

Recent case law on contract drafting and intellectual property issues

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This note provides a brief summary of some recent cases that have caught my eye.

Health warnings:

1. Many more case reports are available nowadays compared with 20 years ago. This is partly due to the ease of publishing and circulating them, by email, compared with old-fashioned paper law reports, where space constraints meant that only the really important cases were published. Therefore, this note is not a comprehensive summary of all recent reported cases in the field of contract law.
2. Cases on the interpretation of contractual wording depend to significant extent on the facts of the individual case, and the interpretation of the individual judge.
3. The higher the court (House of Lords or Court of Appeal) the more authoritative is any opinion expressed by the judge. Some of the following cases are (merely) at High Court level, and some were decided by deputy judges who are not full members of the High Court.

Nevertheless, it is useful to read how judges are interpreting particular wording, and to consider whether contract wording needs to be adjusted in light of these interpretations.

Contract Drafting Cases

Liability clauses

Liability for breach of contract extends only to a type of loss for which a party assumed responsibility: *Transfield Shipping Inc v Mercator Shipping Inc* [2008] UKHL 48

This important House of Lords decision considered a fundamental question of contract law: if a party is in breach of contract, which types of loss is he liable for.

The case concerned the late return of a ship under a contract of hire. The conventional wisdom had been that damages were limited to the hire charges for the number of days of delayed return. However, due to an unusual slump in the market for chartering ships, the owner suffered a much greater financial loss when he cancelled the subsequent hire and was unable to re-hire the ship at comparable rates to those that would have been charged to the cancelled hirer.

The classic case on damages for breach of contract is *Hadley v Baxendale* (1854) 9 Exch 341, in which the court distinguished between (1) losses that arose naturally from the breach of the contract itself, and (2) losses that were in the contemplation of the parties as the probable result of a breach. The latter category has been refined in subsequent cases and has become known as indirect loss.

Lord Hoffmann came up with a new basis for determining damages, by analogy with remoteness rules in tort cases. He considered that it was necessary first to consider whether the loss is “of a kind or type for which the contract breaker ought fairly to be taken to have accepted responsibility.” He concluded that the charterer in this case “cannot reasonably be regarded as having assumed the risk of the owner’s loss of profit on the following charter.”

It is not entirely clear whether this reasoning forms the basis of the House of Lords’ unanimous decision in favour of the charterer. Of the remaining four Law Lords hearing this case, Lord Hope most clearly adopted Lord Hoffmann’s reasoning. Lady Hale expressed considerable reservations with this “novel” approach “which does not emerge clearly from the classic authorities”. She preferred to allow the appeal “on the narrower ground identified by Lord Rodger, leaving the wider ground to be fully explored in another case and another context.” Lord Rodger was able to allow the appeal by reference to traditional authorities. He said: “I have not found it necessary “to explore the issues concerning ...assumption of responsibility, which my noble and learned friend, Lord Hoffmann, has raised.”

Thus two Lords followed the Lord Hoffmann approach, and two Lords based their decision on more traditional grounds. How did Lord Walker, the fifth member of the panel, decide the case? His judgment mainly focuses on the classic authorities, although he states that he found “helpful” the materials cited by Lord Hoffmann in support of his “assumption of responsibility” test. Frankly, his reasoning is not clear. Lord Walker concludes his judgment with the following words:

“For these reasons, and for the further reasons given by my noble and learned friend Lord Hoffmann, Lord Hope and Lord Rodger, whose opinions I have had the advantage of reading in draft, I would allow this appeal.”

Thus, Lord Walker agrees with everyone (other than the Lady Hale). It is not clear from this decision whether we have a new principle of English contract law, but it seems likely that judges in future cases will cite Lord Hoffmann’s reasoning when it suits the case before them.

Does exclusion clause cover liability for deliberate wrongdoing:

Internet Broadcasting Corporation and others v Mar LLC [2009] EWHC 844 (Ch)

A deputy High Court judge considered whether an exclusion clause was effective to cover “a deliberate personal repudiatory breach of contract”. He concluded, as a matter of construction of the wording in the context of the case before him, that it was not.

The language of the exclusion clause was fairly conventional. Among other terms, it stated that it did not exclude liability that cannot be excluded under applicable law. Subject to this carve-out, neither party was to be liable for any financial, indirect or consequential losses. The judge decided that this exclusion clause was not effective in the case before him. In coming to this conclusion he reviewed the classic cases, noted that deliberate wrongful conduct would not be an insurable risk, and commented:

“...if the parties intended an exemption clause to cover a deliberate repudiatory act by one party or either party personally, one would expect to see “clear” language in the sense of “strong” language, for example, *“including deliberate repudiatory acts by [the parties to the contract] themselves...”* Words which literally cover the situation, but also a whole range of lesser situations, will not in my judgment be sufficient.”

Disclaimer of warranties did not cover implied “condition” of satisfactory quality:

KG Bominflot v Petroplus Marketing AG [2009] EWHC 1088 (Comm)

This case concerned, inter alia, whether an exclusion clause was effective to disclaim implied terms under the Sale of Goods Act 1979, and in particular the implied condition that the goods will be of satisfactory quality under section 14(2) of that Act.

The clause in question read: “There are no guarantees, warranties or representations, express or implied, or merchantability, fitness or suitability of the oil for any particular purpose or otherwise, which extend beyond the description of the oil set forth in this agreement.”

The judge pointed out that “conditions” are different from “warranties” under the common law, and that the term implied under section 14(2) is a condition. He held that, because the above wording did not specifically mention “conditions”, it was not effective to disclaim the implied condition of satisfactory quality.

Exclusion of financial and consequential losses was reasonable:

Regus v Epcot [2008] EWCA Civ 361

Regus provides serviced office accommodation. This case concerned defective air-conditioning in a suite of offices that Epcot rented from Regus, whether Regus was in breach of contract, and the measure of damages that Epcot was entitled to recover.

The relevant part of the clause in question excluded liability “in any circumstances” for “loss of business, loss of profits, loss of anticipated savings, loss of or damage to data, third party claims or any consequential loss.”

At first instance, Judge Mackie QC held that this clause was ineffective because it left Epcot with no remedy for the defective air-conditioning.

In the Court of Appeal, Lord Justice Rix, who gave the sole judgement of the court, disagreed. He said: “...the obvious and primary measure of loss for breach of such a kind is the diminution in value of the services provided.” The clause did not exclude this loss.

Lord Justice Rix also rejected an argument that “in any circumstances” purported to exclude liability for fraud and therefore the clause was unreasonable. In favour of his view, Rix LJ cited an earlier case in which the judge had commented that “the court should not be too ready to focus on remote possibilities or to accept arguments that a clause fails the test by reference to relatively uncommon or unlikely situations.”

Rix LJ rejected arguments that there was an inequality of bargaining power and that the clause was unreasonable under the Unfair Contract Terms Act 1977.

Rix LJ also disagreed with Judge Mackie on severance. Judge Mackie had said that the sub-clause in question could not be severed from the rest of clause 23 and therefore the whole clause was unenforceable. However, in Rix LJ's view the sub-clause could be severed.

Finally, on the facts of the case, Rix LJ thought that a limit of liability of 125% of fees paid or £50,000, whichever is higher, was "generous".

Interpretation generally

Meaning of reasonable endeavours and all reasonable endeavours:

Rhodia International Holdings v Huntsman International LLC [2007] EWHC 292 (Comm)

Counsel in this case sought to persuade the deputy judge (Mr Julian Flaux QC, subsequently elevated to the High Court bench) that best endeavours and reasonable endeavours meant the same thing. In support of this argument, counsel cited cases where best endeavours had been equated with using 'due diligence' and other cases where reasonable endeavours had been equated with using due diligence. Therefore best endeavours and reasonable endeavours mean the same thing.

The judge dismissed this argument and said that "as a matter of language and business common sense" they did not mean the same thing. The judge discussed some of the leading cases in this area, including IBM v Rockware Glass [1980] FSR 335 and UBH v Standard Life (1986 – reported only in the Times).

The judge went on to speculate that "An obligation to use reasonable endeavours to achieve the aim probably only requires a party to take one reasonable course, not all of them, whereas an obligation to use best endeavours probably requires a party to take all the reasonable courses he can. In that context, it may well be that an obligation to use all reasonable endeavours equates with using best endeavours..."

Note: for a more recent case in which Mr Justice Flaux (as he now is) considers the meaning of "reasonable", see [Automotive Latch Systems Limited v Honeywell International Inc](#) [2008] EWHC 2171 (Comm), at paragraph 137 onwards.

Implied term allowing termination on reasonable notice:

Jackson Distribution Limited v Tum Yeto Inc [2009] EWHC 982 (QB, Royce J)

This case discusses the well-known principle that, if a long-term contract doesn't include a clause giving either party a right to terminate, a term to this effect may be implied. This principle can be traced back to the case of Martin-Baker Aircraft Company v Canadian Flight Equipment [1955] 2QB 556 and subsequent cases. The judge in Jackson v Tum Yeto considered the factors that determine how long the period of reasonable notice should be (as discussed by Longmore LJ in Alpha Lettings Limited v Neptune Research and Development Limited [2003] EWCA Civ 704 – a fascinating case in which the Court of Appeal also considers whether the judge in the original trial had been too rude and aggressive towards the witnesses and counsel) and in this case decided that 9 months was the appropriate period.

The factors that the judge considered when reaching this conclusion included:

- The degree of formality of the contractual relationship
- Whether there was any non-compete clause in the agreement
- The duration of the agreement

- The percentage of the distributor's turnover that depended on the agreement
- The seasonal nature of the business
- Investment that had been made in the business
- The time it would take to find an alternative business and build it up

How the courts interpret contract wording:

Chartbrook Limited v Persimmon Homes Limited [2009] UKHL 38.

This House of Lords case concerned the interpretation of a "carelessly drafted" payment formula in a contract. The phrase in dispute was "23.4% of the price achieved for each Residential Unit in excess of the Minimum Guaranteed Residential Unit Value less the Costs and Incentives". The "grammatical ambiguity" of this phrase led to radically different payment obligations, depending on the interpretation that was adopted. The most natural interpretation of this phrase might be rendered mathematically as: $RP = 23.4\% \text{ of } (P - MGRUV - C\&I)$. Perhaps if the parties had expressed the formula in this way, they would have realised that it was incorrect.

In the words of Lord Hoffmann, "to interpret the definition of ARP in accordance with ordinary rules of syntax makes no commercial sense", particularly when considered in conjunction with the payment terms in Schedule 6 to the agreement. Instead, the House of Lords decided that the phrase should be interpreted in a way that I would express mathematically as: $ARP = (23.4\% \text{ of } (P - C\&I)) - MGRUV$.

The House of Lords was prepared to look at the overall purpose of the clause, without focussing too closely on the individual words in the sentence. In the words of Lord Hoffmann, "there is not, so to speak, a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed. All that is required is that it should be clear that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant."

See the more detailed discussion of this case on our [website](#).

Interpretation of a patent licence agreement:

Oxonica Energy v Neuftec Limited [2009] EWCA Civ 668.

This case concerned the interpretation of terms in a patent licence agreement. Specifically, Oxonica agreed to pay Neuftec royalties on the sale of Licensed Products, defined as any product 'falling within the scope of claims in the Licensed Application or Licensed Patent'. 'Licensed Application' referred to the PCT application, and 'Licensed Patent' to any patent issuing from that application. The question for the Court of Appeal was the meaning of the phrase 'claims in the Licensed Application or Licensed Patent'. Did it mean (1) any product covered by the claim of the PCT application (currently the widest claim), or (2) any product covered by the claims of either the PCT application or any later patent, even where the later patent's claim might be wider, or (3) any product covered by the claims of either the PCT application or a national application as the case might be? The Court of Appeal upheld the High Court's decision in favour of meaning (1).

This case confirms the principle, already established, that an agreement should be construed as a whole in such a way as to make business sense. Especially in the case of a badly drafted document, a word or phrase may need to be given a meaning different from what at first seems appropriate. It will be necessary to do this if the provision in question would otherwise have a meaning that the

parties are unlikely to have intended.

More generally, the Court of Appeal's judgment serves as a warning to those drafting agreements to be sure that the meaning of a defined term is appropriate in each context in which that term is used. Unthinking copying of definitions and other boilerplate from precedents can result in inconsistencies which a party may seek to exploit, and which may be settled only by litigation. See the discussion of this case on our [website](#).

Other Intellectual Property Cases

Proprietary nature of IP assignments and licences:

Ultraframe (UK) Limited v Fielding [2005] EWHC 1638(4) (Ch)

Not as recent as some of the cases in this note. In the middle of a lengthy judgment (paragraphs 1371-1387) the judge discusses the nature of a licence, and whether it is an interest in property. After reviewing various authorities, he concludes that it is not but that a licence can amount to a right over property. This coincides with my understanding, as discussed in the chapter on transactions in [The Modern Law of Patents](#).

Ownership of academic inventions (Australia):

University of Western Australia v Gray [2009] FCAFC 116 (3 September 2009)

Another very lengthy case, this time from Australia. The appeal court held that a university professor was not employed to make inventions and therefore he, rather than his university employer, owned any inventions (and associated patents) that he made. Although Australian law is not identical to English law in this area, similar issues arise under each country's laws, ie what are the "duties" of the employee under his contract of employment. This case confirms that one should not assume that an academic employee has any duties to make inventions, in the absence of specific contractual obligations to this effect. See our discussion of this case on [our website](#).

Exhaustion of rights (USA):

Quanta v LG Electronics Inc (553 U.S. ____ 2008)

This is an important decision of the United States' Supreme Court concerning 'exhaustion of rights' – the judgment is [here](#).

The principle of 'exhaustion of rights' prevents an owner of intellectual property from asserting his IP rights against someone who purchased a product in an authorised sale – eg a sale by the patent owner's licensee.

The judgment makes it more difficult for an IP owner to grant limited licences that prevent the licensee's customers from using licensed products outside the field of the licence. The terms of any such restrictions should be drafted with this case in mind.

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