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HM Treasury

Parliament Street London SW1P 3AG

From the Legal Adviser

FAX COVER SHEET		
FROM: Mr R N Ricks		DATE: 26TH November 1998
TEL: FAX:	GRO	NUMBER OF PAGES INCLUDING COVER SHEET: 7

RECIPIENT(s) and FAX NUMBER(s)

To Hamish Sandison Bird and Bird
(Please copy to Catherine Milton Bird and Bird)
Jeff Triggs Slaughter and May
(Please copy to N Gray (Slaughter and May))
Catherine Churchard Post Office
Ron Powell DSS Solicitors
Clive Osborne DTI Solicitors
Sarah Graham DSS
Jonathan Evans Post Office
DavidSibbick Director Post DTI
(Please copy to Isabel Anderson Post Office DTI)

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Copy to Ke 9.15 es

Thanks very helpful.

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From the Legal Adviser

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26 November 1998

GRO

BA/POCL LEGAL ISSUES ON EXIT STRATEGY

I enclose a copy of a minute I have sent internally in the Treasury. Copies also go to those present at the meeting and to David Sibbick and Isobel Anderson (DTI) and George McCorkell (BA).

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FROM : R N RICKS
DATE : 26 November 1998
EXTN :
ROOM: GRO

SARAH MULLEN

cc : Adrian Montague
Adam Sharples
Ross Newby
Joseph Halligan

BA/POCL LEGAL ISSUES ON EXIT STRATEGY

I chaired what I think was a very useful meeting yesterday. Those attending on the legal side were Hamish Sandison and Catherine Milton (Bird and Bird), Project Lawyers acting for both DSS and POCL, Jeff Triggs and Nick Gray of Slaughter and May acting for POCL, Catherine Churchard, Post Office Solicitor, Ron Powell DSS Solicitors and Clive Osborne DTI Solicitors. Present as "clients" were Sarah Graham (DSS) and Jonathan Evans (Post Office). David Sibbick and Isobel Anderson (DTI) were hoping to attend but were prevented through a conflict of commitments.

2. I will not attempt a blow by blow "attendance note" of the meeting but I will set out the position, as I see it, in the light of our discussions. I shall be copying this to those attending the meeting for their comments. They will correct me if I have got anything wrong or misrepresented their position.

3. The purpose of the meeting was to discuss the way forward, in practical terms, in the event of failure to agree an acceptable basis for continuing the project.

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4. From Ministers' point of view the most attractive way forward might appear to be to terminate all the contracts forthwith. It is clean and clear cut. It is unequivocal and avoids any uncertainty. However no lawyer involved in the case is recommending this course. The reason for this is the substantial risk of exposure to a successful claim for damages by ICL against the relevant authority alleging wrongful termination. The damages claimed could run into sums in excess of £200 million. Mr Sandison considers that DSS are in a legal position to terminate the contract based on ICL's breach but he accepts that POCL are not in a position to do so. In his view a 13 week notice would need to be given before all contracts could be terminated. This is discussed further below. Mr Sandison has also suggested another tactic which is also referred to below.

5. The option of immediate terminate needs to be considered in the light of discussion on other options. I would however say at this point that those advising Ministers are not in a position to ignore the legal advice which has been given. If Ministers are unhappy with this legal advice it is open to them to seek the advice of the Law Officers. I would add that termination of the Authorities Agreement has to be by the joint action of the authorities and that (except on certain conditions which are not relevant here) neither authority is entitled to terminate its Related Agreement with ICL Pathway without prior consultation with, and consent of, the other. Whilst ultimately a collective view would be reached, in any consultation, a very serious would have to be given to the strong legal advice which POCL have received.

6. Mr Sandison favours issuing a joint 13 week notice by DSS and POCL. In his view this is not strictly necessary for DSS but since it is highly desirable that the public sector parties place themselves in a position to proceed on the same basis, joint action of this kind is desirable. Counsel instructed on behalf of DSS say that there is a good arguable case that Pathways breach gives rise to a right to damages and termination in accordance with the contract and therefore do not rule out this option. Counsel for POCL and their solicitors, on the other hand, do not accept the legal viability of this option. In particular they do not accept that the authorities agreement can be terminated by reliance upon the contract (paragraph 4.4 of Schedule C5). In view of this,

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I would have considerable unease about proceeding along these lines. I also have considerable reservations based on concerns about waiver of the breach. The result of the joint meeting of Counsel (on their own) was that the best compromise way forward was to serve notice making time of the essence.

7. To make time of the essence is to make performance of the contract by a particular time an essential term of the contract entitling the other party to terminate the contract if it is breached. This should not be seen as a friendly act kindly giving the other party more time to fulfil their obligations. It is more in the nature of a hostile act moving towards an end game. It is in the nature of things that service of such a notice is not itself termination of the contract and therefore the contract continues. In this particular case, however, it is extremely unlikely that the contract will merely continue in its present state throughout the period of the notice. The lawyers at the meeting considered various scenarios if the public sector were to serve notice making time of the essence.

8. Firstly ICL could go to Fujitsu for more money and complete the contract in accordance with the notice. This seems the most unlikely scenario of all. If they were unable to come up with acceptable proposals involving varying the contract in their favour, it seems most unlikely that ICL would obtain the necessary funding and have the will to complete the contract on its present terms. Without adequate funding ICL could not continue with the project without running the risk of trading whilst insolvent. They are likely therefore to find some way of walking away from the contract whilst commencing litigation against the public sector parties for anticipatory breach of contract. Alternatively or at the same time they may enter into discussion for a negotiated exit.

9. The option of serving notice making time of the essence thus contains the small "risk" that ICL might complete the contract, but it is essentially to be seen as an exit strategy and is likely to be understood as such by ICL. It may, at first sight, appear counter-intuitive to be keeping the contract alive when Ministers want to bury it. Ministers will need to avoid saying that they are terminating the contract or that the contract is at an end but they will be able to say that the

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coutract will be terminated if there is failure to complete within the time specified. They will also be able to tell ICL that there will be no further discussions on Option 1 (variation of the contract).

10. All the lawyers agree that the period of notice must be reasonable. Mr Sandison agrees that merely to serve a 13 week notice making time of the essence is unlikely to be held to be reasonable. He would not disagree with the view that a much longer period would be necessary to be safely reasonable. He stresses that it is difficult to predict with certainty what would be held to be a reasonable period and, for this reason, he favours termination under paragraph 4.4 of Schedule C5. POCL's Counsel have suggested giving some 8 or 9 months to complete. If the option of making time of the essence is followed, Mr Sandison would not disagree with this.

11. At the meeting Mr Sandison suggested a further option relying on clause 902.10 of the authorities contract. This provides that when one of the authorities terminates their agreement, the other authority can terminate. I have not had time fully to consider this but my initial reaction is that this would be seen by the courts as merely a device to terminate the contracts and be held to be unlawful termination as not being in good faith. Clause 902.11 places the parties under an obligation to negotiate in good faith to make any necessary consequential amendments to the surviving related agreements. Mr Sandison may wish to expand upon his views and other lawyers may also wish to express a view.

12. There was considerable discussion on the question whether the public sector should take the lead in initiating discussions on a without prejudice basis with a view to negotiating an exit strategy. Slaughter and May favoured serving a notice without taking any initiative in relation to discussions. They feared that an initiative taken by the public sector might be taken as a sign of weakness. There was also concern that discussions (even on a without prejudice basis) might appear to be inconsistent with the service of the notice. Mr Sandison favoured serving a notice and writing on a without prejudice basis at the same time. There was, I think, a general consensus that we should not enter into discussions with regard to an exit strategy without taking any formal step to serve notice.

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13. This is an issue which can be put to Ministers to decide. On the one hand there is the risk that suggesting negotiations might be seen as a sign of weakness. On the other hand the service of a notice without any suggestion of a willingness to talk might precipitate litigation in circumstances where it is less easy to move towards a negotiated settlement. Of course, if, on receipt of the notice, ICL wish to enter into discussions it would be open to us to accede to them.

14. Finally we considered what the Chief Secretary would say in writing to ICL. In general the view was that very little would need to be said. The letter would make clear that negotiations on the basis of "Option 1" were at an end. It would not say that the contracts were at an end. It would be, of course, for the public sector parties to write with such notices as are agreed upon. Depending upon what is agreed upon, there would be a factual statement, once any action has been taken by the parties, recording what has been done. In the case of notice making time of the essence, the public notice could simply state that notice has been served requiring ICL to complete by a specified time failing which the contracts would be terminated. This may well be interpreted by the press as effectively a decision to terminate although not an actual termination.

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