Endeavouring To Escape From Under-Performing Licensees: The Meaning Of "Endeavour" Clauses

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Introduction

It is common practice in a wide variety of intellectual property licence agreements governed by English law for the licensee to be granted an exclusive licence to exploit IP within a defined territory for a defined period of time. One of the most common royalty payment mechanics in such licence agreements is for the payment of an annual royalty calculated as a fixed percentage of annual sales turnover or of the net sales price of each "Licenced Product" sold within the territory. Other variations include royalties calculated by reference to unit production or share of net profits. The effect of all such percentage-based royalties is to give the licensor a direct commercial interest in the successful exploitation of the licensed IP: higher sales resulting in higher percentage-based royalties. Due to the exclusive nature of the licence, it is equally important that the licensor is able to either (i) terminate the licence agreement; or (ii) claim for lost royalties, should the licensee be unable or unwilling to properly exploit the licensed IP. Otherwise, the licensor may find itself trapped in a licence agreement receiving significantly less royalties then the IP should be generating.

A common example of contractual provisions that protect a licensor from an under-performing licensee are "endeavour" clauses commonly featuring in English law IP licences. These clauses typically impose an obligation on the licensee to use a variation of "reasonable endeavours," "all reasonable endeavours," or "best endeavours" (the word "efforts" is sometimes used instead of "endeavours") to achieve an outcome that ensures the proper exploitation of the IP. Below is an example of an endeavour clause to promote the proper marketing and sale of "Licensed Products":

"The Licensee shall use its ***best endeavours*** *to promote and expand the supply of Licensed Products throughout the Sales Territory on the maximum possible scale, and shall provide such advertising and publicity as may reasonably be expected to bring the Licensed Products to the attention of as many buyers and potential buyers as possible."* (emphasis added)

Where a dispute arises from a licensor's attempt to rely on breach of an endeavour clause to terminate the agreement, it is likely to centre on whether the actions taken by the licensee were sufficient to satisfy the clause. As a result, a body of English case law has developed providing guiding principles that shed light on exactly what the obligor (*i.e.,* the party required to comply with the clause) may be required to do to satisfy the "endeavour" clause.

In the context of such endeavour contractual provisions, this article explores:

(a) The general principles of contractual interpretation that an English Court will apply to determine the meaning and effect of a contractual provision;

(b) The meaning and effect of endeavour clauses; and

(c) The key principles and risks of terminating a licence contract for breach of an endeavour clause.

Principles of Contractual Interpretation

When interpreting the meaning of a disputed contractual term, the Court will always seek to give effect to what the parties intended the term to mean at the time of contracting. In answering this question, the Court does not attempt to determine what the parties themselves actually intended—the actual or subjective intentions of the parties are irrelevant. Instead, the Court will apply a purely objective test of "*what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean."*[1]

In order to determine what a reasonable person would have understood the parties to have intended, the Court may apply different principles of interpretation. These principles are not competing alternatives, but part of a single unitary exercise involving *"an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated."*[2]

The Meaning of the Words Used

Arnold v. Britton confirmed that the starting point of contractual interpretation is the natural and ordinary meaning of the words used. It will be difficult for a party to argue that the Court should depart from the natural meaning of the words used where their meaning is clear. In *Arnold v. Britton*, the Court noted that parties often enter ill-advised contracts and confirmed

1. *Chartbrook Ltd v. Persimmon Homes Ltd.,* para. 14.
2. *Wood v. Capita Insurance Services Ltd.*, para. 12.

that *"it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice."*[3] The Court may still give effect to the clear, ordinary meaning of a contractual term even if the effect may appear to be unfair or uncommercial.

The Whole Contract Approach

In order to find the objective meaning of a disputed clause, the Court will review it in the light of the rest of the contract, as well as any other related contracts linked to the same overall transaction. In particular, the Court may consider:

- The positioning of the clause within the wider agreement;
- The language of the clause and how it compares to other clauses in the agreement;
- How the clause interacts with the other clauses in the agreement;
- Whether the recitals give an indication as to how the clause should be interpreted; and
- The headings within the contract and whether they are appropriate to the provisions that follow.

Lengthy contracts can contain internal inconsistencies or conflicts. When interpreting the meaning of the contract, whenever possible, the Court will adopt an interpretation consistent with all the terms of the agreement, to give full effect to all provisions. An interpretation that would render any part of the agreement ineffective is likely to be rejected.

The Context of the Agreement

The Court may also consider the relevant factual, regulatory, or legal circumstances that existed at the time of contracting. This background context of the agreement, (the "factual matrix"), can be considered in all cases; it is not necessary for the language of the contract to be ambiguous before the background context can be considered,[4] even when the wording used in the agreement appears to be clear: *"if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had."* [5]

Importantly, this "factual matrix" only refers to what an objective observer would have understood at the time the agreement was entered. The Court will not consider any evidence regarding the parties' conduct before the agreement was entered, including the contents of any pre-agreement negotiations or drafts of the contract in question, nor any conduct or events occurring after the contract was agreed.

Business Common Sense

Where a clause is capable of more than one possible meaning, *"the Court is entitled to prefer the construction which is consistent with business common sense and to reject the other."*[6] As noted above, the Court will not adopt this approach if the language used has only one possible meaning. To balance consideration of the natural meaning of the words used against business common-sense, the Court considers the quality of drafting. Where an agreement is poorly drafted, the Court may give extra weight to business common-sense considerations to determine what a reasonable observer would have understood the parties to have intended.

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The Different Forms of "Endeavour" Clauses

The uncertainty surrounding the interpretation and application of endeavour clauses arises because they do not impose an absolute obligation to achieve a specific outcome. Instead, an endeavour obligation only requires that the obligor try to achieve the specified outcome. Any resulting dispute then revolves around whether the steps actually taken were sufficient to meet this lesser, non-absolute, obligation.

Set out below is a summary of how the Court has interpreted the three standard variations of endeavour clauses. As with any dispute regarding the meaning of a contractual term, the Court will still apply the rules of contractual interpretation summarised above. While the principles established by previous cases provides useful guidance on the characteristics of the most common endeavour clauses, ultimately *"the meaning of the expression remains a question of construction not of extrapolation from other cases…**the expression will not always mean the same thing.**"*[7] (emphasis added)

For all standard variations of endeavour clauses, the meaning of the clause is determined at the time the contract was agreed (per the rules on construction outlined above). However the question of whether the clause has been breached is assessed by reference to the circumstances at the time the obligation is per-

3. *Arnold v. Britton*, para. 20.
4. *Westminster City Council v. National Asylum Support Services*.
5. *ICS v. West Bromwich*, p. 913.
6. *Rainy Sky SA v. Kookmin Bank*, para. 21.
7. *Jet2.Com Ltd v. Blackpool Airport Ltd.*, para. 46.

formed. As endeavour clauses are often a continuing obligation, lasting throughout the term of the contract, the circumstances in which the obligation is performed may change over time. As a result, actions that may satisfy the endeavour clause at one point in time may fall short at another. This underlines the practical difficulties often encountered by obligees, such as licensors, seeking to enforce endeavour clauses.

Despite such evidential difficulties often faced by licensor claimants, the Court has consistently held that such clauses are enforceable and not void for lack of certainty. In *Astor Management AG v. Atalaya Mining PLC* (a case concerning a clause to use "all reasonable endeavours" to secure debt financing) the judge stated:

"The role of the court in a commercial dispute is to give legal effect to what the parties have agreed, not to throw its hands in the air and refuse to do so because the parties have not made its task easy. To hold that a clause is too uncertain to be enforceable is a last resort."[8]

Best Endeavours

This obligation requires the obligor to take all steps in its power that a prudent, determined and reasonable person acting in its own interest and desiring to achieve that result, would take.[9] The objective criteria used to determine whether the obligor has complied with a "best endeavours" obligation is what the obligee itself (*i.e.*, the party seeking to enforce the clause) would reasonably have done. Specific examples of the steps that an obligor may be required to take to comply with a "best endeavours" clause include:

- Requiring the obligor to sacrifice its own commercial interests by committing significant expenditure to achieve the stated objective. In *Jet2.Com Ltd v. Blackpool Airport Ltd*, the airport was required to remain open outside its standard opening hours, at significant cost, in order to comply with a "best endeavours" obligation to "promote *Jet2.com*'s low-cost services." However, the requirement to sacrifice commercial interests does not mean that the obligor must abandon its own commercial interests entirely. For instance, an obligor is under no obligation to undertake any action that could financially ruin it or completely disregard its shareholders' interests;[10] and
- Require the obligor to engage in litigation or to appeal against a decision. This obligation does not extend to engaging in litigation or an appeal that is unreasonable or doomed to fail.[11]

All Reasonable Endeavours

Parties often settle on an obligation requiring "all reasonable endeavours" as a compromise between "best endeavours" and "reasonable endeavours." In *UBH v. Standard Life*, this variation was described as "*a middle position*" between "best" and "reasonable" endeavours. However, the position is not clear cut. Non-binding obiter comments in *Rhodia International v. Huntsman* suggests that "all reasonable endeavours" requires the obligor to undertake all available reasonable steps (as opposed to a single reasonable step) with the effect that there is no practical difference between "best" and "all reasonable" endeavours.

An "all reasonable endeavours" clause may require an obligor to sacrifice its own commercial interests, although this will depend on the nature of the term and the surrounding circumstances. For example, in *Jet2.Com Ltd v. Blackpool Airport Ltd*, the airport was required to sacrifice its commercial interests (by keeping the airport open after standard hours), as this was a core part of the agreement and within the control of the airport. Where the "all reasonable endeavours" clause relates to a more peripheral aspect of the contract and/or requires the cooperation of a third party, the obligor may not be required to sacrifice its own commercial interests.

Reasonable Endeavours

"Reasonable endeavours" is the least stringent of the three primary variations of endeavour clause. In *Minerva (Wandsworth) Ltd v. Greenland Ram (London) Ltd,* concerning an obligation to use "reasonable endeavours" to minimise affordable housing in a building development, the obligation was described as "*what would a reasonable and prudent person acting properly in their own commercial interest and applying their minds to their contractual obligation have done.*"[12] In contrast to a "best endeavours" obligation, the obligation is judged as what a reasonable obligor would have done (not what the obligee would have done, as in the case of "best endeavours").

As "reasonable endeavours" is judged from the perspective of the obligor, a key difference between "best" and "reasonable" endeavours is that a "reasonable endeavours" obligation does not normally require the obligor to sacrifice its own commercial interests. For instance, in *Philip Petroleum Co UK Ltd v. Enron Europe Ltd*, the parties were required to use "reasonable endeavours" to agree to a date for the delivery of natural gas, with a fall-back date to apply if no earlier date was agreed. Philip's refusal to agree to an earlier date (in order to take advantage of falling gas prices) was found not to be a breach of the clause.

While a "reasonable endeavours" clause may not require the obligor to sacrifice its commercial interests, it is likely to be in breach if it deliberately manipulates events to prevent the intended purpose from being satisfied. For instance, in *Gaia Ventures Ltd v. Abbeygate*

8. *Astor Management AG v. Atalaya Mining PLC*, para. 64.
9. *IBM United Kingdom Ltd v. Rockware Glass Ltd.*
10. *Terrell v. Mabie Todd and Co Ltd.*
11. *Malik Co v. Central European Trading Agency Ltd.*
12. *Minerva (Wandsworth) Ltd v. Greenland Ram (London) Ltd,* para. 255.

Helical (Leisure Plaza) Ltd, the property redeveloper (Abbeygate) was subject to a "reasonable endeavours" clause to achieve specific lease conditions "as soon as practicable," which would then trigger a £1.4 million payment to Gaia Ventures if achieved before 4 July 2013. The Court found that intentionally arranging its affairs to ensure that the specific lease conditions were only achieved *after* 4 July 2013 (thereby avoiding the payment requirement) was a breach of the reasonable endeavours clause.

As referred to above, another potential limitation on "reasonable endeavours" clauses is that, while "all reasonable endeavours" and "best endeavours" may require the obligor to take all reasonable steps, under a "reasonable endeavours" clause the obligor may only be required to perform one reasonable step.[13] However, there is little current case law on how this limitation should be applied in practice.

Under a "reasonable endeavours" clause the likelihood of a particular action being successful is of "prime importance" to the question of whether the proposed action will be considered reasonable.[14] As a result, a "reasonable endeavours" clause will often not require the obligor to engage in legal action, such as litigation, due to the uncertainty of a successful outcome.

Conclusion on "Endeavour" Clauses

As summarised above, there are three standard variations of endeavour clauses, with "best endeavours" setting the highest bar of what is required from the obligor, followed by "all reasonable endeavours," and finally "reasonable endeavours." Licensors may also come across further variations to these standard formulations such as "utmost endeavours." There is little case law on the meaning of these further variations, which (like all endeavour clauses) will be construed by the Court according to the standard principles of contractual interpretation.

Ultimately, the only way that licensors can entirely avoid the uncertainty surrounding endeavour clauses is to avoid using them altogether and replace them with an equivalent absolute obligation whenever possible. Conversely, licensees will strive to negotiate less defined terms that give them more wriggle room as to the efforts and steps that they must take to maximise sales of products incorporating the licensed IP. They will therefore strive for the insertion of endeavours clauses, and preferably "reasonable endeavours" rather than "best endeavours."

Terminating a License for Breach of an "Endeavour" Clause

If a licence fails to generate the expected royalties, the licensor may wish to rely on the licensee's breach of the applicable endeavour clause to terminate the licence.

As summarised below, there are considerable risks and uncertainties that a licensor should be aware of before (purporting to be) terminating its licence agreement for breach of an endeavour clause.

Common Law Termination

Separate from any contractual rights of termination, unless excluded in the contract, the licensor has a common law right to terminate where the licensee has committed a "repudiatory" breach of contract. A "repudiatory" breach will occur when:

1) There is a breach of an essential term of the contract (a "condition" of the contract);
2) There is a sufficiently serious breach of a less important "intermediate" term of the contract, which goes to the heart of the agreement or deprives the innocent party of substantially the whole benefit of the agreement; or
3) The party in breach has "renounced" the agreement by refusing to perform it.

The ability of the licensor to terminate for breach therefore depends on whether the endeavour provision breached is: (i) a condition of the contract; or (ii) an "intermediate" term where the breach is sufficiently serious to justify termination. There may be significant uncertainty as to how the endeavour clause should be classified or if the breach is sufficiently serious to justify termination. Ultimately, the Court will decide based on all the facts, including the nature and consequences of the breach. Licensors can reduce this uncertainty by identifying in the licence which terms are "conditions" where breach will allow termination.

The primary risk to the licensor from terminating the licence is if it does so without having the right to do so (*i.e.* the endeavour clause does not fall under Points 1 or 2 above). In this event, the licensor's wrongful termination may *itself* be a repudiatory breach under Point 3 above. As a result, the licensee may accept the licensor's repudiatory breach and sue the licensor for any losses suffered as a result of the licensor's wrongful termination.

As detailed below, in situations where the licence agreement has specific termination provisions, it is important that these are followed closely by the licensor. For a licensor wishing to rely on its common law termination rights, it is equally important not to delay exercising its termination right (subject to the express terms of the contract). This is because when a repudiatory breach occurs, the innocent party may choose to either (i) affirm the contract (*i.e.*, treat it as continuing without losing the right to sue for damages); or (ii) accept the repudiatory breach, that is to say, accept the breach as a repudiation of the contract and so terminate it. Only the latter allows the contract to be terminated. It is important for this choice to be made swiftly because affirmation of a contract

13. *Rhodia International Holdings Ltd v. Huntsman International LLC.*

14. *UBH v. Standard Life.*

can be implied from a party's actions and is irrevocable. For example, a licensor may affirm a licence implicitly by seeking continued payment of royalties from the licensee. In this way, a licensor that fails to terminate the licence promptly may lose its common law right to terminate.

Contractual Termination

Some licences allow a party to terminate for convenience. More often, however, a party is entitled to terminate if a particular event occurs, such as the other party's "material breach" of the licence. Below is an example of a termination clause in a typical English law governed patent licence agreement:

"The Licensor may terminate this Licence immediately by giving written notice to the Licensee if the Licensee commits a ***material breach*** *of this agreement (other than failure to pay any amounts due under this agreement) and (if such breach is remediable) fails to remedy that breach within 14 days of being notified in writing to do so."* (emphasis added)

What will be considered a "material breach" will ultimately be determined on the specific circumstances of the contract and the consequences of the breach. However, it is clear that a "material breach" is a breach which is "*more than trivial but need not be repudiatory.*"[15] To avoid this uncertainty, the contract should expressly state whether the breach of a particular clause would be "material," so as to give rise to a right of termination. Where a breach has not been expressly classified as "material," the licensor will need to establish that the breach is "material." For IP licences, failure to exploit the IP is likely to be a material breach, given that this is a key obligation and the main purpose of the licence. However, licensors may face difficulty in proving that breach of an endeavour clause is a material breach, given the complexities of establishing the scope of such obligations that have been described above.

Choice of Termination Right

When terminating, it is important for the licensor to specify whether it is doing so pursuant to its contractual rights or its common law rights. The choice can have significant consequences, as set out below.

There are significant differences in the damages the licensor may be able to recover depending on whether it has exercised its contractual or common law rights to terminate. Damages for claims brought under the common law are calculated to put the innocent party in the position they would have been had the contract been properly performed. This includes damages for:

- Losses arising from the breach until the contract is terminated; and
- The innocent party's loss of bargain: the losses arising from no longer receiving future performance of the contract.

For licensors, loss of bargain damages is often substantial, as it will amount to estimated future royalty payments it should have received for the remaining term of the licence agreement had the agreement been properly performed, with a net present value discount for accelerated payment in damages.

By contrast, contractual damages are usually limited to recovery for loss under the first point above; loss of bargain is not automatically recoverable unless it is expressly included in the contract. Case law[16] has confirmed that loss of bargain cannot be sought by a party relying solely on a contractual breach basis, even if there has also been a repudiatory breach.

The choice of termination right is also important because a party relying solely on common law termination is at risk of being in repudiatory breach itself, as explained above.

Serving a Termination Notice

Regardless of whether the contract is terminated pursuant to the licensor's common law rights or under its contractual rights, any applicable dispute resolution procedures and/or notice provisions regarding termination must be followed carefully. For instance, if the contract requires that the licensee must be given the opportunity to remedy the breach (as in the example clause above) it is important that this is followed. Failure to follow the termination procedure precisely may render the notice of termination ineffective and may prejudice the licensor's rights.

Once a party is eligible to terminate, it must communicate termination unequivocally. A notice of termination should clearly identify the relevant information, including the basis of the termination.[17]

Conclusion on Termination

A party's termination rights under a licence and in common law have distinct rationales, triggers, and scope for damages. It is important for a licensor seeking to terminate a licence to act consistently and to avoid mistakenly surrendering a right and its entitlement to those damages. It is therefore advisable for the licensor to make clear in all its communications whether it reserves its common law and/or contractual rights.

The decision to terminate should not be taken lightly, as wrongful termination can result in the licensee bringing a counter-claim. Licensors considering termination should always seek specialist legal advice. ■

Available at Social Science Research Network (SSRN): *https://ssrn.com/abstract=3658623*

15. *Compass Group UK and Ireland Ltd v. Mid Essex Hospital Services NHS Trust*, [2013] EWCA Civ 200, paragraph 126.

16. *Phones 4U Ltd (In Administration) v. EE Ltd.*

17. *Standard Bank Plc v. Agrinvest International Inc.*