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ADVANCE PAYMENTS
What Happens To Them When Things Go Wrong?

Advance payments are a common feature of contracts. They are used to fund the work and they provide protection against a customer's default. But what if something unexpected prevents the supplier from completing its side of the contract? What should happen to the money then? The Court of Appeal had to consider this question recently, and its ruling has some important ramifications for POPAI's members.

The customer had paid £15m in advance. The parties agreed that the supplier had then been prevented from performing the contract for reasons beyond its control, that the situation was covered by the force majeure clause, and that the customer had validly terminated the contract. The only thing they couldn't agree on was whether the £15m should be returned.

With that much at stake one might have expected the contract to have been crystal clear about this, but both the judge and the Court of Appeal felt moved to comment on its clumsy drafting. The result was ambiguity. The parties had had very different views of what they were signing, and one of them was about to receive a shock. Even though it had paid out much of the money in performing its side of the contract, the Court of Appeal ruled that the supplier had to return the full £15m.

I doubt whether the supplier would agree that this was the right outcome, but that's the thing about contracts: once they have been signed, they take on a life of their own and the parties' views on what they thought they had signed don't count for much.

What matters for our purposes are two things the Court said. The first was this: *"It does not make any business sense for a buyer to enter into a contract which lacks a right of repayment of the advance in force majeure circumstances. It offends business common sense and ordinary common sense: no reasonable buyer would put the advance at risk in that way."*

In itself that sounds perfectly reasonable, but of course it sounds every bit as reasonable if one substitutes "supplier" for "buyer". Its own version may have appealed to the court, but it didn't explain why and its reasoning certainly doesn't provide a principled answer.

The second thing it said was this: *"A reasonable person might expect very clear words to express such an uneven contract, and there are no such clear words in this Contract."* This is an important development. The principle that clear words are needed to exclude liability for negligence is an old one, but extending this principle to other terms if the contract is "uneven" is new. It begs the question: What is an uneven contract? To which the answer is: Who knows! But it certainly means that the need for robust contracts has increased.

There may even be a third major development from this case. The judge had also managed to read the written contract in a way that meant that the supplier had to return the money, but he also said that if he hadn't been able to do that then he would have read the contract as containing an implied (i.e. invisible) term to that effect. If other judges follow his approach, this will become an invisible term in every supply contract. The Court of Appeal didn't feel that it needed to comment on this because, like the judge, it had been able to read the written terms in a way that achieved what it thought was the right result, but the fact that it has left this development "out there" to develop, instead of killing it outright, is significant.

The principal message from this ruling is clear: it is essential that contracts should state in the clearest possible terms what is to happen to advance payments if external events prevent the completion of the contract. The wider message is that

very clear drafting may be required whenever the contract might be "uneven" - whatever that might mean.

For help with any of these issues, contact:

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