Clayton Comments
Richard Clayton KC

**NEW TRAPS AND TOOLS IN COMMERCIAL CONTRACTING:
WHAT RECENT CASES REALLY MEAN?**

1. I would like to examine some recent contractual case law by focusing on a few broad principles:
    - differentiating between sophisticated, complex agreements drafted by skilled professionals vs short, informal agreements;
    - the relative bargaining power of contracting parties; and
    - how to deal with allegedly oppressive contractual terms.

2. The presentation takes a fresh look at how these issues impact on
    - interpretation of contracts,
    - how contractual terms become incorporated,
    - the reasonableness of excluding a statutory term
    - assessing the reasonableness of post-termination restrictive covenants; and
    - whether a contractual term is a penalty.

3. Distinguishing between the approaches to be taken to sophisticated vs informal agreements are important for contractual analysis, but relatively straightforward- as is fashioning the proper approach to allegedly oppressive contractual terms. More uncertain and complex questions arise concerning how to address inequality of bargaining power

The principle of inequality of bargaining power

4. In <u>*Lloyds Bank Ltd. v Bundy*</u> the Defendant mortgaged his farm to the Claimant to raise money for his son' business and on failing his mortgage payments, the bank began foreclosure proceedings. The Court of Appeal found undue influence since there was a long-standing relationship of confidentiality and trust between C's manager and D.[1] Lord Denning felt the inequality of bargaining power was the rationale for unconscionable bargains, duress, and undue influence and said the law:
` "*gives relief to one who, without independent advice, enters into a contract upon terms which are very unfair or transfers property for a consideration which is grossly inadequate, when his bargaining power is grievously impaired by reason of his own needs or desires, or by his own ignorance or infirmity, coupled with undue influences or pressures brought to bear on him by or the benefit of the other*."

5. However, Lord Dennings' view was rejected by the Privy Council in in <u>*Pao On v Lau Yiu Long*</u> where Lord Scarman held that the Board conclude that "*where businessmen are negotiating at arm's length it is unnecessary for the achievement of justice, and unhelpful in the development of the law, to invoke such a rule of public policy*".[2]

6. In <u>*National Westminster Bank v Morgan*</u> Lord Scarman emphasised that undue influence needs the victimisation of the innocent party by the other contracting party.[3] He said the belief of influence must be elevated by a manifestly detrimental contract or agreement made with a person in a position to govern the other. He pointed out that in <u>*Morgan*</u> the relationship between a bank and its customer was purely one of a commercial nature and not one of "trust and confidence". He observed that there are many relationships where one party relies on the other closely, but this factor does not lead to

[1] [1975] Q.B. 326
[2] | [1980] A.C. 61
[3] [1985] A.C. 686

presumption of undue influence e.g. husband and wife. Lord Denning was, therefore, wrong to say that the law grants relief where there has been an "*inequality of bargaining power*".

7. As a result, there are a few well-established areas of the law where equitable relief is available against harsh or unconscionable bargains eg:
   - the law relating to penalties, forfeitures and mortgages;
   - legislative interferences with freedom of contract designed to protect contracting parties from making harsh or unconscionable bargains.[4]

8. However, it remains doubtful in modern law to what extent there is any general equitable principle entitling the courts to interfere with freedom of contract on the ground that the contract (or a part of it) is, in all the circumstances of the case, a harsh and unconscionable bargain.

9. Until recent years the legacy of nineteenth-century ideology favouring freedom of contract restricted the development of possible residuary principles of unconscionability, although there were signs of a possible resurgence of a broader equitable approach to unconscionable bargains.[5] Subsequently, the courts have shown a determination to adhere firmly to principles of freedom of contract, particularly in commercial contracts between businessmen.[6] Nonetheless, it is clear that relief is possible in certain cases of unconscionable advantage taking and the real question is the scope of these principles involved, particularly when relief should be granted against unconscionable bargains with persons suffering from some form of bargaining disadvantage.[7]

10. A more nuanced perspective is required.

Contractual interpretation- *Wood v Capita Insurance Services Ltd*

11. *Wood* decided by the Supreme Court in 2017 remains the most important authority on contractual interpretation.[8] The proper construction of a contract is not a routine issue in every case, but must be the starting point in many cases.

12. The court's task in interpreting a contractual term is to ascertain the objective meaning of the language which the parties chose when expressing their agreement; As Lord Hoffman pointed out in *Kirin Amgen Inc v Hoechst Marion Roussel Ltd*:[9]

    > *"Construction, whether of a patent or any other document, is of course not directly concerned with what the author meant to say. There is no window into the mind of the patentee or the author of any*

[4] See eg the Unfair Contract Terms Act 1977, below, under the Unfair Terms in Consumer Contracts Regulations 1999 or Consumer Rights Act 2015 Pt 2,and Consumer Credit Act 1974 ss.140A–140C (inserted by ss.19–22 of the Consumer Credit Act 2006;

[5] See, e.g. dicta of Lord Simon in *Shiloh Spinners Ltd v Harding* [1973] A.C. 691, 726; Lord Diplock in A*. Schroeder Music Publishing Co v Macaulay* [1974] 1 W.L.R. 1308, 1315; *Burmah Oil Co v Bank of England*, The Times 4 July 1981 (no relief for mere unfair bargain—there must be an unconscionable bargain—a bargain whose very terms reveal conduct which shocks the conscience of the court); and *Alec Lobb (Garages) Ltd v Total Oil (Great Britain) Lt*d [1985] 1 W.L.R. 173, in which the Court of Appeal did not rule out a broad doctrine of unconscionability, though it held that no unconscientious conduct had occurred.

[6] See, eg *Photo Productions Ltd v Securicor Transport Ltd* [1980] A.C. 827; *The Chikuma* [1981] 1 W.L.R. 314; *Multiservice Bookbinding Ltd v Marden* [1979] Ch. 84

[7] See the Privy Council in *Borrelli v Ting* [2010] Bus. L.R. 1718 which shows that unconscionable conduct which takes the form of illegitimate actions (such as forgery and fraud) that are not threats but that nonetheless constrain the victim's choice can amount to economic duress, unlike unconscionable conduct that does not involve actions that are otherwise wrongful.

[8] [2017] A.C. 1173

[9] [2004] UKHL 46

other document. Construction is objective in the sense that it is concerned with what a reasonable person to whom the utterance was addressed would have understood the author to be using the words to mean. Notice, however, that it is not, as is sometimes said, 'the meaning of the words the author used', but rather what the notional addressee would have understood the author to mean by using those words. The meaning of words is a matter of convention, governed by rules, which can be found in dictionaries and grammars. What the author would have been understood to mean by using those words is not simply a matter of rules. It is highly sensitive to the context of and background to the particular utterance. It depends not only upon the words the author has chosen but also upon the identity of the audience he is taken to have been addressing and the knowledge and assumptions which one attributes to that audience".

13. Furthermore, interpretation is not a literalist exercise focused solely on a parsing of the wording of a particular clause- but required consideration of the contract as a whole and, depending on the nature, formality and quality of its drafting,
    - In *Prenn v Simmonds*[10] and in *Reardon Smith Line Ltd v Yngvar Hansen-Tangen (trading as HE Hansen-Tangen)*,[11] Lord Wilberforce affirmed the potential relevance to the task of interpreting the parties' contract of the factual background known to the parties at or before the date of the contract, excluding evidence of the prior negotiations.
    - more or less weight to be given to elements of the wider context in reaching its view as to that objective meaning;

14. As Lord Clarke JSC stated in the *Rainy Sky*,[12] the interpretation of a contract was a unitary exercise and, where there were rival meanings, the court could give weight to the implications of rival constructions by reaching a view as to which was more consistent with business common sense;
    - but in striking a balance between the indications given by the language and the implications of the competing constructions, the court had to consider
        - the quality of drafting of the clause and
        - also to be alive to the possibility that one side might have agreed to something which, with hindsight, did not serve his interest;

    - similarly the court should not lose sight of the possibility that the provision might be a negotiated compromise or that the negotiators had been unable to agree more precise terms;
    - the unitary exercise involved an iterative process whereby each suggested interpretation was checked against the provisions of the contract and its commercial consequences were investigated;

15. Once a person has read the language in dispute and the relevant parts of the contract that provide its context, it does not matter:
    - whether the more detailed analysis commences with the factual background and the implications of rival constructions; or
    - a close examination of the relevant language in the contract, so long as the court balances the indications given by each.

16. When interpreting any contract, textualism and contextualism could be used as tools to ascertain the objective meaning of the language which the parties had chosen to express their agreement and the

[10] [1971] 1 WLR 1381, 1383H–1385D
[11] [1976] 1 WLR 989, 997
[12] [2011] 1 WLR 2900

extent to which each tool would assist the court in its task would vary according to the circumstances of the particular agreements:

- agreements which were sophisticated and complex because they had been negotiated and prepared with the assistance of skilled professionals might be successfully interpreted principally by textual analysis;
- the correct interpretation of other contracts, such as those which lacked clarity because of their informality or brevity or the absence of skilled professional assistance, might be achieved by a greater emphasis on considering their factual matrix and the purpose of similar provisions in contracts of the same type;
- the recent history of the common law of contractual interpretation is one of continuity rather than change. One of the attractions of English law as a legal system of choice in commercial matters is its stability and continuity, particularly in contractual interpretation

Incorporation of contractual terms- *Parker-Grennan v Camelot UK Lotteries Ltd*

17. In *Parker-Grennan* C opened an online national lottery account on Camelot's website. [13] She ticked a box which appeared on screen to confirm that she agreed to be bound by Camelot's terms and conditions, which were accessible via hyperlinks and drop-down menus on the website. She then played an online instant win game where the screen contained the wording "*match any of the winning numbers to any of your numbers to win prize*". The aim of the game was to match any number in the "*your numbers*" section of the screen with a number of the "*winning numbers*" section to win the prize shown alongside that number.

18. C matched a number which corresponded to a £10 prize but the screen on her laptop also showed ta number in both the "*your numbers*" and the "*winning numbers*" sections alongside a prize of £1 million. When she clicked the 'finish' button her prize, according to Camelot's computer, was £10.

19. It transpired that the reason why C saw what she did was a coding issue which had generated an error in the Java software responsible for the animations. Depending on what device was used to play the game, this resulted in different graphical animations. That software error, which affected only 0.24% of the plays during the 36-hour period before it was detected by Camelot, did not affect the outcome of C's play. Camelot's database recorded that she had won £10 and Camelot therefore explained to her that she had not won £1 million.

20. C applied for summary judgment or, to strike out Camelot's defence. She contended that she had done exactly what it said on the Game Details Screen, i.e. "*Match any of the WINNING NUMBERS to any of YOUR NUMBERS to win PRIZE*" and that that language did not negate the possibility of two sets of matching numbers and thus two prizes being won in a single play. If a software error had led to a situation in which she had won a prize when it was not intended that she should, that was Camelot's problem

21. The Court of Appeal held:
    - the legal test for incorporating terms into a contact was whether Camelot did what was reasonably sufficient to bring the various terms and conditions to the notice of a player of the game. The trader was generally required to signpost *'onerous or unusual terms'*.
        - there had been nothing on the screen which highlighted or otherwise drew specific attention to particular terms within each relevant set of terms and conditions.

[13] [2024] E.C.C. 11

  - But nothing onerous or unusual about the various contractual provisions on which Camelot sought to rely.
  - Anyone playing an game would expect there to be some rules governing how the particular game was played and what had to be done in order to win and the game procedures set out those rules.
- As the terms had not been onerous, there had been no requirement for Camelot to specifically signpost any of them in order to incorporate them into the contract as a matter of common law.
- The question of whether Camelot had done enough to reasonably draw the terms and conditions, as a whole, to the notice of Ms Parker-Grennan before she played the game was quintessentially one of fact.
- In any event, the question was not whether the trader had done everything in its power to make the other party read the terms and conditions. One could not force someone to read the terms and conditions if they could not be troubled to do so.
- The trader only had to take reasonable steps to bring the terms and conditions to their attention, which necessarily involved giving a sufficient opportunity to read them.
- The terms were written in plain English and a simple glossary of the terms used. Important changes were highlighted in summaries which would not have taken her an unreasonable period of time to read and digest. Camelot had done enough to incorporate into the contract between Camelot and C.

The reasonableness of excluding a statutory term *Last Bus Ltd v Dawsongroup Bus and Coach Ltd*

22. In *Last Bus* the Court of Appeal had to consider whether the circumstances made it reasonable to exclude the statutory implied term as to quality.[14]

23. The claimant's claim was that 30 coaches D financed by the defendants under five hire purchase agreements were not of satisfactory quality. However, each of the HP agreements incorporated a standard form exclusion clause, which purported to exclude the term which would otherwise have been implied by s 10(2) of the Supply of Goods (Implied Terms) Act 1973. C contended that the exclusion clause did not satisfy the requirement of reasonableness pursuant to ss 6(1A)(b) and 11 of the Unfair Contract Terms Act 1977.

24. By enacting the UCTA Parliament had not legislated over the whole field of contract. In commercial cases where the parties were of equal bargaining power, they were free to apportion risk as they saw fit without judicial intervention, including by way of exclusion clauses. However, Parliament had legislated to control the reasonableness of certain terms in specified types of contract and those were not limited to consumer contracts. An exclusion clauses based on one party's written standard terms of business (s3) and also those in hire purchase contracts (s 6) were subject to the test of reasonableness, the burden being on the party relying on the term to show that the test was met.

25. Businesses relying on terms which excluded what would otherwise be their liability under the contract had to prove their reasonableness, In cases where commercial parties were found to be of equal bargaining strength (and particularly where they had insurance), the courts had held that the

[14] [2023] 4 W.L.R. 80

bargain of the parties should generally prevail and the clause therefore held to be reasonable under UCTA.

26. Nevertheless, even where the parties were large commercial concerns and were of equal bargaining strength as regards the price to be paid under the contract, that did not mean that they were of equal bargaining strength in respect of the terms.
    - a supplier might be willing to negotiate the unit price, but would only supply on its standard terms, a position taken by all other suppliers in the market;
    - this crucial distinction had to be borne in mind when considering the reasonableness of standard terms and, to a large extent, epitomised the rationale for controlling standard terms of business by statute;
    - the judge was wrong to approach the question of reasonableness of the exclusion clause on the basis that the parties were of equal bargaining strength and the "*marked reluctance to interfere*" was engaged;
    - the prior question was whether, where C was contracting on D1's standard terms of business, the parties were on an equal footing with regard to those terms;
    - the proper starting point was that the exclusion clause contained in standard terms of business of a hire purchase company purported to exclude any and all liability for the quality of the coaches supplied to the claimant, leaving the claimant without a remedy even if it received no value at all whilst having to pay for the hire;
    - such clauses were *prima facie* unreasonable under UCTA ; and
    - the judge had also erred in granting summary judgement an holding that a trial was not necessary to determine the question of reasonableness

Assessing the reasonableness of post-termination restrictive covenants- *Dwyer (UK Franchising) Ltd v Fredbar Lt*d

27. In *Dwyer* C was a company engaged which operated a national emergency plumbing and drainage franchise and granted more than 30 franchises.[15] D1 was a former franchisee and D2 a director and shareholder of D1. The franchise not as profitable as expected and then pandemic. D2 terminated the Agreement by email and begun to operate their own competing business.

28. The trader post contractual terms had:
    - restrictions for 1 year on being engaged, concerned or interested in a business similar to or competitive with C's business and
    - extended to a business operating within a five mile radius of the franchised territory.

29. The trial judge held that the restrictive covenant was an unreasonable restraint on trade and unenforceable whose reasons included:
    - C had known when the Agreement was entered into that D 2 was D1r's only employee and had no experience and that D2 would be at serious risk of losing his family home should the franchise business fail;
    - C (through its "managing director") had formed the view that failure was foreseeable; and
    - no negotiation between the parties and the Agreement was in C's standard form

[15] [2023] F.S.R. 4

30. The Court of Appeal held that enforceability and reasonableness of the covenant should not be assessed as to whether this was employer/employee case rather than to a contract for the sale of a business.
    - Franchise agreements were not in some special category, nor was there a "*one size fits all*" for franchise agreements.
    - In determining the reasonableness of covenants the court did not disregard the circumstances of the covenantor simply because there was a concomitant interest of the covenantor in alignment with that of covenantee.
    - The court would consider a number of factors including:
        - the factual and contractual background and
        - the relative bargaining strength of the parties, which necessarily involved looking at the circumstances of franchisees like the defendants; and
        - determining whether there was such a concomitant interest.
        - Inequality of bargaining power was not only relevant but a significant factor.
        - Where there was such inequality, the court would be astute to examine any restrictive covenant critically and ensure that it was only upheld if it was objectively reasonable between the parties in all the circumstances.
        - Further, it would be relevant to negative any argument (such as here) that the restrictive covenant was reasonable because of the concomitant interests of the parties. On analysis, a franchise agreement may in these circumstances be more akin to a contract of employment than a contract for the sale of a business
    - Various factors in the case demonstrated an inequality of bargaining power between the parties. On the facts of this case, the franchise agreement was more akin to an employment contract than to the sale of a business. The parties' inequality of bargaining power was a significant factor which supported the judge's overall conclusion that the restraint of trade provisions were unreasonable.
    - The judge was right to conclude on particular facts that 12 month restriction was unreasonable and unenforceable. It followed that the provision for the five mile radius buffer zone outside the territory was also unreasonable and unenforceable.
    - There was no goodwill in that D1 had not provided any services in that extended area and it was not reasonable to have that restriction irrespective of whether any goodwill had been established or not.
    - Per Arnold LJ: "*One can well understand the desire of a franchisor like Dwyer to have a standard form of franchise agreement, including a standard form of post-termination restrictive covenant. It is inescapable, however, that not all potential franchisees are equal*."

Determining whether a contractual provision was penal- *Cavendish Square Holding BV v Makdessi ParkingEye Ltd v Beavis*

31. In *Cavendish Square Holding* the Supreme Court considered penalties in two very different contexts.[16]
    - In one case following extensive negotiations in which both sides were represented by highly experienced commercial lawyers, the defendant agreed to sell to the claimant a controlling interest in the advertising and marketing company which he had founded. C greed to pay up to $147m, depending on a calculation of profits, in instalments, with a large amount reflecting goodwill. For a period after the sale D was not to compete with his old business and that, if he did, he would not be entitled to any further payments. When D breached the

[16] [2016] A.C. 1172

non-competition provision, C sought a declaration that he was not entitled to further payments and was obliged to sell his shares to C.

- In the other case D parked his car in a privately-owned shopping centre car park managed by C. Notices prominently displayed at the entrance and throughout the car park stipulated that the maximum permitted stay was 2 hours, parking was free up to that time but that £85 would be charged to those who stayed longer, reducible to £50 if paid within 14 days. D drove out of the car park nearly an hour after the permitted time and was charged £85 by C which he did not pay.

32. The Supreme Court held:

- the common law rule that a term in a contract which constituted a penalty was unenforceable should not be abolished or restricted, since it was a long-standing principle of English law, common to almost all major systems of law, and had a useful role to play in protecting people against some categories of oppressive bargain which were not subject to statutory regulation;
- But that rule should not be extended to cover clauses which imposed onerous obligations on a party on certain contingencies which did not involve a breach of contract, since the courts had no power at common law to regulate the parties' primary obligations;
- the rule applied not only to provisions requiring the payment of money on breach of contract but also to clauses providing for the withholding of payments or the transfer of property;
- a provision was penal if it was a secondary obligation which imposed a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation;
- therefore, the fact that a provision did not provide for a pre-estimate of loss, or that it was deterrent, did not necessarily mean that it was penal, since the legitimate interest of the innocent party might extend well beyond the recovery of compensation for his loss; and
- in a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption had to be that the parties themselves were the best judges of what was legitimate in a provision dealing with the consequences of breach.
- Although clauses had no relationship with the measure of loss attributable to the breach, the claimant had a legitimate interest in the observance of the non-competition provisions which extended beyond the recovery of that loss,
  - D’s loyalty critical to that goodwill; that the parties, who were, on both sides, sophisticated, successful and experienced commercial people bargaining on equal terms over a long period with expert legal advice,
  - they were the best judges of the degree to which each of them should recognise the proper commercial interests of the other; and that, accordingly, the judge had been right to conclude that clauses 5.1 and 5.6 were enforceable since the goodwill of the business was critical to its value and
- D in the second case had had a contractual licence to park in the car park on the terms of the notice posted at the entrance, which he had accepted by entering the site;
  - the £85 charge for contravening the terms of the licence by overstaying the two-hour limit engaged the penalty rule;
  - although neither the owners of the car park nor the claimant could have expected to suffer £85 worth of loss ;
  - if a driver overstayed the two-hour limit, they both had a legitimate interest in the efficient use of the parking spaces for the benefit of other users of the shopping centre which could only be served by deterring drivers from occupying parking spaces for long periods of time; and

    - accordingly, since the charge was no greater than was necessary to achieve that result and was not unreasonable by comparison with charges made for overstaying in local authority parking facilities, the charge imposed on the defendant was not a penalty at common law
- The classification of terms for the purpose of the penalty rule depends on the substance of the term and not on its form or on the label which the parties have chosen to attach to it.
- The fact that a sum is paid over by one party to the other party as a deposit, in the sense of some sort of surety for the first party's contractual performance, does not prevent the sum being a penalty, if the second party in due course forfeits the deposit in accordance with the contractual terms, following the first party's breach of contract.
- A case may raise for consideration both the penalty doctrine and the power of the court to relieve against forfeiture. The two doctrines, both originating in equity, operate at different points and with different effects. Consideration whether a clause is penal occurs necessarily as a preliminary to considering whether it should be enforced, or whether relief should be granted against forfeiture.

5 September 2025