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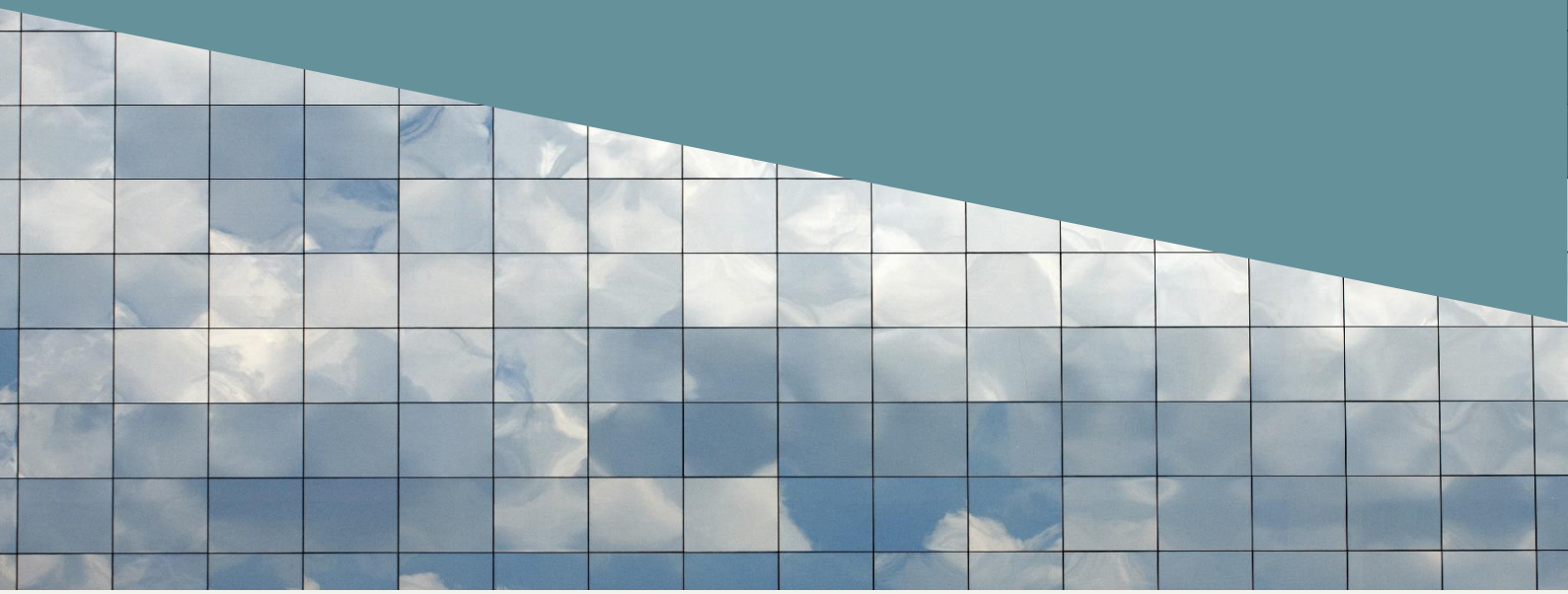

# Do Me a Favour... But How? Helping your counterparties without risking your contractual rights

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A lot of attention has focused recently on how to get out of contracts by relying on frustration or force majeure[1]. In the near future, there will be a reckoning of who has behaved well and who has behaved badly, irrespective of their legal rights. In this article, we look at ways in which our less cynical clients can do their commercial counterparties a favour, to help them get through the short term, without running the risk of losing their legal rights in the long term. While our clients might well want to help out the people with whom they do business, they would not want to lose out if they had to prove in a subsequent insolvency.

## Doing Favours

The Coronavirus Act 2020 makes only a small intervention into the marketplace, by providing at s. 82 for a restriction on forfeiture of business tenancies for non-payment of rent and a corresponding restriction on the operation of waiver. Some tenants have taken that as permission simply to stop paying the rent. However, landlords still have the option to sue, serve a statutory demand or present a winding-up petition.

Other commercial parties are left to decide for themselves what course they take. The messaging from the government has emphasised the temporary nature of the current situation. That may encourage some businesses to focus on guarding their cash reserves in the short term, rather than altering their commercial obligations for the medium term or restructuring the business over the long term.

So what are the options for a business that wants to protect itself, while also protecting its commercial relationships?

[1] A concept so alien that no phrase for it exists in English.

## Doing Nothing

When the USSR placed nuclear missiles in Cuba in 1962, President Kennedy drew up a list of options. The first option was: Do Nothing. When one party to a contract does not comply with their obligations, in most cases there is nothing that compels the counterparty to sue them for the breach. Subject to issues of waiver and estoppel, if one party to a contract is in breach, the other side can wait and see what happens. If the tenant is late with the rent, the landlord can wait to see if they will pay. If the manufacturer has shut down the factory, the buyer can wait to see if it reopens.

The disadvantages of doing nothing stem from uncertainty. The tenant who does not pay the rent knows perfectly well that they are in breach of the lease. The manufacturer who shuts down the factory is well-aware that buyers are left empty-handed. But what they don't know is what the immediate reaction will be, what consequences may flow from the breach in the future and how (or whether) the commercial relationship can be repaired. Coming from the opposite direction, the disappointed landlord or buyer may have no idea how long the difficulties are likely to last and could well take a dim view of their counterparty's behaviour.

Clearly, doing nothing is risky in terms of the relationship. It leaves both sides in a position of complete uncertainty.

## Doing Something

The parties may recognise that they have to do something. An email or a telephone call is a good start. But what, if anything, have the parties agreed, and what effect does their agreement have?

*Promissory Estoppel*

If the parties have agreed some kind of reduction in the amount payable under the contract, the questions that arise are how long it should last and whether it is a true reduction or merely a deferral of the unpaid sums. Promissory estoppel is said to be suspensory rather than extinctive, but in fact is rather more nuanced.

A good starting point is Denning J's judgment in *Central London Property Trust v. High Trees House* [1947] K.B. 130, which related to the difficulties faced by a tenant in paying the rent on a block of flats, due to the absence of people from London during the Second World War. The block was let from 1937 on a 99-year lease at a rent of £2,500 p.a. On 3rd January 1940, the landlord and tenant agreed a reduction in the annual rent to £1,250. By the beginning of 1945, the block was fully let. A receiver had been appointed over the landlord by secured creditors. On 21st September 1945, the receiver demanded £7,916 from the tenant, being the full rent payable according to the terms of the lease. In subsequent proceedings, the receiver claimed only £625, being the unpaid rent for the last two quarters of 1945.

Denning J held that rent was payable in the full amount for those two quarters. He based his decision on the scope of the representation, finding that it was only intended to last during the difficulties. Once the block was fully let at the beginning of 1945, the difficulties had come to an end, as had the reduction. However, although Denning J held that "the reduction in rent applied throughout the years down to 1944", it is not clear what the position would have been if the whole of the arrears had been reclaimed. Plainly, the tenant would not have been obliged to pay the whole rent if it had been demanded at the time, but since the receiver did not sue for that money, the judgment did not have to decide whether the obligation could be enforced at some later date.

The question as to what is suspended and what is extinguished was identified by Stuart-Smith J in *Virulite v. Virulite Distribution* [2014] EWHC 366 (QB). At [122], he held that the question was:

> "whether it is inequitable *in all the circumstances* for the representor to enforce his rights inconsistently with his representation. Those circumstances will include, but are not limited to, the precise terms of the representation, how the representee has responded to the representation, and whether it remains possible for the representee to comply with his original obligation."

At [125], he held:

> "I consider that there may be a material difference between an open-ended forebearance and a promise not to enforce until a particular date is reached or a particular set of circumstances prevails when considering whether it is inequitable to allow the representor to rely upon the original rights and obligations arising under the contract."

So, where the parties have agreed that payment obligations should be reduced, the true effect of that agreement

will be highly fact-specific. It may be far from clear whether, for example, a reduced rent is all that is payable for all time or whether part of the rent is payable now, but the balance is to be paid at some point *in the future*.

If it is the latter, then there is still the question of the period over which the arrears of rent are to be repaid. In *Hughes v. Metropolitan Railway Co* (1877) 2 App. Cas. 439, the landlord had served a notice requiring the tenant to comply with his repairing obligations within six months. The parties then entered into negotiations for the surrender of the lease, which ultimately failed. The landlord was not permitted to forfeit the lease. The House of Lords held that the tenant was entitled to a reasonable time to comply. On the facts of that case, six months was a reasonable period, since that was the length of the original obligation.

What would be a reasonable period where the original obligation was to pay a quarter's rent and that obligation was only suspended? Before the decision in *Cheltenham & Gloucester B.S. v. Norgan* [1996] 1 W.L.R. 343, where borrowers under residential mortgages fell into arrears, the courts would give them between two and four years to pay off the arrears, while maintaining the current payments. After the decision in Norgan, the courts took as their starting point the whole term of the mortgage. Clearly, paying off one or two quarters' rent over the length even of a 25-year would be quite unattractive to many landlords. This is an issue that will have to be worked out by the courts.

*Waiver*

Waiver is a tricky concept that sits between promissory estoppel and variation. It arises where one party requests that the other party should not insist on strict performance of the contract according to its terms. Where the other party agrees, then strict performance will be excused. Like promissory estoppel, where one party makes a representation that they will not insist on their strict rights and the other party acts on it, then performance in accordance with those terms is waived. Unlike variation, waiver does not need to be supported by consideration.

Examples often relate to delayed delivery. Where goods are to be delivered by a particular time or at a particular place, the recipient may agree that delivery should be put off to some other time or effected somewhere else. Once the goods are delivered, the recipient is not entitled to reject them because they are late or to claim damages for the delivery to the alternative location.

The above example is of an irrevocable waiver. Generally however, a party can retract their waiver on giving reasonable notice of their intention to do so to the other party. For example, if the recipient has waived their right to have the goods delivered at a particular time but the goods have still not been delivered, then the recipient could retract the waiver on reasonable notice and impose a new time limit for delivery. Whether the waiver has become irrevocable depends on what has happened subsequently, in particular whether the circumstances are now such that it would be impossible or inequitable to require performance as originally contracted for.

There is less of a risk of waiver arising on informal dealings between the parties, because commercial contracts often exclude waiver. However, in the case of contracts purporting to exclude waiver, questions as to the scope of the clause may arise. For example, a clause that provides that "no delay, neglect or forbearance in enforcing any term of the contract shall be or be deemed a waiver of that term" may cover only cases of conduct, rather than cases where the parties have expressly agreed to depart from the terms of the contract. Similarly, it may only preserve the right to reassert the terms, rather than operating as a complete release.

Once again, therefore, informal discussions between the parties may give rise to uncertainty as to what has been agreed, for how long it takes effect and as to when – if at all – the original contractual rights can be asserted.

## Doing Something, And Doing It Properly

The only sensible course is for the parties to agree a way forward, preferably before either party is in breach of their obligations. A written agreement, embodying the parties' solution, should put to rest most arguments about whether a promise was made, what its precise terms were and how it affects the parties' rights. A written agreement, unlike an oral one, also does not risk falling foul of a "no oral modification" clause in the original contract.

The key matters that the agreement should cover are:

- Whether it is intended to be a permanent modification of the parties' contractual rights or a temporary one.
- If temporary, what will bring the agreement to an end? This might be notice given by one party to the other, or it might be ascertained by reference to an external event (such as a specified government action) or to a fixed date.

- What rights are affected and how. As discussed above in relation to estoppel issues around rent, is this a proper reduction so that the balance will never have to be repaid, or is it only a deferral? If it is a deferral, what is the repayment schedule, and how is it to be enforced in the event of default?
- Where goods are involved, is title to be transferred? Who is to bear the risk of loss of or damage to the goods? Is the seller free to sell someone else the goods in the meantime, and, if they do, are they still obliged to perform the contract when asked?
- Where, perhaps under a contract for services, payments are to continue, what can the paying party expect in return? For example, where a cleaning business is unable to undertake any cleaning services, but the recipient of those services wants to support them by continuing to make payments, what is in it for the recipient?
- Where payments continue, what account, if any, is to be taken of the government's furlough scheme? Are payments to be made at 100%, 20% (to reflect the 80% wage support) or somewhere in between?

*What are the risks?*

Directors of companies are under a duty to promote the success of the company. Under s. 172 of the Companies Act 2006, a director of a company must act in the way he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. Directors must therefore consider how doing a favour for a commercial counterparty is compatible with that duty.

Section 172 sets out a non-exhaustive list of matters to which directors must have regard. Those include the likely consequences of any decision in the long term, the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers and others, the impact of the company's operations on the community and the desirability of the company maintaining a reputation for high standards of business conduct.

With those factors in mind, a director can readily reach the view that it would promote the success of the company to do a favour for a business with which the company has a relationship. Doing so would shore up the company's business relationships, preserve the company's reputation for high standards of business conduct, and even increase the company's chances of getting paid in the long term.

## Conclusion

While it may be tempting to keep quiet or to deal with issues informally, those approaches lead to uncertainty and uncertainty leads to disputes. When the issues are tackled head on, the parties know what to expect from each other, they can plan for the future and they can keep their commercial relationship intact. While arguments about frustration and force majeure might be interesting to law students, attempting to escape from contracts may not be calculated to promote the success of the company, whether in the long term or at all. Cooperation is the key.

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