nevertheless agreed an oral variation should lead to the conclusion that they had agreed to dispense with the NOM clause. He had little sympathy for this saying that *"this does not seem to me to follow."* Rather, he considered that the natural inference from the failure by parties to observe the formal requirements of a NOM clause is not that they intended to dispense with it but that they had *overlooked* it.

Recognising, however, that if the Supreme Court was to uphold the effect of NOM clauses, parties could be exposed to adverse consequences from acting upon an informal variation to their contracts and then finding that they are unable to enforce it, Lord Sumption highlighted the existence and operation of the doctrine of estoppel. He did not consider at length what would be required for the doctrine to provide relief, but did indicate that there would at least (i) have to have been some words or conduct unequivocally representing that the variation was valid notwithstanding its informality; and (ii) something more would be required for this purpose than the informal promise itself.

C. Lord Briggs' concurring judgment

Lord Briggs delivered a concurring judgment, agreeing with the outcome but for different reasons.

Interestingly, he appears to have been driven by concerns that the approach of Lord Sumption was perhaps too radical given that, in his view, Lord Sumption's approach *"would involve a clean break with something approaching international common law consensus*[2]*, unsupported by any societal or other considerations peculiar to England and Wales."*

Lord Briggs' judgment involved his finding (contrary to Lord Sumption) that it is *not* conceptually possible for parties to a contract to agree that they shall be precluded from later agreeing a variation to it in a manner inconsistent with that required by the contract. Rather, they may later agree a variation in a manner inconsistent with the formalities required by their contract if they have, in so agreeing, agreed to remove the NOM clause from their prior agreement. However, it was his view that parties would not usually be found to have agreed to this simply because they

have agreed a variation in a manner that was inconsistent with the contractual requirements for variations. Rather, they will need to have expressly agreed to disapply their agreed formalities for variations, or this must be the *"strictly necessary implication"* of their later variation.[3]

On the facts of the present case, the parties had not made any reference to the NOM clause when agreeing the variation to the payment schedule, and there was no necessary implication that they intended to remove it. That being the case, given the absence of writing, their variation fell foul of the NOM clause.

D. Comment

As a result of this key Supreme Court judgment, commercial parties can now draw greater comfort that a NOM clause included within a contract is likely to be upheld by the English courts so as to render invalid any informally agreed variation that does not comply with the requirements of the contract for making variations. Whilst Lord Sumption's judgment may be regarded as a "radical solution" which breaks away from the approach in a number of common law jurisdictions, it should assist in promoting certainty under English law as to the terms of contracts, and therefore help to avoid costly and difficult-to-resolve disputes arising from allegations by one party that some "oral agreement" was reached that varied the written terms of the parties' contract. The judgment presents a simple solution to the issue – comply with the contractual requirements for variations or your variation won't be effective! It also lays down a rule that commercial parties will not have difficulty understanding or complying with in their commercial dealings. This is the more so given that the rule and the legal consequences of not following it will now likely align with what is probably the expectation of parties that have included such clauses in their contracts.

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[1] This was whether a promise to ultimately pay less money than contractually required could nevertheless amount to "consideration" so as to give rise to a binding contract.

[2] This referred to the position adopted by a large number of common law jurisdictions that such clauses are not effective.

[3] He referred to a variation which required immediate performance and which was made in circumstances where there was not time to record it properly in writing and to sign it, in which circumstances he considered an estoppel would likely arise anyway.