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BRIEFING

NIL BY MOUTH?
EXCLUDING ORAL VARIATION OF CONTRACTS

MAY 2018

- THE UK SUPREME COURT HAS OVERTURNED THE DECISION OF THE COURT OF APPEAL, AND DETERMINED THAT "NO ORAL MODIFICATION" CLAUSES ARE EFFECTIVE
- SAVE IN EXCEPTIONAL CIRCUMSTANCES, THE ENGLISH COURTS WILL BE BOUND TO UPHOLD "NO ORAL MODIFICATION" CLAUSES
- WHEN SEEKING TO AMEND EXISTING CONTRACTUAL AGREEMENTS ALWAYS TAKE CARE TO COMPLY WITH ANY AGREED FORMALITIES, OR ELSE RISK FINDING THAT THE AGREEMENT YOU THOUGHT YOU HAD REACHED CANNOT BE ENFORCED

In order to successfully avoid (or easily resolve) disputes between contracting parties, it is crucial that there is certainty as to the terms of their contractual relationship.

Accordingly, parties are often keen to restrict their ability to amend the terms of their agreements once they have been entered into. If they do envisage that they may amend the terms in the future, the contract will often expressly stipulate how amendments can, and cannot, be made.

Therefore, provisions seeking to exclude oral variations to contracts or prescribing that change must be in writing (No Oral Modification, or "NOM" clauses) have become a commonplace feature. In many types of contract, they are a standard boilerplate clause.

There has, however, been a degree of uncertainty as to whether and to what extent these NOM clauses are effective under English law.

Fortunately, with the Supreme Court's decision in *MWB Business Exchange Centres Ltd v Rock Advertising Ltd,*[1] this uncertainty has been put to rest once and for all. Where parties purport to vary a contract containing a NOM clause other than in accordance with the NOM clause, that variation will be invalid and unenforceable.

[1] [2018] UKSC 24

The conflicting case law

Until recently there was conflicting case law from the Court of Appeal on this issue, the crux of which was whether or not parties can contractually limit the freedom of contract afforded to them by the common law.

In *United Bank Ltd v Asif & Anor* (unreported, 2000), a case involving banking guarantees, the Court of Appeal upheld a decision to grant summary judgment, in part made on the basis that an alleged oral variation to the underlying contract was invalid due to a NOM clause in the original agreement.

By contrast, in *World Online Telecom v I-Way Ltd*[2] the Court of Appeal upheld a decision to refuse to give summary judgment, holding that the question of whether parties could override a NOM clause was too unsettled to allow summary judgment to be given. Ultimately the High Court held that the contract had indeed been varied by oral agreement, notwithstanding the NOM clause [3].

The Court of Appeal revisits the issue

This uncertainty appeared to have been resolved by the Court of Appeal in two decisions given in 2016, with the, perhaps surprising, conclusion that NOM clauses could not prevent parties from varying their contracts by oral agreement if that was truly their intention.

"PARTIES CAN ONLY MAKE CHANGES TO A CONTRACT CONTAINING A NOM CLAUSE IF THEY DO SO IN ACCORDANCE WITH THE NOM CLAUSE. OTHERWISE, THE VARIATION WILL BE INVALID AND UNENFORCEABLE."

In April 2016 the Court of Appeal, in the case of *Globe Motors, Inc & Anor v TRW Lucas Varity Electric Steering Ltd & Anor*[4], expressed the view that NOM clauses should not prevent parties from varying their agreements orally. The judges considered that the general principle of English contract law that the parties have freedom to agree whatever terms they choose (whether in a document, by word of mouth, or by conduct) took precedence over the parties' originally agreed terms.

The Court of Appeal's comments in *Globe Motors v TRW* were obiter. However, in *MWB Business Exchange Centres Ltd v Rock Advertising Ltd*[5] the Court took the opportunity to endorse them and make its approach to NOM clauses binding precedent, at least until any decision of the Supreme Court.

The decision of the Supreme Court

The Supreme Court has now issued its judgment *MWB Business Exchange Centres Ltd v Rock Advertising Ltd*. In doing so it has overturned the decision of the Court of Appeal, and determined that NOM clauses are effective. Accordingly, parties can only make changes to a contract containing a NOM clause if they do so in accordance with the NOM clause. Otherwise, the variation will be invalid and unenforceable.

Giving the leading judgment, Lord Sumption noted that the effect of the Court of Appeal's decision was to override the parties' intentions, as set out in their contract. In Lord Sumption's view it was this interference, and not the suggestion that parties might limit themselves as to how they should vary their agreements in the future, that

[2] [2002] EWCA Civ 413
[3] See *World Online Telecom v I-Way Ltd* [2004] EWHC 244 (Comm)
[4] [2016] EWCA Civ 396
[5] [2016] EWCA Civ 553

offended the principle of party autonomy which the Court of Appeal had relied upon when reaching its decision.

"LORD SUMPTION WENT ON TO CONCLUDE THAT THERE WERE GOOD AND SENSIBLE COMMERCIAL REASONS WHY PARTIES MIGHT WISH TO PRESCRIBE OR RESTRICT THE METHODS BY WHICH THEIR AGREEMENTS COULD SUBSEQUENTLY BE REVISED."

Lord Sumption went on to conclude that there were good and sensible commercial reasons why parties might wish to prescribe or restrict the methods by which their agreements could subsequently be revised. In particular, NOM clauses:

1. prevent attempts to undermine written agreements by informal means, a possibility which can be open to abuse;
2. avoid disputes, not just about whether a variation was intended, but also about its exact terms; and
3. by introducing a measure of formality in recording variations, make it easier for corporations to police internal rules restricting the authority to agree them.

He commented that the arguments against parties' being able to restrict revisions were "entirely conceptual" and, in his view, misconceived. In support of this, Lord Sumption pointed to the many legal systems where it is an accepted principle that specific formalities must be observed for a variation to a contract. These include, for instance, the *Vienna Convention on Contracts for the International Sale of Goods* (1980) and the *UNIDROIT Principles of International Commercial Contracts, 4th ed* (2016).

Further, Lord Sumption took the view that, where parties do agree an oral variation in spite of a NOM clause, it does not automatically follow that they intend to dispense with the NOM clause. As he put it:

"It is not difficult to record a variation in writing… the natural inference from the parties' failure to observe the formal requirements of a [NOM] clause is not that they intended to dispense with it but that they overlooked it. If, on the other hand, they had it in mind, then they were courting invalidity with their eyes open."

Giving a concurring judgment, Lord Briggs agreed that where parties vary their agreements orally in contravention of a NOM clause, it was not to be implied that in doing so they had agreed to remove or vary the NOM clause itself. However, whereas Lord Sumption took the view that the presence of a NOM clause precluded the parties from making any variation save as in accordance with the NOM clause, Lord Briggs held that it was possible for the parties to agree to vary such a contract orally provided that the variation expressly includes a variation of the NOM clause itself.

Lord Briggs' approach therefore softens the position slightly, by opening the door to the idea that parties might, in contravention of a NOM clause, orally agree to remove the NOM clause itself, and thus enable them to orally vary the contract as a whole. However, this small exception aside, the Supreme Court was unanimous that NOM clauses are effective, and must be enforced by the English courts.

The Supreme Court was, however, at pains to show that a party that acts in reliance on an invalid and contractually unenforceable variation to a contract will not be left without recourse to the courts should it be prejudiced as a result. Both Lords Sumption and Briggs emphasised that, in such circumstances, the party that has suffered as a result of its reliance on the invalid variation will, in all likelihood, be entitled to rely on a form of estoppel to protect its position.

Conclusion

The result of the Supreme Court's decision is to reverse the prior line of authority that parties are always at liberty to vary their agreements orally (or by conduct), regardless of any term to the contrary in their existing agreement.

In future, save for the possible exception of cases where a party can convince the court that the parties orally dispensed with the NOM clause, the English courts will be bound to uphold NOM clauses and treat variations in contravention of them as invalid.

"THIS DECISION WILL GIVE COMFORT TO PARTIES WHO WISH TO PROTECT THEMSELVES FROM THE RISK OF UNINTENDED OR AD HOC VARIATIONS TO THEIR AGREEMENTS."

This decision will give comfort to parties who wish to protect themselves from the risk of unintended or ad hoc variations to their agreements. However, it also stands as a warning that when seeking to amend existing contractual agreements parties must always take care to comply with any agreed formalities, or else risk finding that the agreement they thought they had reached cannot, in fact, be enforced.

The principles of estoppel may provide some protection to a party unwittingly caught in such a positon. Alternatively, in some circumstances the party seeking to rely on the varied terms may be able to argue that, if the variation is not valid, the terms should be implied into the contract, or effectively written into it by way of rectification, as though they been part of the contract from the outset.

However, arguments based on estoppel, implication or rectification require the party relying on them to cross high legal thresholds in order to do so, particularly in light of the decisions in *Marks & Spencer Plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [6] and *Arnold v Britton*[7]. A term will only be implied, or written, into a contract where without it, the contract would lack commercial or practical coherence or the change reflects the genuine intentions of the parties at the outset of the contract. Such arguments will therefore fail where the inclusion of such a term would merely be fair, reasonable or indeed commercially sensible given changes to the deal between the parties.

Given these difficulties, and in the light of the Supreme Court's decision, the safest approach will always be to comply precisely with the terms of the agreement when varying it. In this regard, it should also be born in mind that many types of agreement, such as deeds, have specific additional requirements (beyond the agreement's own NOM or similar clause) that must be complied with. It is therefore always wise to consult legal advisers before agreeing any contract, or contractual variation, to ensure that they are properly made.

[6] [2015] UKSC 72
[7] [2015] UKSC 36

FOR MORE INFORMATION

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