Commodities in Focus

“Take it or leave it” and Economic Duress

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A problem frequently faced in turbulent markets is that of a guilty contracting party threatening to breach, or actually breaching, a contract with an innocent contracting party. Where performance of the contract is critical to enable the innocent party to mitigate and protect against losses (or, indeed, where the innocent party needs to maintain its reputation), this problem is exacerbated.

The innocent party can be forced into an impossible situation. It may reluctantly agree to accept a “take it or leave it” offer from the guilty party, amounting to a settlement of the dispute, the details of which provide for the contract to be performed, but on more onerous terms (thus ensuring the losses largely stay with the innocent party and cannot be recovered).

Can the innocent party set aside the agreement on the grounds of economic duress and recover its losses?

This issue was dealt with in the recent case of Progress Bulk Carriers v. Tube City IMS LLC [2012]. The vessel “CENK K” was chartered by owners to charterers on 2 April 2009 to carry shredded scrap from the Mississippi to China, under a sale contract made with the buyers. The laycan was 15-21 April. However, on 7 April the owners then chartered the vessel to a third party. This made the original charter impossible to perform, and amounted to a repudiatory breach of the charter.

On the 16 April the charterers discovered this fact, and faced a huge predicament. The market was declining and they needed the vessel. To arrange a substitute would require the buyer’s consent which could involve receiving a reduced price. However, the owners promised to arrange a substitute vessel to load between the 27-30 April and to cover charterers’ losses. The charterers relied on this promise, and did not seek to locate another carrier for the scrap. Charterers’ buyers agreed to a deferred shipment to 15 May but on terms of a US$ 8pmt discount to the price. Charterers were also incurring costs from the barges waiting to load the scrap in Mississippi.

On the 28 April, and despite exchanges between owners and charterers on the terms of settlement, owners made a “take it or leave it” offer involving owners providing a substitute ship only in return for a full waiver of all claims. The inconsistency with owner’s previous position was self-evident, but the charterer considered it had no choice but to accept these terms under protest.

The charterer successfully applied to set aside the settlement agreement on the grounds of economic duress. It succeeded before an arbitration tribunal and the owners were unsuccessful in challenging that decision before the English court.

Decision

The Court recognised the distinction between economic duress and the normal “rough and tumble” of commercial life and bargaining in contracts. However, it stated that lawful but unethical acts can, in extreme circumstances, amount to economic duress. Two elements were required for duress; causation and illegitimate pressure.

Causation.

The “but for” test applies; such that “but for” the illegitimate pressure the innocent party would never have entered the contract.

Illegitimate Pressure

A range of factors are taken into account:

1. whether guilty party acted in bad faith (here there was no finding of bad faith)
2. whether there was any realistic practical alternative to the innocent party, but to submit to the pressure
3. whether protest was made at the time
4. whether the innocent party affirmed and sought to rely on the contract.
The court affirmed the position that in the context of economic duress the illegitimacy need not involve an illegal or criminal act and was careful to point out that it was not seeking to extend the concept of economic duress to "lawful act dures" in a commercial context. The court felt this would introduce uncertainty in commercial bargaining. Consequently, instances of economic duress would be rare. However, the court in assessing the illegitimacy of the act it was entitled to assess the impropriety of the conduct by reference to it being morally or socially unacceptable in the commercial context, or that it involved a level of impropriety.

In this case the court had no issue with determining that the owner’s acts were illegitimate; owner’s repudiatory breach was the cause of the problems, their continuing conduct was designed to force charterers to accept the settlement proposal and charterers had no realistic practical alternative.

**Practical lessons?**

This decision interestingly seems to extend and clarify the position expressed in a previous key case on economic duress; Kolmar Group AG v Traxpo Enterprises Pvt Limited [2010] (a case of threatened breach, rather than actual breach). In this case, the ruling suggested that a threat to do something illegitimate, most obviously by breaching a contract, would be required for a finding of illegitimate pressure to be made. Interestingly this case was not referred to in the "CENK K" decision, possibly because in the Kolmar case, the Claimant was unopposed and, as such, the legal arguments were not thoroughly aired.

It is important to note that the court will apply the relevant criteria to the specific facts of each case, and the more serious the impropriety which attaches to the conduct, the more likely that any pressure will be viewed as "illegitimate".

Therefore, when negotiating an agreement following a contractual breach, the party in breach should be careful not to cross the line between the rigors of commercial negotiation, and illegitimate economic pressure. If the innocent party is being pushed into a place where its options are so limited that it has no alternative but to agree to the terms imposed upon it, there is a risk of the agreement being void for economic duress. Making misleading promises to the other side is potentially risky behaviour, and could also lead to an unintended binding agreement to provide the promised remedy.

The innocent party should remember to make it clear to the other party that any agreement is being entered under protest, and care should be taken not to affirm the contract once the pressure had been lifted.

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