Legal Briefing

Northrop Grumman Mission Systems Europe Ltd v BAE Systems (Al Diriyah C41) Ltd

[2015] EWCA Civ 844, the Master of the Rolls, Lord Justice Briggs, and Lord Justice Bean

The Facts

In December 2010 BAE Systems (Al Diriyah C41) Ltd ("*BAE*") entered into an agreement with Northrop Grumman Mission Systems Europe Ltd ("*NGM*") whereby NGM would supply software licences together with associated training and support to BAE, in two tranches, on 20 December 2010 and 20 December 2011 (the "*Licence Agreement*").

The Licence Agreement was conspicuous in its brevity and did not include the usual boiler plate clauses providing, for instance, for dispute resolution, limitation of liability, and as to the matter in dispute; termination. There was however an apparent intention to incorporate these provisions by reference, and Sub-clause 5.1 stated that:

> *"5.1 This Agreement shall be governed by the terms contained within the 'Enabling Agreement…" (the "Enabling Agreement").*

The Enabling Agreement was in effect a framework agreement between NGM and a company connected with BAE, "*BAESI*", which set out the terms upon which NGM would provide products and services to BAESI, on behalf of and for BAE.

The Enabling Agreement included the usual boiler plate provisions which were lacking from the Licence Agreement. These included a termination provision which at Sub-clause 10.4 entitled BAESI to terminate "for convenience at any time".

BAE subsequently terminated the Licence Agreement for convenience in November 2011. NGM disputed the termination and commenced Part 8 proceedings seeking a declaration that Sub-clause 10.4 did not apply to the Licence Agreement.

On 8 September 2014 the issue was decided in favour of BAE in the TCC.

The Issue

The principal issue before the Court of Appeal in this case was whether Sub-clause 10.4 of the Enabling Agreement was incorporated by reference into the Licence Agreement by Sub-clause 5.1 so as to entitle BAE to terminate for convenience.

The Decision

The Court firstly framed the issue as being "*purely about contractual construction*", namely, if Sub-clause 10.4 of the Enabling Agreement was found to apply to the Licence Agreement then "*it is common ground that the Licence Agreement has been terminated*".

It then went on to consider the "*leading case*" on "*incorporation of provisions into a contract by reference to another contract, between the same or different parties*", which is *Skips A/S Nordheim v Syrian Petroleum Co Limited* [1984] 1 QB 599.

Skips A/S Nordheim was decided on facts that make the decision inapplicable to the case at hand, however, the judgment includes observations which now represent well-understood principles of construction for incorporation by reference, and most particularly Oliver LJ's two stages of inquiry:

> *"[1] whether the terms are so clearly inconsistent with the contract…that they have to be rejected or [2] whether the intention to incorporate a particular clause is so clearly expressed as to require, by necessary implication, some modification of the language of the incorporated clause so as to adapt it to the new contract…"*

In applying this inquiry, the Court of appeal found as follows:

1. the words "*governed by*" in Sub-clause 5.1 clearly demonstrated an intention that the terms of the Enabling Agreement be incorporated into the Licence Agreement;

2. termination for convenience under Sub-clause 10.4 was not "*flatly inconsistent*" with any clause in the Licence Agreement on the same subject matter;

3. while not inconsistent, differences between the two agreements such as the parties and certain phrases meant Sub-clause 10.4 could not be incorporated un-amended;

4. it was therefore necessary to carry out an "*appropriate manipulation*" of the language of Sub-clause 10.4 to overcome these differences; and

5. the solution needed to strike a balance between giving effect to the words "*governed by*" in Sub-clause 5.1 and allowing *"a level of domination by the Enabling Agreement which would be "surplus, insensible, or inconsistent" with the provisions of the Licence Agreemen*t."

Accordingly, the Court found that Sub-clause 10.4 was incorporated and the Licence Agreement had been validly terminated.

Commentary

The decision in Northrop provides for a common sense approach to be applied to the construction of incorporation by reference clauses, and confirms that this exercise must be carried out in accordance with the usual principles of contractual construction.

On these bases the Court was dismissive of the use of technical arguments, including the considerable effort spent by NGM in attempting to downplay the force of the words "*governed by*" by reference to synonyms.

While the issue of "*incorporation of provisions into a contract by reference to another contract, between the same or different parties*" may well be a mouthful, the principles of construction as set out above are well-settled and straightforward.

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