EIP

Clause Ambiguity and Contract Disputes: Insights from Capita v IBM (2023)

Introduction

This case relates to (as stated by the judge) a "rare dispute as to the construction of a contract where one or both parties do not make some appeal to matters of factual matrix to support their construction". Nevertheless, it has a fairly complex (but largely agreed) background which it is necessary to explore for context.

Background

Capita Business Services Limited ("**Capita**"), a FTSE 100 outsourcing company, provided services under a contract between Capita and an undisclosed client (probably a Government agency) which had been in effect since 2011. The services Capita provided under this contract (the "Managed Services") included IT-related services which Capita had sub-contracted to IBM United Kingdom Limited ("**IBM**") pursuant to a Restated and Amended IBM Agreement (the "**Agreement**") since 2016. This Agreement was extended on a number of occasions, the last being in 2022 when it was extended to 2027.

Under the Agreement, IBM agreed to perform various IT services including those defined as the "Relevant Service". In 2020, the parties entered into negotiations in relation to the replacement of the Relevant Service. These negotiations failed in reaching an agreement relating to the Relevant Services and when the Agreement was extended in 2022 (until 2027) the parties agreed a provision in the 2022 extension of the Agreement known as "Condition 2",

Condition 2 states:

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"Capita is awaiting the [client] to commission work to replace the [Relevant Service], and contract for the ongoing Managed Service of such, and it is assumed that this replacement [Relevant Service] will be operational on or before 30 August 2023.

As such the Contractor's obligations for the Managed Services relating to the current [Relevant Service] shall cease at that time.

Further, any requirement for the Contractor to design and/or build and/or implement such a replacement [Relevant Service], and/or to operate such replacement [Relevant Service], shall be handled pursuant to the Change Control Procedure and at Capita's expense, whether the impact is against the Managed Service, or the IT Upgrade Programme, or other work commissioned by Capita, or a combination thereof."

This case related to a dispute regarding the interpretation of Condition 2.

IBM's interpreted Condition 2 to mean that "in the absence of a variation agreed through the Change Control Procedure, if the Relevant Service had not been replaced by 30 August 2023, it had no contractual responsibility to operate it".

In contrast, Capita argued that Condition 2 implied that IBM had a duty to continue supporting the Relevant Service beyond 30 August 2023, until either the earlier of the agreed 2027 end date or a replacement for the Relevant Service was commissioned by the client and became operational.

On 24 August 2023, Capita issued proceedings seeking a declaration from the High Court that their understanding of Condition 2 was the correct one.

Decision

Mr Justice Foxton refused Capita's application for the declaration and injunction. In making his decision, the judge considered the broader context and purpose of Condition 2. In particular:

The language of Condition 2

Capita argued that the language in the second sentence of Condition 2 is contingent on a replacement for the Relevant Service being operational, as anticipated in the first sentence. It pointed out that the phrase "as such" could be seen as indicating the chosen termination date without that date being dependent on the replacement system's actual operation.

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Additionally, Capita contended that the third sentence of Condition 2, specifying that all aspects of commissioning a new Relevant Service are subject to the contractual change control process, supports its position.

IBM, on the other hand, asserted that the phrase "as such" links the termination date to the assumption that a new Relevant Service would be operational by 30 August 2023.

Ultimately, the judge decided that the words "as such" did not clearly signal that there was the contingency for which Capita argued preferring to side with IBM's position. Even so the judge highlighted the lack of clarity of the Condition noting that although the words "as such" related to the assumption that the new Relevant Service would be operational by 30 August 2023, it was not clear whether the link related to the event (i.e., the new service being operational) or to the date by which the parties anticipated that it would be operational. Further the use of the word "assumed" rather than "expected" in Condition 2 was significant suggesting that the date was intended to have contractual effect.

The contractual context of Condition 2

The judge further ruled that the presence of a termination date in Condition 2 is significant, and the omission in Condition 2 of any reference to the Change Control Process for adjusting charges if the replacement Relevant Service is delayed suggests that the cessation date applies regardless of the replacement's status. In other words, in the judge's view Condition 2 did not oblige IBM to maintain the Relevant Service beyond 30 August 2023, even if the replacement is not operational. This analysis was closer to IBMs interpretation, indicating that the termination date is not contingent on the replacement's readiness.

Reference to business common sense

Both parties also sought to support their arguments on the basis that business common sense required the court to decide in their favour. In particular, Capita argued that allowing IBM to cease support for the Relevant Service on 30 August 2023 without an operational replacement would be highly detrimental to both the client and Capita, both financially and reputationally.

IBM, on the other hand, contended that requiring it to maintain the Relevant Service after 30 August 2023, in case of an event beyond its control, would defy business common sense due to the onerous and risky nature of the task.

However, the judge noted that following the Supreme Court's decision in Arnold v Britton, the uncommercial aspects of any interpretation would have to be "particularly compelling

it could move the dial" from the court's preferred interpretation. Consequently, the court rejected the arguments raised by both parties in support of their cases.

Comment

This legal dispute serves as a stark reminder of the value of precision in contract drafting and the difficulties in trying to persuade a court to fix them by straining the interpretation of the natural words including on the basis of what a party regards a "business common sense". Ambiguities in contracts can lead to costly litigation, damaged reputations and significant financial loss. The case does not identify who would have been responsible for drafting Condition 2, but it does emphasise the importance of using the right legal expertise - not only to create clear and unambiguous contracts but also to safeguard the parties' respective interests, mitigate (or allocate) their risks and ensure the effectiveness and enforceability of their contractual agreements.

For more information on this case or drafting contracts in general please contact Mark Lubbock at mlubbock@eip.com.