ORAL CONTRACTS - I DON'T THINK SO: SUPREME COURT REJECTS ONCE MORE A COMMON CONTRACTUAL WORKAROUND

By Nick Storrs & Johnny Shearman

In recent years, the Supreme Court has shown a keen enthusiasm for going back to legal first principles to consider fundamental issues of law which have affected commercial parties over the years. A recent significant decision of the Supreme Court has continued this trend. In May 2018, the Supreme Court gave its judgment in the case of *Rock Advertising Limited* ("**Rock**") *v MWB Business Exchange Centres Limited* ("**MWB**") [2018] UKSC 24, a case which explored the effect and impact of "*No Oral Modification*" clauses. A No Oral Modification clause is one which precludes oral variations to a contract. The Supreme Court in its judgment found that these should be given legal effect.

At first blush this may seem unsurprising. However, this decision lies against a background of jurisprudence which had introduced uncertainty into commercial relationships, particularly in cases where misunderstandings have arisen between commercial parties who have through the course of their relationship 'agreed' matters orally. The Supreme Court's decision has now given parties helpful guidance as to how they should understand the interaction between a pre-existing contractual commitment and their continuing freedom to agree matter. At the heart of this lies an issue of fundamental importance: which rules supreme, an agreement or a party's autonomy to agree?

Background

The dispute arose under a licence agreement in which MWB permitted Rock to occupy office space in London for a fixed term of 12 months. The licence agreement contained a No Oral Modification clause requiring all variations to be "*agreed, set out in writing and signed on behalf of both parties before they take effect*". After some time Rock fell into arrears and was unable to pay the rent due under the licence agreement. To try and resolve the issue one of Rock's Directors called MWB's credit controller and proposed orally to revise Rock's rent payment schedule. When Rock then started making payments in accordance with the revised schedule, MWB terminated the licence agreement and evicted Rock from the property. A dispute arose as to whether the revised rent proposal had been agreed by MWB. This led to MWB initiating proceedings for the unpaid rent and Rock counterclaiming for wrongful exclusion.

The decision at first instance went in favour of MWB but that decision was overturned by the Court of Appeal. The Court of Appeal

determined that the revised and rescheduled rent proposal amounted to an "*oral agreement*" between the parties which varied the terms of the underlying licence agreement and amounted to an agreement to dispense with the No Oral Modification clause. In reaching its decision, the Court of Appeal emphasised the importance of party autonomy noting that parties should be able to contract out of requirements stipulated in an underlying agreement.

Although the arrears where relatively modest (approx. £12,000), MWB appealed against the Court of Appeal's decision.

The Supreme Court's Decision

On appeal, the Supreme Court unanimously allowed the appeal. The Supreme Court determined that (i) the No Oral Modification clause in the licence agreement was legally effective and (ii) the parties had not impliedly dispensed with compliance through their oral communications.

Lord Sumption gave the leading judgment. He concluded that the law should take the following approach: firstly, No Oral Modification clauses which specify formalities to be observed for a variation are, and should be, given effect by English Law; and secondly, once a contract is concluded, party autonomy is only permitted "*to the extent that the contract allows*".

In reaching this decision, Lord Sumption confirmed that there is no public policy reason why No Oral Modification clauses should not be upheld by the courts and that they neither frustrate nor contravene any specific policy of law. He referred to the fact that often statute prescribes the form of an agreement. For example, section 2 of the *Law of Property (Miscellaneous Provisions) Act 1989* requires agreements for the sale of property to be in writing and signed by the parties. Therefore, there was no good reason why contracting parties should not adopt a similar requirement by agreement; in effect creating their own private law. This is the supremacy of contract. Lord Sumption reasoned that No Oral

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Modification clauses provide commercial parties with legal certainty and avoid disputes about the validity of any variation (and its exact terms). They also provide a mechanism for organisations to monitor their own internal rules limiting the authority to agree variations.

The counterpoint to the argument for supremacy of contract is that parties remain autonomous to reach agreements and which may have the effect of undoing a previous bargain. Lord Sumption gave this short shrift, describing party autonomy as "*a fallacy*". He said "*the real offence against party autonomy is the suggestion that* [parties] *cannot bind* [themselves] *as to the form of any variation*". Many other jurisdictions uphold such clauses, whilst also imposing no formal requirements for the validity of commercial contracts.

Whilst the Supreme Court's decision was unanimous, Lord Briggs gave different reasons. While Lord Sumption's view was that it is simply not possible to orally amend a contract where a No Oral Modification clause exists, Lord Briggs considered that parties should have capacity to orally agree to amend a contract in instances where the parties expressly comment on the No Oral Modification clause (where one exists). In his words, a No Oral Modification clause "*continues to bind until all parties have expressly (or by strictly necessary implication) agreed to do away with it*"; an argument in favour of the supremacy of party autonomy. However, Lord Briggs was in the minority.

In reaching its decision, the Supreme Court

acknowledged the potential for injustice in cases where a party has relied on an oral variation but finds itself unable to enforce it. The safeguard in these cases lies in the various doctrines of estoppel.

The impact

The importance of this decision should not be underestimated. It provides some very helpful clarity on the approach parties should take when agreeing and adhering to the terms of an agreement. In the background lies the issue of certainty, to ensure commercial parties are able to work together knowing the terms on which they are to operate are reasonably clear.

Before the decision in Rock Advertising, No Oral Modification clauses were often found to be ineffective and, in practice, often ignored if not merely overlooked. However, the Supreme Court's decision, means this can no longer be the case. Parties must take care to check the terms of their existing contracts and ensure that No Oral Modification clauses are adhered to (as necessary) to ensure any amendments or variations to their agreements are effective. Even to adopt an approach whereby an oral variation is agreed and later put into writing would, in Lord Sumption's words, be "courting invalidity with [one's] eyes open". This is because there is a real risk that a party may act to its detriment on a purported oral variation only for it to be held to the terms of the original contract.

But the decision does not only impact No Oral Modification clauses, it extends to other parts of a contract which similarly regulate commercial certainty. Entire Agreement clauses, for example, usually seek to exclude prior 'agreements' or oral representations from the bargain to ensure all sides proceed on the same footing. There have been a recent series of cases involving parties trying to circumvent entire agreement clauses, claiming the existence of oral collateral contracts sitting alongside a set of terms which have been clearly and carefully reduced to writing. Often the result of some misunderstanding between parties, the potential for disagreements to arise in respect of 'collateral contracts' in the face of Entire Agreement clauses creates uncertainty and risk which commercial parties would prefer to avoid. It is easy to understand why.

Although the outcome of this case may introduce some additional administrative burden in ensuring stricter compliance with the terms of an agreement, commercial parties should take comfort knowing that there is now only limited scope to depart from the terms of an agreement as a result of oral discussions. The decision in favour of supremacy of contract gives healthy clarity and certainty.

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