20 ESSEX STREET

BULLETIN

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Phones 4U and recent developments in the law of termination: drafters beware

Phones 4U Limited (in administration) v EE Limited [2018] EWHC 49 (Comm)

David Lewis QC and Richard Greenberg report on the recent judgment of Mr Justice Andrew Baker in which Phones 4U obtained summary judgment dismissing a counterclaim brought by EE.

The case will be of particular interest to those practitioners who are involved with drafting contractual termination notices, or advising on the effects of such notices. It may also be the first Commercial Court judgment to consider, albeit not use, emojis.

The key point to note is Baker J's decision that EE could not recover "loss of bargain" damages for repudiatory breach at common law, even if there had been such a repudiatory breach by Phones 4U, because EE's termination letter relied solely on a contractual right to terminate, rather than a right to terminate for repudiatory breach at common law.

The facts

By 2014, Phones 4U's business model was in trouble. Its core business was the selling of mobile phone contracts. Yet, by then, many of the major mobile network operators, including Three, O2 and Vodafone, had decided to bring their arrangements with Phones 4U to an end.

EE decided to follow suit. On 12 September 2014, EE informed Phones 4U that it would not renew or replace its trading agreement with Phones 4U (the "Agreement"). That afternoon, the board of Phones 4U met and resolved to seek the appointment of administrators. On 15 September 2014, the retail outlets of Phones 4U did not open for business. Online trading ceased.

On 17 September 2014, EE sent a termination letter to Phones 4U. The letter terminated the Agreement, *"in accordance with clause 14.1.2 of the Agreement"*. Clause 14.1.2 was a standard insolvency termination clause, which entitled EE to terminate based solely on the fact of appointment of administrators by Phones 4U (§78-79). In familiar fashion, the termination letter provided that, *"nothing herein shall be deemed to constitute a waiver of any default or termination event, and EE hereby reserves all rights and remedies it may have under the Agreement…"*

The dispute

Baker J's judgment deals with Phones 4U's application for summary judgment under CPR Part 24 dismissing EE's counterclaim. That counterclaim was for loss of bargain damages resulting from the termination of the contract. EE claimed loss of over £200 million. Phones 4U's underlying claim was not relevant for these purposes.

The issues that fell to be determined under Phones 4U's application for summary judgment were as follows. First, was there a breach by Phones 4U? Secondly, if so, was it a repudiatory breach? Thirdly, was there a renunciation by Phones 4U? And, fourthly, did the terms of EE's termination letter defeat any claim by EE for damages for loss of bargain?

EE had brought another counterclaim, which related to a statement on Phones 4U's website referring to EE and Vodafone in explaining why Phones 4U was offline. The statement concluded with a sad face emoji. This other counterclaim, and the effect of that statement, fell outside the scope of Baker J's decision. Accordingly, the Judge left open the question of whether the case, *"will offer the court at trial an opportunity to consider the use of the sad face emoji as creating or involving a breach of contract"* (§12).

The decision

In summary, the Judge decided the four issues referred to above as follows:

First, on the question of whether there was a breach by Phones 4U (and on the assumption that the relevant obligations existed), it was held that EE had a reasonable prospect of establishing breach as alleged (§35).

Secondly, on the question of whether that breach was repudiatory, it was held that EE had a reasonable prospect of establishing repudiatory breach on the part of Phones 4U at the time of EE's termination letter (§54). The issue came down to whether, as at the date of termination, it was objectively likely

that the cessation of trading would continue long enough to deprive EE of substantially the whole remaining benefit of the Agreement.

Thirdly, in the light of the decision on repudiatory breach, any final view the Judge might have come to on the renunciation question was insufficient to lead to summary judgment, and he said no more on the issue (§58).

Fourthly, on the question of whether the terms of EE's termination letter defeated any claim by EE for damages for loss of bargain, it was held that they did defeat such a claim (§§130-133). We discuss this fourth issue in more detail below.

Loss of bargain damages

The significance of Baker J's decision is that a claim for damages for loss of bargain will be bad in law, even if there has in fact been a repudiatory breach or renunciation, in circumstances where: (i) a contractual right to terminate also exists, triggered otherwise than by breach (actual or anticipatory); (ii) that right is expressly exercised; and (iii) at the time of termination, no mention is made of any breach (§§83, 86). Given the Judge's other findings, this "pure point of principle" is the *ratio* of his decision. The danger to the drafters of contractual termination notices is clear and present.

The analysis flows from the terms of EE's termination letter. As the Judge put it, *"the relevant issue of construction is whether by its termination letter EE purported to exercise a common law right to terminate for the repudiatory breach and/or renunciation now alleged. EE requires an affirmative answer"* (§131). EE did not receive an affirmative answer. Its letter communicated unequivocally that EE was terminating the contract in exercise of, and only of, its right to do so under clause 14.1.2. That contractual right existed independently of any breach (§132). In these circumstances, EE's termination letter had not done what it needed to do in order to ground EE's loss of bargain claim. The letter did not clearly communicate that EE was exercising its common law right to terminate for repudiatory breach.

One question that arises is how this result sits with the well-known principle, established by *Boston Deep Sea Fishing & Ice Co v Ansell* [1888] 39 Ch D 339, that a party who terminates a contract for a bad reason may subsequently defend itself against a claim for wrongful termination by reference to a good reason extant at the time of termination, whether or not then known to that party. In this regard it is striking that EE's claim for damages for loss of bargain was dismissed in circumstances where the Agreement had been terminated and it was assumed that Phones 4U was in repudiatory breach at the time of termination. A key distinction appears to lie between defence and attack, ie. claim.

The Judge distinguished the *Boston Deep Sea Fishing* principle on the basis that the present case did not concern a purported termination alleging 'repudiation A' that cannot be made out but where different 'repudiation B' existed at the time. The *Boston Deep Sea Fishing* principle means that, in such a case, the innocent party can successfully *defend* itself, ie. show it has no liability for wrongful termination, because it could instead have terminated lawfully for 'repudiation B'. But that principle does not allow the innocent party to claim damages premised on termination for 'repudiation B' when, on the facts, it did not so terminate (§129). In this case, EE was not able to say that it terminated for the repudiation it wished to prove at trial, which rendered its loss of bargain damages claim unsound.

Another important aspect of the decision is that the termination letter – and EE's counterclaim – was not saved by the fact that it made clear that it was not to be taken as waiving any breach that might exist, any rights in respect of which were reserved. As Baker J put it, *"a right merely reserved is a right not exercised"* (§132). The Judge went on to say that EE may pursue all remedies that may be available to it bearing in mind that the contract was terminated under clause 14.1.2, but not for breach. However, EE was not entitled to "*re-characterise the events after the fact and claim it terminated for breach when that is simply not what it did*" (§132), with the result that the counterclaim was dismissed.

Conclusion

The judgment of Baker J in *Phones 4U Limited (in administration) v EE Limited* is a noteworthy development in the law of termination and there appears to be no precise precedent (§118). Baker J's thorough review of the authorities, which is beyond the scope of this newsletter, shows the various inter-connecting principles at play in the context of repudiation and contractual termination.

The specific effect of his decision is that if a termination letter communicates clearly a decision to terminate only under an express contractual right to terminate that has arisen irrespective of breach, then it then it cannot be said that the contract was terminated for a breach and, in those circumstances, a claim for damages for loss of bargain at common law cannot run. In practical terms, the decision highlights the need for abundant care in the drafting

of termination notices, particularly with an eye on the type of claim that an innocent party may wish to bring following termination. Terminate in haste, repent at leisure…

If you require advice on any of the topics discussed in this briefing from David, Richard or any member of 20 Essex Street please contact: clerks@20essexst.com

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David practises across a spectrum of general commercial and private international law disputes, both in Court and arbitration, in areas including civil fraud, energy, commodities, shipping, banking, insurance and the conflict of laws.

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