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Court of Appeal ruling on injunctions to prevent breach of contract

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Introduction

Court of Appeal delivers landmark ruling on the availability of injunctions to prevent breach of contract.

In a landmark decision on injunctions the Court of Appeal has confirmed that the existence of a contractual clause which has the effect of limiting or excluding the damages available for breach may be taken into account by the court on applications for injunctive relief when assessing whether damages are an adequate remedy in the American Cyanamid sense

Lewis Silkin acted for the successful party AB, both at first instance and at the Court of Appeal.

Background

The underlying dispute concerns an internet-based electronic platform used internationally to buy and sell goods and services by entities involved in the mining, metals and other natural resources businesses. The Defendant ("CD") owns or controls the intellectual property in the platform. By a licensing agreement dated 1 October 2005, CD licensed the Claimant ("AB") to market and sell (or sub-licence) the platform within the Middle East. AB's sole registered buy-side customer is XCo.

The licensing agreement was to continue to 31 December 2010, and thereafter to renew annually. By a letter dated 6 June 2013, CD gave notice that it would terminate the licensing agreement at midnight on 31 December 2013. AB's position was (and remains) that CD's threatened termination was unlawful, and constituted a repudiation of the licensing agreement, which AB elected to affirm.

The dispute between the parties was referred to arbitration under LCIA Rules. AB applied under s.44 of the Arbitration Act 1996 for an interim injunction to restrain CD from terminating the licensing agreement pending the conclusion of the arbitration.

The law

Under s.37 of the Senior Courts Act 1981, the High Court may grant an injunction (whether interlocutory or final) in all cases in which it appears to the court to be just and convenient to do so. In *American Cyanamid* [1975] AC 396 Lord Diplock laid down guidelines for the judicial application of s.37, stipulating that the following factors should be taken into account:

- Whether there is a serious issue to be tried;
- Whether damages would be an adequate remedy;
- Whether the "balance of convenience" favours granting an injunction;
- Whether there are any special factors present.

Subsequent cases have provided further guidance on how Lord Diplock's formulation (often referred to as the *American Cyanamid* principles or test) should be interpreted and applied.

The decision at first instance

The Judge at first instance, Stuart-Smith J, concluded that there was a serious issue to be tried as to whether CD was entitled to terminate the licensing agreement, and that the "balance of convenience" clearly favoured the granting of an injunction. However, Stuart-Smith J concluded that it would not be appropriate to grant an injunction because in his view AB had not been able to demonstrate that damages were an inadequate remedy.

AB's case

Initially AB submitted that damages would not be an adequate remedy in circumstances where (1) termination would destroy AB's business (on the basis that AB would no longer be able to perform its contractual obligations to XCo) (2) damages would be very difficult to quantify, and (3) there was a risk that if the licensing agreement was terminated, AB's external funders would not be willing to fund the arbitration. Stuart-Smith J did not accept that any of these matters would render damages inadequate.

An additional argument, which emerged for the first time during the course of oral submissions, centred around the existence of a limitation and exclusion clause in the licensing agreement (clause 11.4). The question for the Court was essentially whether the fact that AB's recoverable damages may be limited and/or excluded by that clause rendered damages an inadequate remedy in the *American Cyanamid* sense. In particular, can damages be said to be "inadequate" if they are limited or excluded by agreement? This question became the focus of the decision at first instance and the subsequent appeal.

AB relied primarily on the Court of Appeal decision in *Bath and North East Somerset District Council v Mowlem plc* [2004] BLR 153. The Bath case concerned a dispute arising out of a contract for the restoration of Bath's Heritage Spa buildings. The contract contained a liquidated and ascertained damages clause providing for

damages to be paid at the rate of £12,000 per week in the event of delay. In the event there were delays in completion of the works, caused in part by a dispute as to whether particular defects were the responsibility of the contractors, Mowlem.

The Council instructed another firm of contractors to complete the works, and applied for an interlocutory injunction to restrain Mowlem from denying the new contractors access to the site. The Council argued that further delays would cause it to suffer loss in excess of the liquidated damages payable under the contract. Mowlem, on the other hand, argued that the provision for liquidated damages represented what the parties had agreed would be an adequate remedy for delay. The trial Judge rejected Mowlem's argument and granted the injunction.

The Court of Appeal upheld the decision at first instance. Mance LJ, delivering the lead judgment, rejected Mowlem's suggestion that the agreed liquidated damages offered a quantification of loss which was conclusive not merely in the context of a claim to recover damages, but also in the context of a claim to an injunction. Mance LJ emphasised that the equitable jurisdiction has a more fundamental objective, namely to "*avoid any further financial loss and any cause for a claim to such damages*", and that the contract freely entered into by the parties should not be regarded as setting a price for a party's breach of contract, nor to preclude the court from granting other appropriate relief. He also pointed out that as even courts at the date of breach may lack confidence in their ability to quantify damages: a fortiori, the parties' rough and ready assessment before the event in their contract may not give rise to adequate compensation "*so that to leave a party to claim in damages may mean that it will suffer loss which the grant of an interlocutory injunction would completely avoid.*" Mance LJ also observed that the *American Cyanamid* test is not a statute and (endorsing the view of Lord Goff in *R v Secretary of State, ex parte Factortame Ltd* (No. 2) [1991] 1 AC 603) is not "*intended to fetter the broad jurisdiction conferred on the courts by section 37*".

CD's case

CD relied on two first instance decisions (both of which were decided post Bath), namely *Vertex Data Science Ltd v Powergen Retail Ltd* [2006] EWHC 1340 (Comm) and *Ericsson v EADS Defence* [2009] EWHC 2598 (TCC).

Vertex sought an interlocutory injunction preventing Powergen from terminating an outsourcing agreement under which it provided Powergen with various kinds of customer services. Tomlinson J refused the injunction on the basis that its effect would be to require the parties to continue to work together. Tomlinson J also suggested (albeit *obiter*) that he could not see how it could be unjust for a party to be "*confined to such remedy in damages as is determined to be the extent of the bargain which it struck*". Tomlinson J referred to the Bath case, but suggested that it was an "*extraordinary case on the facts*".

The *Ericsson* case concerned a contract for the supply of software and related support services, and contained a limitation and exclusion clause not dissimilar to clause 11.4 of the licensing agreement in this case. Ericsson sought an injunction, and claimed that damages would not be an adequate remedy. Akenhead J disagreed, stating "*I cannot see that it is unjust that a party is confined to the recovery of such damages as the contract, which it has entered into freely, permits it to recover*".

Ultimately Stuart-Smith J concluded that he should follow the approach adopted by Akenhead J in *Ericsson*, and distinguished the Bath case on the basis that the liquidated damages clause was a pre-estimate of full compensation for delay, whereas limitation or exclusion clauses seek to exclude categories of loss from the scope of recovery altogether. Clause 11.4 was part of the package of rights and obligations which set the commercial expectations of the parties, and was "*part of the price that [AB] had agreed to pay when executing the Licensing Agreement*".

Somewhat unusually, Stuart-Smith J added a postscript to his judgment, in which he referred to a perceived tension between the decisions in *Bath* on the one hand, and Vertex and *Ericsson* on the other. He also expressed a "feeling of unease" in respect of the result, and a "nagging doubt" that the approach that he had chosen to adopt may be too inflexible. As a result, and due to the wider implications of the point in question, he granted AB permission to appeal.

The decision of the Court of Appeal

The appeal focused on a narrow point of law, namely the application of the adequacy of damages aspect of the *American Cyanamid* test in cases of alleged breach of contract where the contract in question contains a provision limiting the recoverable damages to below what might otherwise be available as a matter of law. In general terms, the parties' submissions mirrored those advanced at first instance on that point.

The Court of Appeal unanimously and emphatically upheld AB's appeal. Underhill LJ, delivering the lead judgment, essentially followed and endorsed AB's reasoning and analysis of the relevant law. He stated that the *Bath* case constitutes binding authority on the point under review, and in any event AB's position is right in principle.

Underhill LJ stated that the relevant aspects of Mance LJ's judgment in *Bath* contain a clear statement of principle (which forms part of the *ratio* of that decision) and applies in this case. It makes no difference in principle whether the contractual restriction in question takes the form of a cap on the amount of damages recoverable or the exclusion of certain heads of loss, as in both cases the parties' agreement is concerned with what damages should be recoverable in the event of breach. The unusual facts of the case (as alluded to by Tomlinson J in *Vertex*) do not affect the reasoning.

As to the wider point of principle, Underhill LJ again endorsed the reasoning of Mance LJ in *Bath*, and the submissions advanced on behalf of AB in this case. The primary obligation of a party is to perform a contract, and the requirement to pay damages in the event of a breach is a secondary obligation. An agreement to restrict the recoverability of damages in the event of a breach cannot be treated as an agreement to excuse performance of that primary obligation. The "rule" that an injunction should not be granted where damages would be an adequate remedy

should be applied in a way which reflects the substantial justice of the situation, and that is the basis of the s.37 jurisdiction.

Underhill LJ also rejected CD's "floodgates" argument, namely the risk that if AB were to succeed then in every case where the victim of a threatened breach of contract seeks an interim injunction he could rely on the existence of an exclusion or limitation clause to claim that damages would not be an adequate remedy. Every case will turn on its own facts, and a claimant will still have to show that if the threatened breach occurs there is (at least) a substantial risk that he will suffer loss that would otherwise be recoverable but for which he will (or at least may) be prevented from recovering in full, or at all, by the provision in question. However, if he does, it will not be enough for a defendant to say that the restriction in question was agreed.

Lord Justice Laws endorsed the lead judgment, and arguably went a step further by suggesting that where a party to a contract stipulates that his liability or the damages that he must pay will be limited in the event of breach, that is a circumstance which in justice tends to favour the grant of an injunction to prohibit the breach in the first place. Lord Justice Ryder, who also agreed with Underhill LJ's judgment, stated that he favoured the re-casting of the "adequacy of damages" question along the lines suggested by Sachs LJ in *Evans Marshall & Co Ltd v Bertola SA* [1973] 1 WLR 349, namely: "*is it just in all the circumstances that a [claimant] be confined to his remedy in damages?*"

CD's application for permission to appeal to the Supreme Court was refused. The application may be renewed with the Supreme Court directly, although given the principled and emphatic nature of the Court of Appeal's judgment the prospects of such an application or appeal succeeding would appear to be slim.

Comment

The significance and pervasive impact of this decision are self-explanatory. Contracts containing clauses which purport to limit the losses that may be recovered in the event of breach are a ubiquitous part of commercial life, and it is common for parties to seek injunctive relief when faced with actual or threatened breach (the outcome of which can have serious commercial consequences for both sides).

Accordingly the lack of previous authority on this point is surprising, as noted by the judge at first instance and in the Court of Appeal. Nevertheless the tension in the underlying law as alluded to by Stuart-Smith J has now been resolved (although in light of the Court of Appeal's conclusion that it was bound by the decision in *Bath*, it is arguable that in fact no such tension existed).

As Underhill LJ observed, each case will turn on its own facts, and establishing the inadequacy of damages will only "open the door" to the exercise of the court's discretion. Nevertheless parties to contracts containing analogous provisions should now be aware that they may be used to support an application for injunctive relief. Accordingly parties wishing to avoid the possibility of injunctions to prevent termination (or other breaches) will need to consider carefully tailored contractual wording to that effect.

More generally, the decision represents a welcome reminder of the underlying function of the Court, when exercising a discretion based on an equitable jurisdiction such as that which applies to applications for injunctive relief. The mechanistic and narrow approach propounded by CD is at odds with the scope and overriding purpose of the court's discretion under s.37. What the Court is in fact required to do is to stand back, look at the matter in the round, and consider how best to achieve a just and fair outcome based on the circumstances of any given case. That is precisely what the Court of Appeal has done here, and it is to be welcomed.

To read the entire judgment go to *AB v CD* [2014] EWCA Civ 229.

For further information on this subject please contact:

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