Dispute Resolution

June 2012

# DISPUTE RESOLUTION BULLETIN

**This is the first edition of the HFW Dispute Resolution Bulletin. It will be produced monthly, and will deal with topical legal issues, as well as providing reports on court decisions from around the world which impact on our clients' daily business. The intention for the Bulletin is to provide a useful resource for our clients and we would welcome any feedback that readers may have.**

## "All reasonable endeavours" clauses - how far must you go?

In hard times, businesses seek ways to limit costs. Contracts are reviewed and obligations which require *"all reasonable endeavours"* and lose money come under careful scrutiny. How far you have to go to perform these obligations was the subject of recent litigation. The answer the Court reached may surprise.

The case, *Jet2.com Ltd v Blackpool Airport Ltd* (2 April 2012), concerned a dispute between a low cost airline and the owners of Blackpool Airport. In 2008, they made a fifteen year agreement (the "Agreement") to develop the airline's services there. They agreed to "cooperate together and use their best endeavours" to promote the airline's low cost services and the airport agreed to use *"all reasonable endeavours"* to *"facilitate"* the airline's low cost pricing.

Following the Agreement, the airport was made available to the airline outside its usual opening hours. The airline could not obtain prime operating slots for its low cost services at destination airports at peak times, so its flights to Blackpool often had to take-off before 7.00am or land after 9.00pm, when the airport would otherwise have been closed.

The economic recession affected both parties. The airport lost money. It was sold and the new owners brought in new management to cut costs and make it profitable.

As part of their strategy, the new management wanted to end the early and late flights. The airline was by then alone in operating outside usual hours. It was expensive to keep the airport open late and an extra 120,000 passengers per year were needed from the airline to make extended hours viable. The airline refused to base additional aircraft in Blackpool and chose to expand from Manchester instead. Nonetheless, the airline argued that the airport had no right to end the flights.

Things came to a head when, after warnings, the airport forced two of the airline's late flights carrying more than 300 half-term holiday travellers to divert to Manchester and the airline had to bus them 75 miles to Blackpool. Litigation followed.

The airline argued that promoting its low cost service under the Agreement required the airport to accept arrivals and departures outside usual hours. The airport said that its obligation to *"promote"* was limited to advertising and marketing, and the terms of the agreement could not compel it to do anything contrary to its own commercial interests. It had to exercise *"all reasonable endeavours"* and it would not be reasonable to perform in a way that lost money.

The case was argued in a number of ways but the main battleground was the meaning of the *"best"* and *"all reasonable endeavours"* provisions. (It was common ground that these expressions meant the same thing.)

The judge at first instance found in favour of the airline. The airport appealed but in a split decision, the Court of Appeal upheld the lower court's ruling. The airport's decision to revert to usual hours breached its obligation to *"promote"* the airline's low cost services under the Agreement. The fact that the obligation was qualified by *"best endeavours"* did not get the airport off the hook. The Court of Appeal specifically agreed with the judge at first instance, that the these words did not entitle the airport to choose whether to perform based on whether it lost money. The airport assumed the commercial risk of making losses by staying open outside usual hours under the Agreement and its profitability was influenced by other factors such as its relations with other airlines. However, the Court of Appeal did agree that the airport was not necessarily obliged to stay open for particular hours throughout the (long) life of the Agreement.

What does this judgment mean if you have *"best"* or *"all reasonable"* endeavours obligations in your contract? The Court of Appeal was careful to confirm that the meaning will depend upon the context in which the undertaking is given and that the object of the endeavours will always be important in deciding whether an agreement is legally enforceable. Nevertheless, there are several warnings. First, adding the words to an obligation does not make performance optional. Performance requires doing what is reasonable in the circumstances - and what is reasonable can be commercially burdensome. Secondly, the fact that performance causes losses does not of itself make something unreasonable if it would otherwise be reasonable. The lesson is clear - a *"reasonable endeavours"* obligation has teeth, and the Court can and will enforce it.

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## Letters of credit and jurisdiction

The intrinsic autonomy of letters of credit was reinforced in a recent decision of the Commercial Court in *Petrologic Capital SA v Banque Cantonale De Geneve and another* (8 March 2012).

The claimant (Petrologic) bought oil products from an Austrian company and applied for a standby letter of credit ("LC") from Banque Cantonale, the issuing bank. Believing that it was a victim of fraud, Petrologic initiated proceedings in the Swiss courts for an interim injunction to stop payment out under the LC. Although initially successful, the injunction was overturned on appeal. Another injunction was issued in criminal proceedings in Geneva but Petrologic was concerned that this might be discharged at any time.

Petrologic then tried to bring proceedings against the bank in the English Court. The initial contract and the bank's terms and conditions signed by Petrologic set out that the relationship between the two parties was to be governed by Swiss law and Geneva jurisdiction. It expressly stated that it applied to all current, new and future business relations and expressly contemplated that documentary credits would, or might, form part of that future business.

Petrologic nevertheless sought to found jurisdiction in the English Court under Article 23 of the Lugano II Convention, which is in the same terms as Article 23 of the Brussels Regulation.

In order to satisfy the requirements of Article 23, Petrologic had to demonstrate that the clause which it relied on as conferring jurisdiction on the English Court was the subject of consensus between the parties. It had to show that it had a "good arguable case" (which the Court characterised as being "a much better argument than the bank").

Petrologic relied on three main arguments:

1. The mandate given to the bank to open the LC contained an agreement for exclusive English law and jurisdiction, which was intended to govern the relationship concerning the LC between Petrologic and the bank.

2. The LC itself contained an English law and jurisdiction clause that should be taken to govern the related contract between Petrologic and the bank.

3. Petrologic was entitled under the Contracts (Rights of Third Parties) Act 1999 (the "CRTPA 1999") to enforce the jurisdiction agreement on the basis that this agreement purported to confer such benefit on them.

The Court rejected all three arguments.

In relation to the first argument, Petrologic failed to demonstrate consensus between the parties that the English law and jurisdiction clause in the LC should govern the relationship between them. There was no convincing evidence that the mandate to open the LC was intended to vary the existing terms of their contract. The English law and jurisdiction clause was no more than one of the terms Petrologic wanted the bank to include in the LC.

Petrologic's second argument was also rejected: there was no room for any such construction of the contract between Petrologic and the bank in circumstances where there was already an express law and jurisdiction agreement which governed the relationship between them.

Petrologic's attempt to rely on the CRTPA 1999 failed. The intended effect of the CRTPA 1999 is to enable a third party to enforce a term of a contract where there is a dispute between the contracting parties. Petrologic was seeking to take the benefit of the clause in the LC for itself, so as to avoid the Swiss law and jurisdiction clause in its own contract. There was no dispute between the actual third party beneficiary and the bank, nor was any intention shown by those two parties to grant Petrologic such benefit.

Letters of credit are by their nature autonomous. They provide a certainty of payment which is key to the efficient operation of international commerce. The Court's decision to reject Petrologic's argument that the jurisdiction clause in an LC could vary the terms of an existing contract between a customer and its bank reinforces this concept.

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## The basics of corporate insolvency explained (Part 1)

Insolvency is often perceived as mysterious, with confusion about the aims, outcomes and applications of each insolvency process. Not all insolvency proceedings will necessarily lead to the demise or breaking-up of a company – and a company need not necessarily be technically 'insolvent' to be involved in measures such as administration and Company Voluntary Arrangements ("CVA"s).

In the current financial climate, it is essential to have some understanding of the different processes in order to be prepared for the insolvency of companies with which you have contractual relations, or challenges within your own organisation.

In the first of two articles, HFW Associate Charles Caney provides a guide to the basics of corporate insolvency.

### What is insolvency?

Under the Insolvency Act 1986 ('the Act'), a company is said to be insolvent either when it is unable to pay its debts when they fall due or when liabilities exceed assets on the balance sheet. These are known respectively as the cash flow and balance sheet tests. The cash flow test includes future and contingent debts.

Creditors can formally instigate proceedings under the Act for an unpaid debt of as little as £750 if a statutory demand has not been complied with.

### Contractual effect of insolvency proceedings

Certain contracts and many loan agreements will contain a clause terminating the contract if one party is subject to any form of insolvency or bankruptcy proceedings. Under a loan contract, there is often also a 'cross default' clause, so that defaulting on payment to any creditor will give rise to an event of default in the loan contract.

This can lead to a butterfly effect, where a relatively small default on one debt can lead to cross defaults on other loans and contracts and a series of breaches and claims, escalating the level of debt and litigation.

### The 'rescue culture'

During the recession of the early 1990s, the trend was towards administrative receivership, where one secured creditor had the ability to control the insolvency and effectively break-up the company. Since then, there has been a significant shift in attitude. More recent legislation, particularly the Enterprise Act 2002, places the statutory emphasis on rescuing companies in difficulty. The focus now is on administration, taking a collective approach to achieve the best outcome for creditors as a whole. This has the backing of both government and creditors, since it is accepted that restructuring or reorganisation is likely to produce a greater collective benefit than asset stripping.

'Pre-packaged' administration is available where a sale of the business has already been agreed, allowing faster, cheaper proceedings and the ability to shed bad debts whilst retaining inherent brand value.

### Conclusion

For a company facing financial difficulties and its directors, early advice on the options available is key; failure to do so may have unintended adverse consequences for both. The insolvency regime should not necessarily be viewed with apprehension: as well as giving creditors protection, it can also assist a company in troubled times.

For creditors, an appreciation of the various insolvency options and the likely impact insolvency might have on a debtor company is important in informing the best approach.

Next month's article will look at the main insolvency procedures that a company can be subject to, being administration, CVAs and liquidation.

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