MACFARLANES

ORAL VARIATION – POSSIBLE EVEN WHERE THE CONTRACT SAYS NOT?

In a recent decision, based on principle rather than commerciality, the Court of Appeal has considered the law regarding the effect of clauses prohibiting oral variation of agreements. It has held that, even if a clause says an agreement can only be amended in writing, it can still be amended orally, or by conduct.

This decision means that though such clauses remain useful, they can no longer be relied upon definitively. Though the court's comments were *obiter,* they may be decisive in any future case where this is an issue. Commercial parties will therefore need to remain vigilant to ensure that, despite the existence of such clauses, they do not unwittingly vary agreements by what they say and do.

BACKGROUND

The decision (in *Globe Motors Inc. and others v TRW Lucas Verity Electric Steering Limited and another* [2016] EWCA CIV 396) concerned a long term, exclusive supply agreement (the Agreement). In November 2002, TRW Lucas agreed to purchase from Globe all of its requirements for electric motors for cars and started purchasing "Gen 1" motors from Globe. In 2005, allegedly in breach of the Agreement, TRW Lucas started purchasing "Gen 2" motors from a third party competitor of Globe. Globe claimed damages for breach of contract.

In its defence, TRW Lucas asserted that it was not obliged to source "Gen 2" motors from Globe, but even if it was, the losses were minimal because Globe had transferred all its manufacturing to a subsidiary company in Portugal (Globe Porto), with whom TRW Lucas did not have a contractual relationship. TRW Lucas had entered into the Agreement with Globe, which included, at Article 6.3, a provision that the Agreement *"can only be amended by a written document which (i) specifically refers to the provisions of this Agreement to be amended and (ii) is signed by both Parties".*

As no such written amendment had occurred, Globe Porto was not a party to the Agreement.

FIRST INSTANCE DECISION

At first instance, HHJ Mackie QC found that TRW Lucas was in breach of the Agreement when it purchased "Gen 2" motors from an alternative supplier. In addition, despite the existence of the anti-oral variation clause, HHJ Mackie QC found that the Agreement had been varied by the conduct of the parties who had operated as if Globe Porto was a contracting party to the Agreement. TRW Lucas appealed.

COURT OF APPEAL DECISION

The Court of Appeal, disagreeing with HHJ Mackie, concluded that "Gen 2" did not fall within the definition of "Product" for the Agreement and, as such, TRW Lucas was not in breach of the Agreement. It therefore did not need to consider the anti-oral variation clause. That said, given the existence of two inconsistent Court of Appeal authorities on the point, and having heard full argument, it decided that it ought to give a considered view.

In *United Bank v Asif* (unreported, 11 February 2000, CA), Sedley LJ, in the Court of Appeal, upheld a first instance decision that a non-oral variation clause in a deed of guarantee could not be disregarded. By contrast, in *World Online Telecom v I-Way* [2002] EWCA Civ 413, some two years later, Sedley LJ said that the question of whether the parties could override a clause excluding unwritten variations of an agreement was unsettled. He said that *"in a case like the present the parties have made their own law by contracting, and can in principle unmake or remake it".*

In the present appeal, the court had sympathy with the position of TRW Lucas. It was entirely legitimate that parties to a formal written agreement should wish to insist that any subsequent variation should be agreed in writing as a protection against the raising of subsequent ill-founded allegations that its terms were varied orally or by conduct. There were policy considerations in upholding anti-oral variation clauses, which promote certainty and avoid false and frivolous claims. The court could see force in the practical benefits of restricting the manner in which an agreement can be varied.

That said, none of the judges could find a *"doctrinally satisfactory"* way of achieving that result. The general principle of English law is that, absent any statutory or common law restrictions, parties are free to agree whatever terms they choose. The consequence is that, in principle, the existence of an anti-oral variation clause does not preclude the parties later making a new, oral agreement, varying the original agreement. As LJ Moore-Bick said, *"if there is an analogy with the position of Parliament, it is in the principle that Parliament cannot bind its successors".*

It did not follow though that anti-oral variation clauses were of no value. Difficulties of proof arise whenever it is claimed that a contract has been made or varied orally or by conduct. The existence of an anti-oral variation clause will make that burden of proof more difficult. Parties will encounter significantly greater difficulties in showing that both parties intended that

what was said or done should alter their legal relationship when they previously agreed to provisions requiring formal variation. Clauses such as the one under consideration therefore have considerable *"practical utility".*

In the current proceedings though, the Agreement had been varied by conduct. TRW Lucas ordered products from Globe Porto, who subsequently supplied and invoiced TRW Lucas for those products. TRW Lucas also submitted volume forecasts and warranty claims under the Agreement to Globe Porto rather than Globe. On the basis of *"open, obvious and consistent"* dealings over a long period, there was no other explanation but that the parties intended to add Globe Porto as a party to the Agreement.

COMMENTARY

This decision will come as a surprise to those who, despite the inconsistent authorities, had presumed that their positions were secure and that anti-oral variation clauses do what they say on the tin. Such clauses are common place in commercial contracts and companies may feel that losing the commercial certainty of such clauses is a high price to pay for the general freedom to contract, particularly in circumstances where the parties have agreed to waive that freedom. Equally, uncertainties will no doubt arise when the person said to have orally or by conduct varied the contract does not necessarily have the authority to bind that party.

TRW Lucas thought that it had contracted with Globe, a financially secure and US based company. It will be concerned to have discovered that, without any legal discussions, and simply through its conduct, it is now in a contract with a smaller, foreign company as well. The current position though, of adding a party to an agreement, may not though be as bad as if, through the parties conduct, Globe, the financially secure party, had left the agreement. One wonders what type of conduct would have been necessary for such a finding.

Of course, anti-variation clauses still have important practical and evidentiary value and parties should continue to include them. Such clauses also encourage parties to document variations properly which may help to avoid future disputes. That said, the lesson from this case is simple: parties in commercial agreements cannot just rely on their agreements. They need to be careful about they say and do as well.

The full Court of Appeal Judgment can be found here.

UPDATE

In June 2016, the Court of Appeal handed down a decision approving the above decision. As such, the position that an agreement can be amended, notwithstanding the existence of an anti-oral variation clause, is now binding.

In the decision of *MWB Business Exchange v Rock Advertising*, Kitchen LJ noted that the court, in *Globe Motors v TRW Lucas*, had considered the issue of oral variation in depth and with the benefit of very full argument. It would require a powerful reason for the Court of Appeal now to come to a conclusion or adopt a different approach than all the members of that court. LJ Kitchen said *"[t]o my mind the most powerful consideration is that of party autonomy"* and quoted Now York Court of Appeals Judgment saying:

"Those who make a contract, may unmake it. The clause which forbids a change, may be changed like any other. The prohibition of oral waiver, may of itself be waived… What is excluded by one act, is restored by another. You may put it out by the door, it is back through the window. Whenever two men contract, no limitation self-imposed can destroy their power to contract again…"

CONTACT DETAILS

If you would like further information or specific advice please contact:

LOIS HORNE
PARTNER
LITIGATION AND DISPUTE RESOLUTION
DD +44 (0)20 7849 2956
lois.horne@macfarlanes.com

ALEXA SEGAL
SOLICITOR
LITIGATION AND DISPUTE RESOLUTION
DD +44 (0)20 77914116
alexa.segal@macfarlanes.com

JULY 2016

MACFARLANES LLP
20 CURSITOR STREET LONDON EC4A 1LT

T +44 (0)20 7831 9222 F +44 (0)20 7831 9607 DX 138 Chancery Lane www.macfarlanes.com