VOISIN LAW

Stuck between a rock and a hard place: the finer points of implied contractual terms and dol under Jersey contract law | 1

Introduction

Last year the Royal Court heard the case of Hard Rock Limited and Anor v HRCKY Limited [2023] JRC169. The case stemmed from a dispute regarding a franchise agreement (the "**Franchise Agreement**") granted by the respondent Hard Rock Limited ("**HRL**") to the appellant HRCKY Limited ("**HRCKY**") which allowed HRCKY to run a Hard Rock Café in the Cayman Islands.

The Franchise Agreement was terminated in June 2013 by HRL. In a judgment dated 19 December 2013 it was determined that this termination was lawful but that HRCKY may have a number of arguable counterclaims which should proceed to trial. At this juncture, the claims were limited to allegations regarding the breach of the implied term of good faith. In 2015, HRCKY expanded these allegations to include that they had been induced to enter into the contract on the basis of misrepresentations amounting to dol or erreur. The remaining disputed issues were:

- whether HRL fraudulently misrepresented the anticipated profits of the restaurant business. Had HRCKY been aware of the true likely position, or indeed even of the risks having regard to the worldwide experience of Hard Rock Café franchises, it would never have entered the Franchise agreement in the first place. As a result, the loss which it has sustained extends to the investment made in a business it would never have entered.
- the unreasonable way in which HRL responded to the requests made by HRCKY for changes in the standard operating business model which HRL insisted upon was a breach of the implied duty of good faith under the contract itself. This caused or contributed to the losses sustained by HRCKY in the operation of its business.

These contended matters meant that the Royal Court had to consider the scope of the doctrine of dol, in particular whether one party in the possession of significant information is under a duty to inform the other party of that information before they enter into a commercial arrangement. The Royal Court was also left to determine whether the implied term of good faith forms part of the law of Jersey and if so whether it was breached. The Royal Court would also need to assess what losses were caused by or flow from any findings of dol, erreur, misrepresentation or breach of an implied term.

Summary and the Royal Court's conclusions

The Royal Court concluded that:

- dol par reticence and the general implied term of good faith do not form part of Jersey law.
- an implied term of good faith does form part of Jersey law in relation to long-term relational contracts.
- the Franchise Agreement is such a long-term agreement and there is nothing within it to exclude an implied term of good faith.
- The complaints of HRCKY whether on the basis of dol, dol par reticence, fraudulent misrepresentation or any kind of erreur are dismissed.
- The claims for breach of an implied term applicable to the Franchise Agreement are dismissed.
- HRCKY failed to prove that any loss stemmed from any breach of an implied term.
- The financial losses of HRCKY during the operation of the Franchise Agreement arise out of factors

external to both HRCKY and the Hard Rock Group.
- Had HRCKY been able to establish any breach amounting to dol, fraudulent misrepresentation or erruer, further evidence would have been required in respect of losses arising from any such findings.

The rationale for these conclusions and the practical implications of the Royal Court's determinations are discussed in detail below.

What is dol par reticence/reticence dolosive (fraudulent silence)

Dol is a legal concept generally analogous with fraud, which forms part of Jersey law through customary law.

In this case, the contention was that actions taken by one party amounted to dol par reticence (misrepresentation by non-disclosure). The majority of legal systems are crafted in such a way that where one party is under an obligation to warn or inform the other party, then the silent party may be found liable for failing to reveal the relevant information. In this regard, there is a divergence between English and French law. In England, the general rule is that mere silence cannot constitute misrepresentation. Contrastingly, the courts in France have accepted the position that a knowing and dishonest failure to disclose a matter which the other party has an interest in knowing, may result in dol par reticence and as such give rise to an annulment (and potentially damages). This ties into the pre-contractual duty which exists in French law. In France, the concept is known as reticence dolosive (fraudulent silence).

In Jersey, it has been accepted in the context of some contractual relationships, for instance insurance contracts that mere silence could amount to misrepresentation (see Sutton below). However, it has been unclear as to whether the concept of dol par reticence applied generally.

Why was it material in the case?

HRCKY in this appellate action had contended that it had been induced to enter into a Franchise Agreement on the basis of dol par reticence. The Franchise Agreement permitted HRCKY Limited to run a franchise restaurant of the global chain Hard Rock Café within the Cayman Islands.

Why was this case significant

The Hard Rock case was significant because it provided welcome clarity as to whether mere silence can amount to actionable misrepresentation generally. A contention was that where there was an asymmetry between the contracting parties, there was an obligation on the more astute party not to withhold material facts. The Court in Hard Rock analysed a number of salient judgments including *Steelux Holdings v Edmonstone [2005] JLR 152 ("**Steelux**").* The obiter comments of the Royal Court in *Steelux* were central to the notion that the omission of material facts by the more knowledgeable party could amount to fraud:

"Silence can, in certain circumstances, amount to fraud. If one party, particularly a party who is more experienced and worldly-wise than the other, is silent as to a material fact which, if it had become known to the other party, would have led to a refusal to enter into the contract, that may well amount to fraud

which may lead to a setting aside of the contract. In French law, the concept is known as réticence dolosive. We would characterize it as dishonest or fraudulent silence".

The Court then considered Birt's observations in *Toothill v HSBC Bank Plc [2008] JLR 77* ("***Toothill***") which expressed caution at the views expressed in *Steelux* noting that the comments made in *Steelux* were obiter and that the general position under English law was materially different, as there is no general duty to disclose material facts but that there are statutory and common law exceptions to this position. Birt added:

"This court would wish expressly to leave open the question of whether the law of Jersey should recognize a duty of positive disclosure in the wider circumstances envisaged by the Bailiff or whether a duty of positive disclosure should be confined to those circumstances where it exists under English law, even if, jurisprudentially, it is preferred in this jurisdiction to treat it as dol par réticence. Such a decision would be a matter of considerable practical importance to those who contract under Jersey law and should be the subject of full argument and consideration".

A further case analysed by the Court was *Sutton v The Insurance Corporation of the Channel Islands Limited [2011] JLR 80 ("**Sutton**").* In *Sutton*, it was noted that the doctrine of reticence dolosive was:

"useful in a case such as the present because it forms part of that package of principles which go to identify whether the parties to a contract of insurance, being a contract uberrima fides, have that common will or volonté to make it, and thus provide a proper basis for an assertion that la convention fait la loi des parties".

However, in Hard Rock it was decided that the conclusions in Sutton should be limited to claims in relation to non-disclosure by an insured and otherwise was a case that turned on its own facts:

"*In our judgment, we consider that the reference to reticence dolosive in paragraph 48 of Sutton was not necessary for the Court to find against the plaintiff and therefore its reference to réticence dolosive is obiter and not binding upon us. The contract between the plaintiff and the defendant in Sutton was a contract of insurance which, as the Royal Court noted at paragraph 48, was a contract of utmost good faith. In relation to insurance contracts, it is well known that a failure to disclose a material fact entitles an insurer to avoid a contract of insurance and accordingly a claim made under a void contract of insurance will be rejected*".

Ultimately, the Royal Court decided that dol par reticence is not a principle of Jersey customary law that applies to all Jersey law contracts. Having considered Steelux, Toothill and Sutton there was no clear consensus on the law. Secondly, the extension of the concept of dol as envisaged in Steelux had its routes in jurisprudence of the French Courts and amendments to the French civil code. The Royal Court also determined that such a development would be a step too far in that:

"*The introduction of such a principle is more than a refinement or clarification of Jersey contract law. Rather such a development would fundamentally alter the starting point for contractual negotiations which, even as noted in Steelux, requires parties to have regard to their own interests. The recognition of such a principle would have too many wide ranging consequences for too many contracts and could lead*

to a plethora of disputes where one party sought to set aside a contract on the basis of an allegation that the other party failed to disclose a material fact".

The final reason relied upon was that protection of contracting consumers was already a realm that the legislature had intervened for instance through the Supply of Goods and Services (Jersey) Law 2009 and that any judicial input on the topic may cut across existing legislation.

Practical takeaways

In view of the Royal Court confirming that fraudulent silence is not a principle of Jersey customary law and that silence is not actionable generally the parties to a contract and their advisors should dedicate careful thought to the warranties they wish to receive from the seller. Additionally, contracting parties should be very through in their pre-contractual enquiries.

What is *Erreur*?

In England and Wales, *erreur* is understood as "mistake" and "misrepresentation". Mistake in English law is a doctrine that concerns an error made by one or more of the parties to a contract as to the terms of the contract. Misrepresentation is an English law doctrine which operates where a party has been induced into a contract by the non-contractual statement of the other party, which statement is false.

Erreur is the French Law principle which deals with an error made by one of more of the parties to a contract as to a term of that contract. *Erreur* in French law requires the error to operate on a fundamental quality of the contract in order to avoid the contract. The error is assessed subjectively and any lack of valid consent will render the contract void *ab initio*. English law will not cause a contract to be avoided unless the defendant is in some way implicated in the claimant's lack of consent.

It is seen to be far more fitting for *erreur* and *dol* to be used to address circumstances of error and deception in Jersey contract law.

The *Steelux v Edmonstone case* began to redress the balance for Jersey's customary law roots.

In the Steelux Holdings case – the courts made an important distinction between English law and Jersey law. The cases on *erreur* / misrepresentation are, in some ways, even more confused. From one perspective, these differences can be seen as merely reflective of the broader debate on the sources of Jersey law of contract, which we have already analysed in detail above. That may be true, but the interrelated nature of the heads of *vices de consentement* means that confusion over sources has spilled over into the substantive law. The interpretation of *erreur* by the Jersey courts as a form of misrepresentation may itself be a product of this phenomenon, as may the eliding of the concept of false and fraudulent statements in *Steelux Holdings Ltd*, which has broken down the distinction between *erreur* and *dol.*

The scope of claims based on erreur in Hard Rock and what was significant in the Hard Rock case?

The court outlined the three different kinds of erreur obstacle:

(a) Erreur sur la nature du contrat – a mistake as to the nature of the agreement. Classically this is where one party thought that an item was being loaned while the other party thought that a gift was being made;

(b) Erreur sur l'objet – a mistake as to the subject matter of the contract; and

(c) Erreur sur la cause – a mistake as to the basis or purpose of the agreement.

The pleaded case referred to erreur sur la cause, namely that "The vast majority of restaurants (owned by the Hard Rock Group) made a loss and were not profitable", however it was not a erreur sur la cause because the basis or purpose of the Franchise Agreement were clear to both parties, namely Hard Rock would receive royalties in return for allowing HRCKY to operate a Hard Rock Café selling food and beverage and merchandise in the Cayman Islands. Rather, HRCKY's complaint is that they did not understand that an essential part of the Hard Rock Café franchise, namely the sale of food and beverage, was based on a model where the vast majority of the food and beverage side of Hard Rock cafes owned by the Hard Rock Group made a loss and were not profitable.

The complaint of HRCKY, was that if it is an erreur at all, is that the erruer is capable of amounting to an erreur sur la substance (an *erreur* relating to the very essence of the contract itself or a mistake as to some essential quality of the subject matter of the contract).

What was significant in this case?

In relation to erreur, any erreur obstacle renders a contract void. Accordingly, the entire agreement clause will fail for the same reasons outlined by the Court of Appeal in Hard Rock in relation to claims in dol.

Practical takeaways:

The practical takeaways for prospectively contracting parties are neatly set out at para 177 of the Judgment:

"*Parties may seek or make pre-contractual inquiries and seek warranties or other assurances based on the answers to those enquiries. It then becomes a matter of negotiation about the extent of risk a party is willing to accept or not. Often if a party is not willing to accept a risk or a term cannot be agreed to address that risk then that party can walk away from the contract. Parties are therefore free to decide whether to accept a clause excluding any liability for statements made prior to the contract which do not amount to dol.*"

Ultimately, therefore, there remains an onus on contracting parties to make the pre-contractual enquiries they deem necessary and to have a solid understanding of their risk tolerance in relation to a particular transaction or contractual relationship.

Entire Agreement Clause ("**EAC**")

What are they?:

They are clauses which often from part of contracts. The practice of including EAC's in contracts is thought

to have begun in the United States. The purpose of such a clause is to achieve, the exclusion of liability for statements other than those set out in the written contract.

Relevance:

The Franchise Agreement at the heart of the dispute included an EAC, in the following form:

"*This Agreement, the documents referred to herein, and the attachments hereto, if any, constitute the entire, full, and complete Agreement between Franchisor and Franchisee concerning the subject matter hereof, and supersede all prior agreements, no other representations having induced Franchisee to execute this Agreement. No representations, inducements, promises, or agreements, oral or otherwise, not embodied in this Agreement (as defined in the preceding sentence) or attached hereto (unless of subsequent date) were made by either party, and none shall be of any force or effect with reference to this Agreement or otherwise. Except as otherwise provided in this Agreement, no amendment, change, or variance from this Agreement shall be binding on either party unless mutually agreed to by the parties and executed by their authorized officers or agents in writing*."

A key issue in the litigation was whether the EAC precluded the claims of dol, misrepresentation or erruer as discussed above.

Conclusions of the Court:

The Royal Court referred to the Court of Appeal's comments in *HRCKY v Hard Rock Limited and Anor [2019] JCA 123*. The Court of Appeal had noted that it was difficult to see how a party who has by deception encouraged another party to enter into a contract can thereafter rely on any part of a contract which has only been entered into as a result of that deception. Further that:

"*When a contract is induced by such fraudulent or false conduct then it will be void and the contract will fall. That will mean that each and every one of the clauses, terms and conditions of the contract will be regarded as being void and not enforceable by either party. This will apply as much to an "entire contract" clause as it will to any other clause in the void contract, and it seems to us to mean that the existence of such a clause is no answer to a claim that the contract has been induced by dol. If the contract has been induced by dol, that is by fraud or falsehood, then the contract falls as a whole and cannot be kept alive by a condition which was as much induced by the fraud of falsehood as any other."*

The Court then refined this position by noting that in *Hore v Valmorbida and Anor [2022] JRC 202 ("Hore")*, the effect of a finding of dol is that a contract is voidable rather than void i.e. able to made void as opposed to automatically void. The Royal Court concluded in this respect that as a matter of principle, the existence of an entire agreement clause should not prevent, following a finding of dol, the innocent party from electing to claim damages, rather than have the contract avoided for the reasons set out for same reasons of the Court of Appeal.

The Royal Court noted that the power vested in the Court to refuse an election should not mean that a claim for damages based on a finding of dol is then precluded by an entire agreement clause. The Royal Court then added that the entire agreement should not be able to save the perpetrator of a dol in such

circumstances, the Court saw no difference between this scenario and one where a party elects to claim damages on the basis of dol where it would also be unjust or inequitable for an entire agreement clause to prevent a claim for damages following a finding of dol.

The Royal Court then clarified that there was a distinction between the party electing to claim damages or only being awarded damages because a contract cannot be declared void and a positive act of affirmation following a finding of dol. If an innocent party is aware of the facts that amount to dol then proceeds to affirm the contract, that party cannot later rely on the concept of dol. The Royal Court did however note that it is not reliance on an entire agreement clause, but reliance on an act of affirmation. In determining what an affirmation was for these purposes the Royal Court once again referred to Hore, which set down the following test, the election to rely on its contractual rights must be made by the innocent party in knowledge of dol/fraud, the onus is on the party who has committed the fraud/dol to prove that the innocent party equipped with the knowledge of dol and fraud has treated the contract as binding and has made that election to rely on their contractual rights and that the Court should be slow to hold that an innocent party made such an election.

Practical Takeaways:

The primary takeaway from the Royal Court's comments is that an EAC will not generally exonerate a party guilty of dol, misrepresentation or erruer. What may also be extrapolated from the judgment is that notwithstanding the high threshold in the test set down in Hore a party in knowledge of dol or fraud, who in view of this fact wish to have the contract voided or claim damages, should be careful not to affirm the contract through their conduct.

Conclusions

This case is no doubt valuable for clarifying that there is no general duty of good faith in Jersey contracts and confirming that dol par reticence is not a principle of Jersey customary law that applies to all Jersey law contracts. Beyond the black letter law, the case serves as a salient reminder of the importance of pre-contractual enquiries and of parties satisfying themselves that they know the bargain they are committing themselves to when contracting.

In 2024, the Court of Appeal in HRCKY Limited v Hard Rock Limited and Anor [2024] JCA069 heard an appeal against the 2024 judgment made by HRCKY on the basis of nine grounds, the first eight of which concerned disputed issues of primary fact and evaluation. The final ground of appeal was to challenge the decision of the Royal Court that dol par reticence does not form part of Jersey law where commercial arrangements are concerned. The Court of Appeal ultimately decided to dismiss the appeal.

This note is intended to provide a brief rather than a comprehensive guide to the subject under consideration. It does not purport to give legal or financial advice that may be acted or relied upon. Specific professional advice should always be taken in respect of any individual matter.