



LEGAL BULLETIN



Economic Duress – When will a Contract be set aside?

by

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Some of you may have seen or heard of the expression: “the parties are the masters of their own contractual fate”. By and large, this is true. Indeed, the courts are normally slow to interfere in agreements reached between two commercial entities (as distinct from agreements between consumers and commercial entities), but they will interfere in agreements procured by the exertion of economic duress by one party on the other.

The ingredients of actionable economic duress are as follows:-

- a) There must be pressure whose practical effect is that there is compulsion on, or a lack of practical choice for, the “victim”; and
- b) The pressure must be illegitimate and a significant cause which induces the “victim” to agree to enter into the agreement.

There are a number of factors which the courts will take into account in deciding whether or not there has been illegitimate pressure exerted by one party on the other:-

- a) Does the pressure amount to an actual or threatened breach of contract?
- b) Was the person who has been accused of having exerted illegitimate pressure acting in good faith or bad faith?
- c) Did the victim have any realistic alternatives but to submit to or accept the illegitimate pressure?
- d) Did the victim protest at the time or immediately after the pressure was exerted?; and
- e) Was the contract affirmed? (in other words, did the victim, by his conduct, accept the agreement entered into as a result of the illegitimate pressure exerted on him by the other party?).

So what behaviour will amount to “illegitimate pressure” in the context of a construction contract? Examples might include a threat by a sub-contractor to withhold the delivery of a crucial piece of plant or equipment until an extension of time is granted or the sub-contract price is increased. Conversely, it might include a threat by a main contractor to refuse to grant the sub-contractor an extension of time (and to apply LADs for delay), unless the sub-contractor agrees to carry out a substantial variation at minimal cost.

In **Carillion Construction Limited v. Felix (UK) Limited (TCC, November 2000)**, a case in which an agreement was set aside on the ground of economic duress, Carillion sub-contracted certain cladding works to Felix. As the contract proceeded, Carillion started to complain about delays by Felix.

In meetings convened to discuss the apparent inability of Felix to complete the sub-contract works on time, Felix stated that they wanted Carillion to agree the value of their projected final account before they released certain project documentation. A little later, Felix began to comment that delivery of sub-contract materials was dependent upon the agreement of their sub-contract final account. This was a serious threat to Carillion as any delay to the delivery of the sub-contract materials was likely to delay the completion of the main contract works and make Carillion liable to LADs of £75K a week. One of Felix's Directors stated in correspondence that if agreement could not be reached on the final account value of their sub-contract works, he "*could not predict*" when the cladding works would be complete.

Felix submitted a draft sub-contract final account in the sum of £3.314M. Carillion thought that this contained arithmetical errors and was, in fact, worth no more than £2.756M, £558K less than Felix's valuation.

Carillion approached two other contractors to complete the cladding works. One was not interested in the work whilst the other could not deliver in sufficient time for Carillion's programme. The system was bespoke cladding so alternatives were not readily available.

Carillion then took legal advice from their in-house advisors. They considered the possibility of obtaining an injunction requiring Felix to perform the sub-contract but this was rejected. They also considered adjudication proceedings but, given the time constraints, adjudication was considered too lengthy. They concluded that the only way of ensuring deliveries of the cladding materials were made was to agree Felix's final account on the best possible terms.

A meeting was then held at the conclusion of which Felix actually increased their final account valuation, without any substantiation, by a further £174K. Throughout the meeting, Felix made it clear that the only way that the works would progress was for Felix and Carillion to agree the final account. Carillion then asked Felix what sum they required. Felix indicated £3.3M and after some negotiation, an agreement was concluded at £3.2M. Solicitors were then instructed to draw up the agreement.

Once the agreement was in place, Carillion wrote to Felix to record their displeasure at the way the negotiations had been conducted. Carillion indicated that they felt they had been left with no practical choice but to consent to the agreement under duress and complained that Felix's conduct amounted to a breach of contract. Felix did not respond and simply took the view that Carillion's letter was simply a case of commercial sour grapes.

Carillion then issued court proceedings to set aside the final account agreement on the grounds of economic duress. The court decided that the final account agreement had indeed been brought about by economic duress and should therefore be set aside. So what were the reasons for the court's decision?

- a) The threat Felix made not to complete the cladding work until Carillion had agreed their final account was a breach of their contractual obligation to complete the cladding works by the sub-contract completion date. Felix only withdrew their threat after their figure for the final account had been agreed by Carillion.
- b) The final account agreement was not a commercial compromise as it had been made as a result of the threat made by Felix.
- c) Felix knew that other trades were dependant on them completing the cladding works and that Carillion could not complete the main contract works without the cladding.
- d) Carillion had considered whether or not they had any realistic and practical alternatives.

Another, more recent economic duress case was **Capital Structures v. Time & Tide Construction Limited (TCC, March 2006)**.

Capital entered into a sub-contract with Time & Tide for the erection of structural steelwork and pre-cast flooring works.

During the sub-contract works, Time & Tide issued a supplementary order to Capital for the supply, delivery and erection of balconies, Juliettes and staircases. Disputes arose between the parties as to Capital's entitlement to interim payments for these works as a result of which Capital withdrew their labour from site. Time & Tide then issued notices purporting to omit the staircase work from Capital's sub-contract (on the basis that the supplementary order was no more than a variation to the original sub-contract).

The employer then became involved and contacted Capital direct and advised them that if they did not deliver the balcony materials to site, the employer would have no choice but to step into the main contract. Time & Tide stated that the financial consequences of this would have been "disastrous" for them.

It was against this background that a settlement agreement was entered into by Time & Tide and Capital which provided for the release of the materials by Capital and for payment for those materials and certain other works by Time & Tide.

Time & Tide paid Capital for the materials but then refused to make any further payments in breach of the settlement agreement. It was that failure to make payment that Capital referred to adjudication. In the adjudication proceedings, Time & Tide stated in their Response that they challenged the Adjudicator's jurisdiction on the ground that they were *"..forced to enter into the settlement letter under economic duress..."*.

The court accepted that there was an *"arguable, albeit shadowy, case as to economic duress"*.

This was presumably because Capital knew that their decision to refuse to deliver the balcony materials to site was having a detrimental effect on Time & Tide's contract with the employer and that Time & Tide would face serious financial consequences if the materials were not delivered to site. Although the court did not decide whether or not this had in fact been the case, it was not prepared to enforce the decision made in favour of Capital by the Adjudicator until it had heard full argument on the economic duress point.

So what are the consequences of a contract being set aside on the ground of economic duress?

The "victim" will normally be entitled to recover any money it has paid under that agreement. If work has been undertaken or services have been performed under that agreement, then an adjustment will be made for the value of that work or for those services calculated in accordance with the terms of the original agreement.

In summary:-

- a) Economic duress is difficult to prove. It will only arise where the conduct is illegitimate and amounts to a breach of contract. If the conduct is legitimate, then it will not amount to duress.
- b) There has to be a lack of practical alternatives available to the "victim".
- c) If there is a right of suspension under the contract, then a suspension will be legitimate and will not amount to economic duress.
- d) It is necessary to object immediately otherwise the party who subsequently complains of duress will be deemed to have affirmed (i.e. accepted) the contract.
- e) The doctrine of economic duress only really applies if there is already a contract in place and is unlikely to apply to pre-contractual negotiations. This is because the parties will be used to the rough and tumble of commercial bargaining at the pre-contract stage and, at the end of the day, will be the "masters of their own contractual fate".

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