



AND THE OSCAR GOES TO... FREEDOM OF CONTRACT!

Morality clauses are back in the spotlight after a spate of high-profile scandals in Hollywood. Many studios are questioning how best to protect themselves from the financial and reputational damage done when claims are levied against their leading lights. After Kevin Spacey's fall from grace, Netflix may still have to pay him a significant sum after terminating his contract for *House of Cards*.

A Hollywood studio can protect itself by inserting a broad morality clause into contracts in order to easily dismiss employees who make the transition from *famous* to *infamous*. However, their employees are wary of being kicked to the curb for a minor infraction of an over-zealous morality clause. For example, studios like Fox News are inserting broad clauses against “moral turpitude” or engaging in acts that bring the artist into “public disrepute, contempt, scandal or ridicule”. Their employees must be wary that a catch-all clause may encompass minor faux pas as well as immoral behaviour.

Of course, scandals are not limited to Hollywood; as seen with the recent and distressing Oxfam episode, which demonstrates how difficult it can be to remove entrenched senior staff members in the wake of abuse claims.¹ A “moral turpitude” provision could certainly smooth the path of organisations attempting to rid themselves of misbehaving staff members but what is to stop these clauses being used against employees who only commit minor infractions?

The freedom to be shackled

The debate around morality clauses reaches to the heart of the doctrine of ‘freedom of contract’. This is a fundamental building block of the English common law, whereby parties to a contract are generally free to agree to whatever terms they like:

“A basic principle of the common law of contract ... is that parties to a contract are free to determine for themselves what primary obligations they will accept”².

The parties are given broad scope to set out the terms of their contract without the courts adopting an activist approach to renegotiate commercial bargains.

The legal profession, however, is divided on this issue. Many argue that ‘freedom of contract’ is, in some instances, a poisoned chalice.

For example, it makes sense for companies to require their employees to sign Confidentiality & Non-Disclosure Agreements (NDA) to protect business secrets. But what about the risk that these agreements could be used to gag employees who may otherwise speak out about abuses in the workplace? Parliament is set to examine the use of NDAs in the wake of the Presidents’ Club Scandal, after female waitresses were allegedly harassed at a men-only dinner attended by politicians and businessmen.³

English law has faith that both parties will come to an agreement that reflects their respective interests. The danger is that the NDA becomes an alternative to a proper investigation and results in a cover up of improper behaviour. So, in effect, the ‘freedom of contract’ doctrine can become a smokescreen that allows wrongful behaviour to continue out of the public’s view.

When does the court intervene?

There are some ways in which the common law builds barriers to unfettered freedom of contract in order to protect parties from bad bargains, especially where there is an asymmetric relationship between the parties, such as an employer-employee or business-consumer relationship.

Government legislation forbids employers from treating employees unfairly for reporting wrongdoing. With regard to NDAs, an employee cannot contract out his or her right to ‘blow the whistle’ on claims of abuse. If the employee’s disclosure amounts to a ‘protected disclosure’ and it is in the public interest, reporting abuse

should trump any NDA.⁴ In contracts between businesses and consumers, a business cannot exclude or limit its liability for death or personal injury caused by negligence or supplying defective goods.

Under the Unfair Contract Terms Act 1977 (UCTA) companies cannot avoid liability by inserting exclusion clauses that fail a test of *reasonableness* by restricting wronged party’s rights to make a claim. There are also controls written into law that mean an employer cannot contract out of its duty to not discriminate against staff.⁵

When do the courts steer clear?

Since 2015 we have seen several cases where the courts affirm that it is not their role to interfere in the drafting of a contract agreed between two commercial parties, even when one party has superior bargaining power. Judges now emphasise “the primacy of language” because “language, properly used, should speak for itself and it usually does”. This means that the words on the page, rather than the presumed intention behind those words, is the alpha and omega of a commercial contract.⁶

The Court of Appeal has reinforced this trend by confirming that an exclusion clause which excluded liability for “any claim” was sufficient to exclude liability for all forms of negligence.⁷ This also means that the court is perfectly happy to let parties enter into ill-advised contracts and suffer their consequences. It is not within the court’s remit to rescue a party from the consequences of its own poor judgment.⁸

Recent case law has rolled back the *contra proferentem* rule in exclusion clauses. The *contra proferentem* rule states that, where there is doubt about the meaning of the contract, the words will be construed against the party who put them forward. So

1. <https://nypost.com/2018/02/16/oxfam-director-says-sex-abuse-claims-will-stain-charity-for-years/>

2. *Photo Production Ltd v Securicor Transport Ltd* [1980] A.C. 827

3. <https://www.theguardian.com/uk-news/2018/jan/25/mps-call-for-police-investigation-into-presidents-club-scandal>

4. <https://www.gov.uk/whistleblowing>

5. <https://www.gov.uk/guidance/equality-act-2010-guidance>

6. Lord Sumption, ‘A Question of taste: The Supreme Court and the Interpretation of Contracts’ – Harris Society Annual Lecture. Available at: <https://www.supremecourt.uk/docs/speech-170508.pdf>

7. *Persimmon Homes Ltd and others v Ove Arup & Partners Ltd and another* [2017] EWCA Civ 373

8. *Arnold v Britton* [2015] UKSC 36

in a contract that excludes liabilities for certain eventualities, the court will not use unclear drafting as a stick to beat the party who inserted the exclusion clause. This is because the court views exclusion clauses as “part of the contractual apparatus for distributing risk” so will not approach such clauses “with a mindset determined to cut them down”.⁹

Parties can also agree that a certain state of affairs exists at the time of the contract even if that is not the case. A non-reliance clause will therefore generally be upheld even in circumstances where it is clear that a party may rely on statements made by another party.¹⁰

The courts will even protect contracts that are born out of fraud. In English common law, a contract by which one party agrees to pay a bribe to the other is certainly illegal¹¹ but a contract born out of a bribe is perfectly legal and enforceable. In a recent case, HFW successfully defended an application to set aside enforcement of a Chinese arbitration award that had allegedly been “tainted” by fraudulent documents. This allegation of fraud was not enough for the court to unravel the basic right of parties to contract with one another.¹²

Penalty clauses

The Supreme Court has recently restated the rule on penalty clauses in the appeals of *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis*¹³. While acknowledging that the “penalty rule is an interference with freedom of contract” which “undermines the certainty which parties are entitled to expect of the law” the court emphasised that the penalty rule regulates only the remedies available for a breach of a party’s primary obligations, not the primary obligations themselves.

Previous tests that focussed on whether a contractual provision was a penalty or a genuine pre-estimate of loss were considered to be unhelpful. The true test was whether the provision imposing a detriment on the party in breach was out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation (and there can be no proper interest in simply punishing the defaulter).

The Court recognised that a legitimate remedy for a breach of contract may not be financial compensation and this can be reflected in the parties’ agreement. It may also uphold a clause which protects legitimate commercial interests, notwithstanding that the breach of contract may not cause the innocent party equivalent financial loss. For example, a large parking fine for overstaying a time limit was justifiable because it deterred long-stay parking, preserved a good flow of traffic, and generated income for the parking lot.¹⁴

The court’s revised focus on proportionality is in line with the importance placed on freedom of contract in English law.

Lights, camera, action!

Unfortunately, not all contracts are a love story where both parties walk away happily into the sunset. They can often result in one party suffering a significant detriment. The court understands that contention and calamity are a natural part of the cut and thrust of business.

Before the camera starts rolling, you must ensure that you have protected your rights against your counterparty and that you can maximise your benefits under the contract.

In the commercial world, there are many ‘unknown unknowns’; things

that are beyond the contemplation of both parties when they enter into a contract. Recent case law demonstrates that each party must be its own white knight and a master of its own contracts. Legal advice from HFW can help protect you in an uncertain climate and provide for many eventualities.

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9. *Persimmon v Ove Arup* [2017] EWCA Civ 373

10. *JP Morgan Chase v Springwell* [2010] EWCA Civ 1221

11. In *National Iranian Oil v Crescent Petroleum* [2016] 2 *Lloyd's Rep* 146 the English court confirmed that it will not enforce an award that gives effect a corrupt practice, such as to enforce payment or recovery of a bribe.

12. <http://www.hfw.com/English-court-reviews-the-fraud-unravels-all-principle-April-2017>

13. [2015] UKSC 67

14. *ParkingEye Ltd v Beavis* [2015] UKSC 67 (*ParkingEye*)

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