By Sean Wilken KC

Pitfalls in Terminating PFI Contracts

Anecdotally it appears that terminating PFI contracts, once anathema, is becoming more common. Further, an ageing PFI estate means the parties to PFI arrangements are becoming increasingly at loggerheads over historic defects, life cycle and hand back issues. This may enable on or both of the parties to allege that there has been a repudiatory breach of the various agreements. Assuming that there is a set of contractual termination provisions and there is not an exclusive termination clause (one which excludes any common law right to terminate by accepting repudiatory breach), the parties may have a choice whether to terminate under the contractual terms or by accepting a repudiatory breach. This choice raises commercial and legal issues for the parties.

Commercially, there is the obvious question whether a contractual termination or a claim for damages would leave a party better off. Whilst this is an obvious question, the answer to it may not be – particularly where there are equity and debt adjustments to be made on termination. There is also the issue that contractual termination very often carries with it post-termination cooperation provisions. These may be onerous and obviously would not apply if the contract was terminated for repudiatory breach. Thus, there may be reasons to avoid a contractual termination route and to proceed down the repudiatory breach route – even though so doing would require the party claiming to establish causation and loss[1].

Legally, there is the question of whether one can terminate both contractually and by accepting a repudiatory breach[2]. This question is far from straightforward. The learned authors of Wilken & Ghaly *The Law of Waiver, Variation and Estoppel* 3rd Ed OUP considered the point as it stood in 2012 at 6.14 where they said:

6.14 Three points emerge from these cases. First, it is not uncommon for the parties to provide for a contractual termination to carry with it specific rights and remedies which would not flow under the common law. Thus, a contractual termination may require the return of property and plant or the payment of additional monies but an accepted repudiation will simply discharge the parties from all future performance. Dependent on the facts, therefore, it may well be in one party's then commercial interest to pursue one course and not another. Second, what the result of pursuing one course rather than the other will depend on facts and the individual contract terms at issue and how those relate to the stance later adopted by the parties.[3] This flows from the facts that (a) contracts obviously differ and (b) there is no particular, requisite form for the acceptance of a repudiation.[4] Third, absent unusual contractual wording, there is, however, nothing to prevent a party serving both a common law notice and a contractual notice—in the alternative—in an attempt to preserve its rights.[5] If that course is adopted it should be remembered, however, that any preservation of rights might only be short-lived. At some point it is highly likely that the parties will have to act as if one or other was valid—that is, proceed with the contractual termination or the repudiation. At that point, as and when the parties proceeded down one path or the other,[6] the benefit of any reservation of rights would be lost.

This commentary relied on: *Shell Egypt West Manzala GmbH v Dana Gas Egypt Ltd* [2010] EWHC 465 and since then there have been two further relevant authorities: TLC v Leofelis SA [2012] EWCA Civ 985; and *Phones 4U* Ltd v EE Ltd [2018] EWHC 49.

In *Shell Egypt* the issue was whether Shell lost the ability to claim loss of bargain damages because Shell had exercised a contractual right to terminate (see analysis at [104 – 5] in Phones 4U). The arbitrators held that Shell had lost that right. On appeal, Tomlinson J (as he then was) said as follows:

31. *Certain principles emerge clearly from the authorities.*

i) "An act of acceptance of a repudiation requires no particular form: a communication does not have to be couched in the language of acceptance. It is sufficient that the communication or conduct clearly and unequivocally conveys to the repudiating party that [the] aggrieved party is treating the contract as at an end." See Vitol SA v Norelf Ltd [1996] AC 800 at 810-11 per Lord Steyn. That was however a case of acceptance by silence, or more accurately by the failure of the sellers to take any further step to perform the contract which was apparent to the buyers and from which they knew that the sellers were treating the contract as at an end. Before Shell can avail themselves of this principle they must first overcome the hurdle of showing that their Termination Letter did not communicate a clear intention to terminate contractually under Clause 3.1.8 rather than to terminate for repudiatory breach.

ii) The invalid invocation of a right to terminate contractually on account of a breach of contract is capable of being effective to accept a repudiatory breach as terminating the contract if it unequivocally demonstrates an intention to treat the contractual obligations as at an end. See Stocznia Gdanska SA v Latvian Shipping Co. [2002] 2 Lloyd's LR 436. That however was a case where the contractual provision invoked was not a self-contained code, resort to which would necessarily exclude resort to the remedies generally available at law, but was rather "built on the underpinnings of the common law remedies for breach of contract" – see per Rix LJ at page 449, paragraph 72. Clause 3.1.8 may not be a complete code but resort thereto is inconsistent with treating the contract as terminated by acceptance of a repudiatory breach, not least because the clause is not triggered by breach and provides that in the event of resort to it Centurion shall not be obliged to repay to Shell any amounts paid under Clause 3.1.1. Mr McCaughran for Shell realistically accepted that if the Termination Letter is to be taken as an unequivocal communication by Shell of its decision to terminate the contract under Clause 3.1.8, it cannot also serve as effective to accept Centurion's repudiatory breach as terminating the contract.

iii) The principle which Mr McCaughran thereby recognised was authoritatively stated by Christopher Clarke J in Dalkia Utilities Services plc v Celtech International Ltd [2006] 1 Lloyd's LR 599. The context in that case was that the same conduct was capable of giving rise to a contractual right to terminate and a common law entitlement to accept a repudiatory breach. Since prima facie the innocent party can rely on both rights recourse to the former does not constitute an affirmation of the contract since in both cases he is electing to terminate the contract. However, if a notice "makes explicit reference to a particular contractual clause, and nothing else, this may, in context, show that the giver of the notice was not intending to accept the repudiation and was only relying on the contractual clause; for instance if the claim made under the notice of termination is inconsistent with, and not simply less than, that which arises on acceptance of a repudiation … In the present case markedly different consequences would arise according to whether or not there was a termination under Clause 14.4 or an acceptance of a repudiation." See per Christopher Clarke J at pages 632-633.

iv) The threads were drawn together by Moore-Bick LJ in Stocznia Gdynia SA v Gearbulk Holdings Ltd [2010] QB 27, 46 at paragraph 44 of his judgment:

"It must be borne in mind that all that is required for acceptance of a repudiation at common law is for the injured party to communicate clearly and unequivocally his intention to treat the contract as discharged: see Vitol SA v Norelf Ltd… per Lord Steyn. If the contract and the general law provide the injured party with alternative rights which have different consequences, as was held to be the case in Dalkia Utilities v Celtech, he will necessarily have to elect between them and the precise terms in which he informs the other party of his decision will be significant, but where the contract provides a right to terminate which corresponds to a right under the general law (because the breach goes to the root of the contract or the parties have agreed that it should be treated as doing so) no election is necessary. In such cases it is sufficient for the injured party simply to make it clear that he is treating the contract as discharged… If he gives a bad reason for doing so, his action is nonetheless effective if the circumstances support it. That, as I understand it, is what Rix LJ was saying in paragraph 32 of his judgment in Stocznia Gdanska SA v Latvian Shipping Co, with which I respectfully agree."

32. The present is a case where the contract and the general law provided Shell with alternative rights which have different consequences…

Tomlinson J then went on to hold that the arbitrators were correct to find that Shell had adopted the contractual termination route and, as a result, had lost the right to claim loss of bargain damages. This was in part because of a concession made by Counsel for Shell

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1 See *Peregrine Aviation Bravo Ltd v Laudamotion GmbH* [2023] EWHC 48 at 181

2 I park for present purposes that if one is contractually terminating, one must exactly comply with the contractual procedures – see *Lombard North Central Plc v European Skyjets Ltd* [2022] EWHC 728 (QB) at [103]

3 For examples of the care with which the Courts will scrutinise the communications between the parties to ascertain whether there has been an election and if so, what the results of that would be, see *Drake Insurance Plc v Provident Insurance Plc* [2003] EWCA Civ 1834; [2004] QB 601 at [102] ff per Rix LJ; *Leofelis SA v Lonsdale Sports Ltd* [2008] EWCA Civ 640; [2008] ETMR 63 at [66 ff] per Lloyd LJ; *Shell Egypt West Manzala GmbH v Dana Gas Egypt Ltd* [2010] EWHC 465 at [33 ff].

4 See *Vitol SA v Norelf Ltd* [1996] AC 800 at 810, 1 per Lord Steyn.

5 See *Shell Egypt West Manzala GmbH v Dana Gas Egypt Ltd* [2010] EWHC 465 at [33 ff].

6 Indeed, the parties might have to proceed down one path or the other as refusing to do so could in some cases amount to a further repudiation of the contract.

that if the contractual termination route had been used, then no claim for damages flowing from repudiatory breach could be made – a concession which Tomlinson J said was the right one to make.

This question of whether the concession was correct was revisited in Phones 4U. There Andrew Baker J commented as follows:

118. None of the authorities is a precise precedent for the situation in this case. The closest cases are Cavenagh and Shell Egypt. Cavenagh is not a precedent for exactly this case, because there was no loss of bargain claim there by the employer; however, the basis upon which the Court of Appeal decided the case would rule out any such claim. The dismissal of the arbitration appeal in Shell Egypt would have been a decision directly in point, albeit at first instance so not binding on me, but for the concession I referred to in para 105 above. I said I would come back to Tomlinson J's view that the concession was rightly made, and I do so now.

119. That view, expressed in terms at para 31(ii), was built upon the starting point expressed at para 31(i), namely that Shell had to show "that their Termination Letter did not communicate a clear intention to terminate contractually under Clause 3.1.8 rather than to terminate for repudiatory breach". Mr Wolfson QC criticised that, arguing that the correct starting point was the presumption against giving up valuable rights (see Gilbert-Ash) and that there had been numerous cases where failure to refer to the common law right of termination had not defeated a common law loss of bargain damages claim. To my mind, those criticisms are misplaced. Shell Egypt was an arbitration appeal where arbitrators had held that the termination letter did not communicate a decision to terminate for repudiatory breach but rather communicated solely a decision to terminate under clause 3.1.8. Tomlinson J's particular formulation of what Shell had to show was apt for a case in which they had to persuade the court that in so holding the arbitrators had erred in law. Further, as my review of the cases has found, none is a decision contrary to that of the arbitrators upheld by Tomlinson J.

120. The principle as formulated by Tomlinson J also, and this is its importance for the present case, takes it as a given that a decision to terminate for the repudiatory breach later relied upon must in fact have been communicated. Hence, the critical question (per Tomlinson J at para 32) was whether Shell's termination letter unequivocally communicated (only) an election to terminate under clause 3.1.8, because if so, it could not "also serve as effective to accept Centurion's repudiatory breach as terminating the contract" (that being the proposition Tomlinson J saw as rightly conceded, see para 31(ii)).

121. Mr Wolfson QC argued that Tomlinson J was wrong to say, at para 31(ii), that resort by Shell to clause 3.1.8 was "inconsistent" with terminating for repudiatory breach at common law because: (a) the clause was not triggered by breach; and (b) it provided for Centurion to have no liability to repay amounts previously paid to it under clause 3.1.1. Tomlinson J said that to distinguish the case on its facts from Stocznia v Latvian Shipping and to relate it to the analysis in Dalkia at para 144. To my mind, none of that affects the correctness in principle of the proposition that if a termination letter communicates clearly a decision to terminate only under an express contractual right to terminate that has arisen irrespective of any breach, then it cannot be said that the contract was terminated for breach and so a claim for damages for loss of bargain at common law cannot run. The matters identified by Tomlinson J as "inconsistencies" are not like the "markedly different consequences" of common law and contractual termination in Dalkia. Given the Court of Appeal's decision in Stocznia v Gearbulk, I can see room for the argument that if clause 3.1.8 had been triggered by (the facts constituting) the very breach later complained of, (b) above might not have been a sufficient inconsistency of consequence to drive an interpretation of Shell's termination letter that it did not exercise the common law termination right but only the contractual right. But that, again, does not affect the soundness of the test taken by Tomlinson J to be correct.

122. Shell Egypt was also criticised by Liu [2011] LMCLQ 4, relied on by Mr Wolfson QC. Leaving aside the point actually decided by Tomlinson J (as to the purport of Shell's termination letter, on its proper construction), Liu's criticism of the judge's approach as a matter of principle seems to me to have depended on the proposition that it is sufficient, for the loss of bargain claim at common law, that the claimant should have communicated unequivocally that it treated the contract as discharged, whatever it might say as to why. There were dicta that could be read as supporting that proposition (eg per Rix LJ in Stocznia v Latvian Shipping at para 32, per Moore-Bick LJ in Stocznia v Gearbulk at paras 44 to 45). However, it has now been authoritatively rejected by Leofelis v Lonsdale. It remains true, as Liu emphasised, that "acceptance" of a repudiation requires no particular formality or form of words (see Vitol v Norelf). But it must communicate a decision to terminate for the repudiation later said to found the claim, in exercise of the common law right to terminate arising upon that repudiation, if a normal loss of bargain claim at common law is to be viable (ie leaving aside the inventive alternative claim suggested on appeal in Leofelis v Lonsdale). Otherwise, the claimant cannot say the termination and therefore its loss of bargain resulted from the repudiation sued upon.

123. I also disagree with Liu's suggestion that it was "wholly unsatisfactory" for Shell to have been "deprived" of loss of bargain damages where: (a) Centurion had been guilty of repudiation; and (b) the contract had in fact been terminated. Shell was not "deprived" of anything. It was taken to have chosen to terminate under clause 3.1.8 alone, a decision carrying a different set of risks and rewards, as built into the contract by the parties, as against a decision to terminate at common law alleging repudiation. It is not unsatisfactory to hold Shell to that element of the bargain. The injustice imagined by Liu assumes a connection between: (a) the repudiation; and (b) the termination; but the arbitrators' decision, upheld by Tomlinson J, was that Shell had not made that necessary connection.

124. ....

125. This case also does not concern a termination of a contract expressed to be for a repudiatory breach or renunciation that existed and gave rise to a contractual right of termination where only the contractual right is cited as justifying the termination. For such a case, two different issues arise: first, whether on the proper construction of the relevant contract, the innocent party only had the contractual right, ie whether its common law right was excluded or replaced, not merely supplemented; if not, then, secondly, whether the express reliance on the contractual right of termination defeats a common law claim for loss of bargain damages founded upon the conduct cited by the innocent party when terminating.

126. In such a case, if the innocent party succeeds on the first issue, then it has expressly terminated upon the basis of the very repudiation upon which it subsequently founds its cause of action. It can therefore say that the termination resulted from that repudiation; nothing more is required prima facie to found the common law loss of bargain damages claim. Reliance on a contractual right of termination when terminating in such a case is not inherently inconsistent with the subsequent pursuit of that claim. For this type of case, in general I agree with the analysis in Dalkia at paras 143 to 144. That analysis does not bind me, and was in any event obiter. However, it was treated as correct by Burton J and the Court of Appeal (obiter) in Stocznia v Gearbulk, which was in turn relied on by the Court of Appeal in Cavenagh; and Tomlinson J agreed with it in Shell Egypt at para 31(iii) (even if, strictly, I think he was wrong to describe it as authoritative). I would therefore be most reluctant to differ from the analysis in Dalkia if I disagreed with it. As it is, I agree with it.

Thus, *Phones 4U* could be said to present a contradiction. At [126] Andrew Baker J says that reliance on a contractual right of termination is "*not inherently inconsistent*" with a claim for loss of bargain. [126] must, however, be read with [118 – 125]. Those passages confirm *Shell Egypt* and that if you terminate under the contractual termination provisions, the right to claim loss of bargain damages is lost. That is further consistent with two basic principles of contract law. First, when faced with a repudiatory breach, the innocent party has to elect whether to accept the breach. If the innocent party does accept the breach then the contract ends there and then. Second, if, however, the innocent party does not accept the repudiatory breach by insisting

on the performance of the contract, then the contract continues and the repudiatory breach becomes a "thing writ in water".

The final authority is *TLC v Leofelis SA* [2012] EWCA Civ 985. This is a complicated authority – not least because some of the arguments relevant to this article were raised solely before the Court of Appeal. The relevant passages are as follows:

32. Mr Baldwin also put his case on the basis that it was possible to ignore the stated ground for termination in the 28 September 2007 letter and to treat the acceptance of the repudiation as having been made on more general grounds, namely Lonsdale's breach of the exclusivity obligation under the 2002 licence, regardless of the particular conduct relied on, and ignoring the incorrect particularisation of the relevant conduct. If that were correct, then it would not be a Boston Deep Sea Fishing case at all. This new proposition is not consistent with how the case was put to Kitchin J nor with how it is pleaded at paragraphs 39 and 40 of the Defence and Counterclaim. It seems to me that this approach cannot overcome the fact that the termination was expressed to be on the basis of the continued subsistence of the German injunction. That is very clear from the terms of the letters dated 14 and 28 September 2007. I agree with the judge that the catch-all phrase "without prejudice to any other breaches" makes no difference. It did not prejudice Leofelis' right to rely on other breaches, but it did not mean that Leofelis did thereby rely on another breach, of which it was not aware.

33. The principle underlying the Boston Deep Sea Fishing case has never been put forward as being that the unknown but justified ground for accepting a repudiation is to be read into the letter or other communication by which the unjustified reason is asserted. I do not see that the principle can or should be understood as extending that far. It does not allow the innocent party to assert that it did accept repudiation on the correct (though unknown) ground; rather it allows that party to meet a claim that its conduct in terminating the contract, though apparently unjustified because done on the wrong ground, is to be taken as justified because it could have been done on the right ground, not because it was done on the right ground. It operates as a shield against a claim for damages on the basis of wrongful termination, not as a sword to claim damages (for the future) on the basis of justified termination. For that reason it seems to me that, if Leofelis is to overcome the problem of its reliance on the German injunction in the letters of 14 and 28 September 2007, which is a causation issue, it must do so by showing that the German injunction was so closely connected with the wrongful SIA arrangements that the termination of the contract by the letter of 28 September 2007 cannot be seen as independent of Lonsdale's breach of contract, but rather that it was part of the chain of causation connecting Lonsdale's repudiatory breach with Leofelis' termination of the contract. In effect Leofelis would need to prove that, if Lonsdale had not undertaken its course of action aimed at interfering with Leofelis exclusivity under the 2002 licence and favouring Mr Schotsman's companies, it would not have sought or obtained the German injunction, or at any rate that, once Evans-Lombe J had held it to have been unjustified, Lonsdale would have had it discharged.

To unpack the reasoning here:

(a) *Boston Deep Sea Fishing* is authority for the proposition that if Y terminates the contract wrongly on one ground, it can defeat X's claim for damages for wrongful termination on the basis that Y could have terminated on another ground;

(b) The Court of Appeal says, however, that one cannot, in essence, rewrite the grounds of termination to rely on that for which one could have terminated. This is of a piece with the decision of Andrew Baker J in *Phones 4U (supra)*; but

(c) The Court of Appeal also appears to be saying that if one can causally and directly link the grounds of termination to the repudiation then a claim can be made.

Thus, on the authorities, there are passages that would support the proposition that a claim for damages can be based on repudiation where Y has terminated using the contractual provisions provided that there is, as a question of fact, sufficient overlap as to the sources of the claim.[1] Yet, there are also passages to the contrary. What therefore are the parties to do where there are both contractual grounds to terminate and the possibility of accepting a repudiatory breach?

From first principles there appear to be two situations:

(a) The contractual right to terminate and the right to accept the repudiation are coterminous – that is, the contract does not provide for additional rights on termination inconsistent with the instantaneous termination that occurs on acceptance of a repudiation breach;

(b) The contractual right to terminate and the right to accept repudiation are not coterminous. In this case, the contract provides for additional rights on contractual termination which assume the continuation of obligations under the contract.

In the former case, there is the argument that one can substitute one for the other as there is, in substance, no election – the contract terminates immediately, without more, under either route.

In the latter case, however, there is a distinction between the two routes. The one offers the benefit of continuing obligations, the other terminates all obligations as between the parties immediately. There is therefore an election to be made. Does Y choose one or the other? Under the law governing an election,[2] once Y chooses termination under the contract, then Y has gone down that route. Y cannot then reverse direction and claim the benefit of the other route – not least because an unaccepted repudiation is a thing writ in water and Y has affirmed the contract.

Practically, therefore, parties dealing with a terminating PFI contract will have to go through the exercise of ascertaining whether there are both rights to terminate contractual and to accept a repudiatory breach. If there are, are those rights coterminous. If they are (which is unlikely given the complex termination regimes in PFI projects), it may be possible for the party seeking to terminate "to have their cake and eat it". The more prudent route, however, would be to ascertain in detail which route is the more appropriate and then to make a choice, once and for all, on that basis.

1 See, however, *Peregrine Aviation Bravo supra* at [164 ff] where the Learned Judge took the view (obiter) that the concepts of repudiation and contractual termination were – at least in that case – clearly distinct.
2 See Wilken & Ghaly *supra* Ch 6 *passim*