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Litigation and Dispute Resolution *Review*

EDITORIAL

In this edition of the Litigation Review we report on *McGraw Hill International Ltd v Deutsche Apotheker Und Arztebank EG* in which Cooke J considered whether the English court had jurisdiction over a claim for negative declaratory relief in a dispute involving allegations, against a Dutch bank and a ratings agency, that complex financial products had been mis-sold to investors. Cooke J provides a helpful analysis of two alternative jurisdictional grounds under the Brussels Regulation that are often relevant in the context of cross border mis-selling claims: where the alleged "harmful event" took place in a tortious claim and whether a dispute can be said to arise "*out of the operations of a branch, agency or other establishment*" of the defendant (see **Conflict of Laws)**.

We cover *Dexia Crediop S.p.A. v Regione Piemonte* in which the Court of Appeal refused to set aside a default judgment on the grounds that the defendant had delayed in engaging with two sets of English High Court proceedings. In its judgment the Court of Appeal considered whether the controversial principles laid down in *Mitchell* and *Denton* apply to applications to set aside default judgments (see **Procedure**).

We cover a number of decisions of interest to those involved with drafting commercial agreements. In *Crestsign Ltd v National Westminster Bank plc and Royal Bank of Scotland plc* "non-advisory" wording in contractual documentation was found to be sufficient to protect banks from a negligence claim. In *Titan Europe 2006-3 plc v Colliers International* the transferee of a 'non-recourse' securitised loan was permitted to bring a claim against a valuer for losses caused by the negligent valuation of the underlying commercial property, a persuasive factor being the presence of a contractual obligation for the transferee to pass on proceeds of a successful claim to the noteholders. Recent rulings by the Court of Appeal and Flaux J in the *Starlight Shipping* insurance litigation are of interest for their broad interpretation of settlement agreement wording, in particular in relation to what claims are settled, and whether certain third parties, such as employees and legal advisors, are covered (see **Contract**).

Felicity Gemson's article on a recent bonus dispute looks at when a decision is considered to be a "contractual discretion" and thus subject to implied constraints in terms of how the discretion is exercised. Felicity considers some drafting strategies in this context (see **Employment**).

Finally, James Freeman provides an overview of the new LCIA arbitration rules, which apply to arbitrations commenced after 1 October 2014. The new rules contain a number of interesting and helpful changes, including new provisions regarding the appointment of an emergency arbitrator and a new mechanism for consolidation and joinder of arbitral proceedings (see **Arbitration**).

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Arbitration

THE LCIA'S NEW 2014 ARBITRATION RULES

The London Court of International Arbitration (the **LCIA**) has published in final form its new arbitration rules (the **2014 Rules**), which apply to arbitrations commenced after 1 October 2014. The changes between the 2014 Rules and a set of draft rules, published in February 2014, are relatively limited. This article describes the most important changes.

The 2014 Rules do not substantially change how LCIA arbitration works. The basic structure of the existing LCIA rules (the **1998 Rules**) remains essentially intact, along with the features which previously made the LCIA Rules distinctive (such as the ability to have the full tribunal appointed on an expedited basis in urgent cases; see Article 9A of the 2014 Rules).

Instead, the amendments are largely intended to bring the LCIA Rules up to date with contemporary arbitration practice. Some of the amendments follow those seen in the recent wave of revisions to major sets of arbitral rules (including changes to the UNCITRAL Arbitration Rules in 2010, the ICC Arbitration Rules in 2012 and the HKIAC Administered Arbitration Rules in 2013). The introduction of an emergency arbitrator mechanism is a notable example; another example is the new provision allowing consolidation of arbitrations. The LCIA has not, however, simply fallen into line with other arbitral institutions. In addition to the existing distinctive provisions which have been retained, the 2014 Rules include some novel amendments, most notably new rules controlling parties' choice of counsel and the conduct of counsel.

Almost every rule has been amended to some extent, in many cases apparently to clarify the existing provision without changing its essential effect.

Changes to promote efficiency

A number of amendments aim to make the arbitral process under the LCIA Rules more efficient. The concern, commonly expressed by users of arbitration – that the process was taking too long and costing too much – has been a significant influence behind all the recent revisions to the key arbitral rules.

Timetable for award (Article 15.10)

Perhaps most significantly, the arbitral tribunal will have to render its final award as soon as reasonably possible after the last submission from the parties and in accordance with a timetable, which the tribunal must notify to the parties and to the registrar. Considering the widespread concern about the time that tribunals can take to render awards, this unique provision is likely to be welcomed. Although the rule allows for the timetable notified by the tribunal to be revised if necessary, it should nevertheless put substantial pressure on arbitrators to produce their awards promptly.

Declarations by prospective arbitrators (Article 5.4)

Prospective arbitrators will have to declare not only that they are independent and impartial, but that they are "*ready, willing and able to devote sufficient time, diligence and industry to ensure the expeditious and efficient conduct of the arbitration*". This mirrors the ICC's requirement for arbitrators to provide statements of their availability.

Standard form Requests and Responses (Articles 1.3 and 2.3)

In an intriguing development, parties will be able to submit Requests and Responses on standard electronic forms available on the LCIA website. These forms have not yet been published and their precise layout is not known. As such, it is not clear that this is intended to encourage shorter Requests and Responses in standard formats, by avoiding the replication that occurs to some extent at present between Requests and Responses, on the one hand, and later statements of case, on the other.

Consolidation (Article 22.1)

The ICC and HKIAC included in their revised rules new provisions about the consolidation of arbitrations, and the joinder of new parties to existing arbitrations, to address concerns that arbitration can be difficult where multi-party or multi-contract disputes arise. The LCIA Rules already contained a (fairly limited) joinder provision, which remains essentially the same (now Article 22.1(viii)). In addition, the 2014 Rules will enable the arbitral tribunal to consolidate arbitrations, in two situations: first, where the parties agree to this in writing, and with the approval of the LCIA Court (Article 22.1(ix)); and, secondly, where multiple arbitrations have been commenced under the same arbitration agreement, or under compatible arbitration agreements, between the same parties, provided that the arbitral tribunal has not been formed for the other arbitration(s) (Article 22.1(x)).

These new consolidation provisions are more conservative than those in some other arbitral rules, particularly the 2013 HKIAC rules, which, subject to certain conditions, permit the consolidation of arbitrations where there are different sets of parties.

Emergency proceedings

The 2014 Rules retain the provision allowing parties to apply to the LCIA Court for the expedited formation of the arbitral tribunal in cases of exceptional emergency (Article 9A).

In addition, the 2014 Rules also introduce a mechanism for the appointment of an emergency arbitrator (Article 9B). This enables urgent interim relief to be granted by an emergency arbitrator in the period before a full tribunal has been constituted. This brings the LCIA in line with the rules of most other major arbitral institutions such as the ICDR, the ICC, the SIAC and the HKIAC, which have successively adopted such a mechanism in their new rules. The emergency arbitrator provision was included in parentheses in the draft circulated in February 2014, but the LCIA has decided to adopt it. Interestingly, the provision suggests that the emergency arbitrator will be empowered to render "awards". This is presumably intended to address concerns that interim "decisions" may not be enforceable under the New York Convention, but it is unclear whether national courts will regard these awards as such in a New York Convention sense.

Emergency arbitrator provisions have proven to be popular. For example, the SIAC recently reported that it had handled 34 emergency arbitrations since the procedure was introduced into its rules in July 2010. The LCIA Rules are the only ones, however, to provide for both an emergency arbitration procedure and for the expedited formation of the full tribunal. It will be interesting to see which option is more often chosen by users, and for what reasons.

Legal representatives

Perhaps the most innovative provisions in the 2014 Rules are the ones relating to parties' legal representation, which currently have no equivalents in other major sets of arbitral rules. There are two relevant sets of provisions in the 2014 Rules.

Notification of legal representatives (Articles 18.2-18.4)

The 2014 Rules require parties to notify the arbitral tribunal of the names of their legal representatives, and of changes to their legal representatives. A change in legal representation requires the approval of the arbitral tribunal. The arbitral tribunal can withhold approval where the change could "compromise the composition of the Arbitral Tribunal or the finality of any award (on the grounds of possible conflict or other like impediment)". This provision is intended to address the situation that has arisen in some cases where proposed changes to a party's counsel have threatened to derail the arbitral process by introducing a potential conflict of interest between the new counsel and one of the arbitrators. In *Hrvatska Elektropriveda v Slovenia*, the arbitral tribunal invoked an inherent power to take measures necessary to preserve the integrity of the proceedings and the 2014 Rules essentially put that "inherent power" on an express footing.

Conduct of legal representatives (Articles 18.5-18.6 and Annex)

There has been an ongoing debate in arbitration circles about whether more should be done to define standards of professional conduct for lawyers in international arbitration, given the lack of clarity about which rules, if any, apply in this context, and the potential for inequality of arms between parties when their lawyers are subject to different sets of ethical obligations. The LCIA is the first institution to attempt to tackle this issue in its rules. The Annex to the 2014 Rules lays down certain guidelines for "good and equal conduct" by legal representatives. These are expressed in quite high-level terms and essentially provide that legal representatives may not:

- "unfairly…obstruct the arbitration";
- "knowingly make any false statement to the Arbitral Tribunal";
- "knowingly procure or assist in the preparation of or rely upon any false evidence…";
- "knowingly conceal…any document (or part thereof) which is ordered to be produced…"; or
- deliberately initiate any unilateral contact with any arbitrator.

Although expressed as short-form principles, the guidelines in the Annex cover similar ground to the IBA's Guidelines on Party Representation in International Arbitration, published in 2013. Like the IBA Guidelines, the new guidelines will, by being included in the LCIA Rules, form part of the parties' arbitration agreement and responsibility for compliance must, therefore, lie with the parties, rather than their counsel. Their contractual basis means that they must also be subject to any mandatory rules of professional conduct to which counsel are subject under their home bar rules.

The tribunal is empowered to decide whether or not there has been a violation of the guidelines and choose from a range of sanctions prescribed by Article 18.6. These include a written reprimand, a written caution as to future conduct in the arbitration and "*any other measure necessary to fulfil within the arbitration the general duties required of the Arbitral Tribunal…*". It will be interesting to see what measures arbitral tribunals will take under this general power.

COMMENT

Provisions like the new emergency arbitrator mechanism and the various rules designed to improve the efficiency of LCIA arbitration bring the LCIA Rules in line with contemporary arbitral practice. At the same time, the LCIA has retained the distinctiveness of its rules with innovative new provisions such as the rules on the conduct of legal representatives.

Ultimately, the 2014 Rules represent a case of cautious evolution, rather than revolution, and are unlikely to fundamentally alter the character of LCIA arbitration. Nevertheless, the changes should ensure that the LCIA's rules remain among the most popular for users of international arbitration and may further increase the efficiency of proceedings, which is of course to be welcomed.

This article is based on a more detailed piece, which discusses certain other innovations as well as changes that were not made and is available on our website.

WHERE ON THE WEB?

http://www.allenovery.com/publications/en-gb/Pages/The-LCIA's-New-2014-Arbitration-Rules.aspx

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Banking

SECURITISED LOANS: WHO IS THE PROPER CLAIMANT FOR LOSSES CAUSED BY NEGLIGENT VALUATION?

Titan Europe 2006-3 plc v Colliers International UK plc (in liquidation) [2014] EWHC 3106 (Comm), 30 September 2014

The transferee of a non-recourse securitised loan, rather than the noteholders, was the proper claimant in a claim against a valuer for losses caused by the negligent valuation of the underlying commercial property (which had been carried out for the original lender). The presence of a contractual obligation for the transferee to pass on proceeds of a successful claim to the noteholders, coupled with the loss suffered when the transferee purchased the loan for more than it was worth, were persuasive factors supporting the transferee's right to bring a claim.

Background

On 22 December 2005, Credit Suisse First Boston International (**CSFB**) loaned EUR 110 million to Valbonne Real Estate BV (**Valbonne**). Valbonne owned a very large commercial property in Nuremburg (the **Property**), on which the loan was secured.

In deciding to make the loan, CSFB relied on a valuation of the Property by Colliers International UK plc (**Colliers**). CSFB then securitised the loan, together with a package of other loans secured on other properties. As part of this, Titan Europe 2006-3 plc (**Titan**) was created as a special purpose vehicle. Titan's roles included issuing floating rate notes (the **Notes**). On 27 June 2006, Titan bought the package of loans using funds provided by subscribers for the Notes.

Other than the land value of the site, or the ability to attract replacement tenants for a huge, aging and complex set of buildings, a principal component of value in the Property was the covenant of the then tenant, Quelle Aktiengesellschaft (**Quelle**). However, in 2009 Quelle's parent company filed to open bankruptcy proceedings and Valbonne defaulted under its Facility Agreement. Quelle's lease was terminated at the end of 2009 and by January 2010 Jones Lang Lasalle valued the Property at EUR 12.4 million. Titan began proceedings against Collier in negligence for undervaluing the Property. Titan alleged that it had suffered a loss by buying the package of loans, where the security was far less than it had been led to believe by the valuation.

Who was the proper claimant?

One of Collier's main arguments in its defence was that Titan was the wrong claimant. Titan had issued the Notes on a non-recourse basis, and so had lost nothing. Collier argued that CSFB might possibly have suffered loss when it lent to Valbonne, but it had not brought any claim. Assuming the Noteholders had relied on Collier's valuation, they were also alternative possible claimants: Colliers' valuation had been addressed, among others, to "*any actual or prospective investor… in any securities*".

To the extent that Noteholders had assigned claims to Titan (which two of them had), Titan could have claimed as assignees of those Noteholders, but was not doing so.

Further, Colliers said that the securitisation could have been structured to allow specified parties to bring claims based on negligent valuation, but this had not happened and the effect of the structure actually adopted was that the Noteholders were the right claimants, if a claim existed.

In support of its claim, Titan argued that the various "*Limitations of Valuations*" in, for example, the Term Sheet, Offering Circular and a CD ROM meant that no

Noteholder could reasonably have relied on Colliers' work. Even if that were not so, the Noteholders could not form a class of claimants as there was no way of working out who they were. Even if there had been, the Notes were tradable, so membership of such a class might change. Quantifying loss, and showing causation, would be an "*intractable obstacle*".

On this point, Blair J, perhaps inevitably, held that "*in the case of a complex structured financial transaction of this kind, the circumstances in which legal claims may… be brought depend upon the contractual terms, typically contained in a number of different agreements*". He also held that, since the Notes were transferrable, "*as a matter of principle, rights arising out of* [such]*… debt instruments attach to the notes themselves for the benefit of the holder for the time being*."

Blair J saw force in Titan's argument that there would be real practical difficulties in the Noteholders being the claimants. The difficulties were such that it was "*more likely than not*" that the Noteholders would not feasibly be able to make a claim. Further, he felt that Colliers' argument that the valuation had been addressed to potential investors was weak in the context of the whole contractual scheme.

Blair J accepted that, in economic terms, it was the Noteholders who had suffered loss, but this did not mean that, in law, Titan could not bring a claim, especially where the effect of the Cash Management Agreement and the Deed of Charge and Assignment was that Titan was contractually obliged to pass on to Noteholders any amounts received from a successful claim. He also held that, if Titan could show causation "*it suffered a loss the moment it purchased… a chose in action worth less than the price paid for it*". The fact that the funds used for the purchase came from third parties was irrelevant. The fact that Titan was a non-recourse issuer was also irrelevant (this was on the basis of the "*res inter alios acta*" principle according to which a party's rights normally cannot be affected by rights under contracts to which it is not a party).

On this basis, Titan was a proper claimant.

Was Colliers negligent?

This part of the case did not raise any new legal principles concerning negligent valuations, though Blair J did provide a helpful summary of the basic elements required to bring such a claim. Among these, he noted that a claimant had to show that a disputed valuation "*was one which no reasonable valuer would have reached and was outside the permissible margin of error*". It follows from this that a court may disagree with a specific valuation without holding that it was negligently arrived at. Rather, a claimant must show that no properly competent and conscientious valuer could have reached such a valuation. Further, (as in many other cases of professional negligence) even a valuer who arrived at a figure outside an appropriate range may escape liability provided he had done his work with reasonable skill and care.

In this case, on the facts, Colliers were found to have been negligent, though both parties agreed that the Property was particularly difficult to value.

COMMENT

It is difficult to assess the significance of Blair J's ruling for potential claims for negligence where securitisations are involved. Despite its length, the majority of the judgment is taken up with analysis of the different claims made about whether Colliers had in fact been negligent (Blair J did not find that all of Titan's allegations were justified). Rather less was taken up with why Titan was entitled to claim.

Blair J seemed taken by Titan's suggestion that, if it was not a proper claimant, no party would be able to bring a claim for loss which had indeed been suffered. The implication of some of his remarks was that, because Titan was bound to pass on any recovery to Noteholders, allowing Titan as a claimant would ensure practical justice to be done. While there is no general principle that says that, so long as a loss has been incurred due to negligence, recovery will be available even if it involves a "proxy" claimant, this result presumably reflects what the parties – except perhaps valuers – intend in most comparable cases.

In finding that Titan was a proper claimant, Blair J noted that the complexity of securitisations meant that "*the distribution of loss can be difficult to pin down*". For those involved in securitisations, disputes like this

one can perhaps be most easily avoided by ensuring that there are agreed and clear provisions in the documents which identify parties with a right to claim. This applies equally to, for example, valuers, as it may form a way of limiting their potential exposure, or at least identifying its extent.

As regards Noteholders – who actually bear any economic loss – the case highlights the practical problems they may have in recovering damages unless the documents make clear who is entitled to claim. Further, Blair J made clear that Titan's claim would have failed, but for the provision requiring it to pass on to Noteholders any sums it recovered. While one would often expect such provisions, potential subscribers and later holders should always check that such provisions are in place, or risk being in a position where, even though they have demonstrably suffered a loss through negligence, there is no workable mechanism by which they can get damages.

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HIGH COURT DISMISSES CLAIM RELATING TO MIS-SELLING OF INTEREST RATE SWAPS

Bailey v Barclays Bank plc [2014] EWHC 2882 (QB), 27 August 2014

The High Court struck out and summarily dismissed a claim by a company in relation to the alleged mis-selling of an interest rate swap by the bank. The decision confirms established principles that a bank does not generally tend to owe fiduciary duties to its customers and that a body corporate (such as the second claimant in this case) does not constitute a "*private person*" and as a result does not have rights of action under s150 Financial Services and Markets Act 2000 (**FSMA**).

Both claimants were customers of the bank (the second claimant was a company that was owned by the first claimant). Based on advice provided by the bank, the claimants entered into an interest rate swap agreement for a notional figure of GBP 2 million at a fixed interest rate for a fixed term of ten years (the **Swap**).

The claimants subsequently made a number of complaints about the suitability of the Swap and the manner in which it was sold to them by the bank. In particular, the claimants alleged that the Swap was unsuitable because it had been sold to them at a time when interest rates were falling, instead of rising (as the bank had allegedly advised), and that the notional amount for the purposes of the Swap was far in excess of the sums that they had actually borrowed from the Bank. The claimants sought:

- a declaration under s27 FSMA that the Swap was unenforceable against the second claimant;
- rescission of the Swap;
- damages; and
- equitable compensation.

Shortly before the hearing, the first claimant accepted an offer of redress from the bank. As a result, the High Court only considered the issues between the bank and the second claimant's claim. The second claimant applied to amend its particulars of claim to allege that:

- the bank had breached various provisions of the FSA's Conduct of Business Rules (**COBS**) as a result of the way in which it had sold the Swap to the claimants;
- it had a right of action against the bank in respect of its alleged breaches of COBS pursuant to s150 FSMA.

The bank's application for judgment against the second claimant required the High Court also to consider two claims in the existing particulars of claim:

- first, a claim for relief for breach of fiduciary duty by the Bank; and
- second, a claim for a declaration of unenforceability under s27 FSMA.

Breach of COBS rules – no prospect of success

The court concluded that the allegations made by the second claimant regarding the Bank's breaches of COBS had no realistic prospect of success. The second claimant's arguments related to its view that the Swap was a bad investment, as opposed to there being anything wrong with the way in which the Swap was implemented by the Bank.

Not a "private person"

In any event, the court held that the second claimant had no cause of action against the Bank under s150 FSMA on the basis that it was a company, not a "*private person*" (as required by s150). The court followed *Titan Steel Wheels Ltd v Royal Bank of Scotland plc* [2010] EWHC 211 (Comm) in holding that the second claimant did not constitute a private person for the purposes of s150 notwithstanding the fact that it had not suffered the losses of which it complained "*in the course of carrying on business of any kind*".

Compliance with COBS not incorporated into contract

The second claimant argued that, even if there was no statutory right of action, the breaches of COBS were actionable by it in contract on the basis that compliance with COBS had been expressly or impliedly incorporated into the contract between the bank and the second claimant. The court also rejected this argument on the basis that a "*plain reading*" of the contract in question did not support it.

As a result, the court dismissed the second claimant's application for permission to amend its particulars of claim in its entirety.

Alleged breach of fiduciary duty

The court summarily dismissed the second claimant's claim for relief for breach of fiduciary duty because a bank does not usually stand in a fiduciary relationship to its customers. There was nothing exceptional in this case that would have given rise to a fiduciary relationship.

Declaration of unenforceability

Section 27(1) FSMA provides that an agreement made by an authorised person in the course of carrying on a regulated activity in consequence of something said or done by a third party in the course of a regulated activity carried on by the third party in contravention of the general prohibition on carrying on regulated activities without permission is unenforceable against the other party. The general prohibition is set out in s19 FSMA.

In support of its claim for a declaration of unenforceability under s27 FSMA, the second claimant alleged that the bank employee who provided the claimants with advice in relation to the Swap was a "*third party*" carrying on a regulated activity in contravention of the general prohibition of such conduct in s19 FSMA. The court held that s27 FSMA was not engaged on the basis that the individual who provided advice to the claimants was not a "*third party*" but that he was the bank's employee and agent.

COMMENT

This decision is likely to be welcomed by financial institutions that are the subject of pending claims regarding the sale of interest rate swaps. The High Court was quite clear in this case that a body corporate cannot bring an action against a financial institution in respect of alleged breaches of FSA or FCA Rules (including COBS) under s150 FSMA.

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Conflict of laws

WHERE "HARMFUL EVENT" OCCURRED IN MIS-SELLING CLAIM

McGraw Hill International (UK) Ltd v Deutsche Apotheker Und Arztebank EG [2014] EWHC 2436, 18 July 2014

Interesting jurisdiction issues arose in this mis-selling claim by investors who bought Constant Proportion Debt Obligations (**CPDOs**) arranged by the then ABN Amro Bank NV, and rated by Standard & Poor's (**S&P**). The English court accepted jurisdiction over S&P's claim for a negative declaration against both the investors and the Bank. The ruling considers issues which arise in claims for negative declaratory relief (which are often used as a way of forum shopping) against multiple defendants.

The investors had purchased the AAA/AA- rated products after having attended meetings (in their own countries – Germany, Austria and Switzerland) at which certain marketing materials and presentations were delivered by the Bank and discussed. The essence of the investors' complaint was an alleged misstatement of risk associated with the CPDOs, in particular that statements concerning the rating were misleading because, the investors alleged, the ratings lacked reasonable grounds and were not the product of the exercise of reasonable care.

S&P first commenced proceedings against the investors in the English court seeking a negative declaration that it was not liable to the investors, that the Bank was not liable to the investors (the Principal Declaration), and that if S&P was liable to the investors then the Bank was also liable in respect of the same damage (the Alternative Declaration), although there was no claim for a contribution or indemnity. The investors then commenced proceedings in the Netherlands against the Bank and S&P.

The Bank challenged the English court's jurisdiction.

No *lis*

Cooke J cited with approval dicta that supported the Bank's argument that there must be a credible claim (a ***lis***) between a claimant seeking a negative declaration and the defendant. Citing Lord Woolf MR in *Messier-Dowty Ltd v Sabena SA* [2000] 1 WLR 2040 "*... if a defendant is added to the proceedings, despite the absence of any credible claim, solely to claim jurisdiction against a party who would otherwise not be joined to the proceedings. Such tactics are an abuse of the process of the court ...*"

The Bank argued that, between it and S&P, there was no *lis*, ie no genuine claim between the claimant and defendant. On the Principal Declaration, Cooke J agreed. Both S&P and the Bank contended that they had no liability to investors, so there was no issue between them. On this ground alone, the court refused jurisdiction over the Principal Declaration claim.

On the Alternative Declaration claim, there was a *lis* between S&P and the Bank, ie a serious issue to be tried because in the event the contingency (namely that S&P is liable to the investors) comes into play, the Bank will deny that it is liable in respect of the same damage. Cooke J was confident that both would hold diverging opinions as to their share of the liability in these circumstances; there was, therefore, a *lis* between them.

English court has jurisdiction under Article 5.5 Brussels Regulation (operations of a branch)

Cooke J was satisfied that the English court had jurisdiction over the Alternative Declaration claim under

Article 5.5 Brussels Regulation, because the dispute arose out of the "operations of a branch" in England. Cooke J relied on the key role played by the Bank's London branch, which had:

- created the marketing materials that had been delivered to investors in their countries of domicile during meetings; and
- engaged, communicated with, and provided information to S&P about the rating.

The degree of connection between the dispute and England was to be compared, not with the investors' places of domicile or any other *forum conveniens*, but instead with the defendant's domicile (Netherlands).[1] None of the relevant activities had taken place in the Netherlands. Cooke J found that the connecting link between England and the dispute was "extremely strong" and justified the English court taking jurisdiction under Article 5.5.

No jurisdiction under Article 5.3 (place where the harmful event occurred)

Cooke J agreed with the Bank that the English court could not take jurisdiction under this ground. Article 5.3 can be interpreted to mean either the place where the damage occurred, or the place of the event giving rise to it. In this case there was no contention that the damage occurred in England, so the focus was on the place of the event giving rise to the damage. S&P argued, unsuccessfully, that this was England because the origin of the rating lay in London and in the creation of the marketing material there and that, therefore, this was where the misstatements originated.

Cooke J rejected this argument, finding instead that, in relation to the allegedly misleading written materials, the place where the harmful event occurred for the purposes of Article 5.3 was the place where the materials were delivered and received, not the place where they originated. This was in each investor's country of domicile, where the meeting had taken place, not England.

No jurisdiction under Article 6.2 (third party proceedings)

Cooke J held that the Bank could not be seen as a third party because:

- the Bank was one of a number of defendants to S&P's claim for declarations with no distinction drawn between it and other defendants; and
- S&P was not claiming an indemnity or contribution from the Bank at this stage.

COMMENT

As Cooke J acknowledged, the primary purpose of the English proceedings seemed to be to secure the appearance of the investors and the Bank in S&P's home jurisdiction, ie England, rather than in the Netherlands. The negative declarations against the investors were not challenged on a jurisdictional basis, but there was more difficulty for S&P in establishing the English court's jurisdiction over the Bank, albeit it ultimately succeeded in doing so for the Alternative Declaration under Article 5.5. Negative declarations involve a reversal of the normal roles of claimant and defendant, and are often used as a strategy to ensure a court is first seised of a dispute, in priority to another. What is interesting about this case is Cooke J's findings on:

- *lis*: the ruling highlights the importance of there being a *lis*, or a "serious issue on the merits to be tried",[2] between the parties. Especially in multi-party litigation, a court will want to establish that there is a genuine *lis* between the claimant and each of the defendants – this is described as a threshold requirement, and one which needs to be met before the grounds of special jurisdiction are even considered.
- *degree of connection as a relative concept*: when considering the special grounds of jurisdiction under the Brussels Regulation (ie those that allow a deviation from the defendant's court of domicile under Article 2), Cooke J reflected on the underlying policy reason for them, ie that in some types of disputes there is a forum that has a closer connection with the dispute than the defendant's domicile.

Special grounds of jurisdiction, such as Article 5.5, displace the normal rule that a defendant should be sued in its place of domicile, so it is the place of domicile (ie the Netherlands in this case) which must be compared when considering which court has the required nexus with the dispute – not some other court.

– *written marketing materials*: if these contain misleading information, in a tortious claim, the harmful event will, for the purposes of Article 5.5 be held to be where the materials were delivered and received, not where they were created. This fact is perhaps not likely to affect how marketing is carried out, but it is perhaps a point to remember when deciding where potential investor claimants are likely to mount legal action in the event of a mis-selling claim.

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[1] As per Lord Phillips in *Anton Durbeck GmbH v Den Norske Bank ASA* [2003] QB 1160.

[2] Cheshire & North's Private International Law, 14th Edition, pages 226-7.

Contract

BROAD INTERPRETATION OF SETTLEMENT AND JURISDICTION PROVISIONS

Starlight Shipping Company v Allianz Marine & Aviation Versicherungs AG & ors [2014] EWCA 1010, 18 July 2014 and [2014] EWHC 3068 (Comm) 26 September 2014

Two recent rulings in this long-running insurance dispute have provided clarity on aspects of the interpretation of settlement agreements. The Court of Appeal has confirmed that the ruling in *Fiona Trust v Privalov* [2007] Bus LR 1719, that fine distinctions between words such as "under" or "in relation to" should no longer be made in relation to arbitration agreements, applied equally to jurisdiction agreements and settlement clauses. The words "full and final settlement" pointed to the intention of the parties that all claims in relation to the loss of the vessel should be included in the settlement. A further ruling by Flaux J found that the settlement agreements also covered any claims against third parties (such as employees, individual underwriters, legal advisers). The ship owner's claims in Greece against these third parties therefore breached the settlement agreement, and therefore the third parties were entitled to a decree of specific performance and damages.

This is the resumption of the appeal from Burton J in the *Alexandros T* [2012] 2 All ER (Comm) 608 granting summary judgment to Company Market Insurers (**CMI**) and Lloyd's Market Insurers (**LMI**) against the ship owners and associated companies (together, the **owners**) for declarations, damages and indemnities in respect of the owners' proceedings in Greece seeking damages from the insurers, despite proceedings for sums due under the relevant insurance policies being settled as long ago as December 2007 and January 2008. The owners' application to stay the proceedings failed before Burton J but, on appeal, this court stayed the English proceedings pursuant to Article 27 of Council Regulation 44/2001 (EC). The Supreme Court lifted that stay and will accordingly proceed to decide the rest of the owners' appeal.

After a ship sank, ship owners Starlight commenced English proceedings against various insurers (the **Insurers**) in 2006 (the **2006 proceedings**) for breach of insurance policies that contained English exclusive jurisdiction clauses. The proceedings were settled in 2007 and 2008, culminating in settlement agreements, followed by Tomlin Orders which stayed the 2006 proceedings "*save for the purposes of carrying into effect the terms agreed between the parties*".

In 2011 Starlight and the managers (**OME**) commenced Greek proceedings against the insurers. Although the claims were for breaches of the Greek Civil and Criminal Code, the factual allegations were "entirely familiar" to the English action and arose out of the alleged manner in which the insurers handled Starlight's claim with respect to the lost ship.

The insurers responded by, *inter alia*:

- issuing applications in the 2006 English proceedings, seeking summary relief for declarations and damages against Starlight and OME (the latter subsequently having been added as a third party); and
- issuing fresh English proceedings (the **2011 proceedings**), without prejudice to their applications under the 2006 proceedings, with a variety of causes of action, including breach of the jurisdiction clauses in the policies, breach of the terms of the settlement agreement and declarations that the settlement agreements (which included indemnity provisions) settled all claims against them.

Burton J granted summary judgment to the insurers. However, the Court of Appeal stayed both these proceedings, holding that it was bound to do so by virtue of Article 27 Brussels Regulation, but expressed no view as to the correctness or otherwise of Burton J's decision to grant summary judgment. The insurers appealed to the Supreme Court which lifted the stay. This Court of Appeal judgment examines Burton J’s decision, not on jurisdictional grounds this time, but on the merits.

Greek claims fell within the settlement provision and the indemnity provision of the Settlement Agreements

The Court of Appeal found that the Greek claims were clearly brought in relation to the loss of the vessel, and so fell within the indemnity and settlement provisions of the settlement agreements. It was the obvious intention of the parties that the settlement provision and the indemnity provision should "march together" and also, ever since the decision of the House of Lords in *Fiona Trust v Privalov* [2007] Bus LR 1719, fine distinctions between words such as "under" or "in relation to" should no longer be made. Although the *Fiona Trust* case related to an arbitration agreement, the Court of Appeal stated that the same principle should apply to jurisdiction agreements. Likewise, settlement clauses are analogous to both arbitration and jurisdiction clauses and should therefore be given a sensible commercial meaning; the words "full and final settlement" point to the intention of the parties that all claims in relation to the loss of the vessel should be included in the settlement.

The Court of Appeal rejected the owners' argument that the *Fiona Trust* principle was not universal and should not apply to settlement agreements (relying on *Barclays Bank plc v Nylon Capital LLP* [2011] EWCA Civ 826; [2012] Bus LR 542 in which *Fiona Trust* was distinguished). *Barclays* was about a clause requiring an expert to determine the allocation of partnership profits; any other dispute would have to be determined by the English courts in any event. In these circumstances, the rationale of *Fiona Trust* (that sensible businessmen would not want their disputes to be determined partly by arbitration and partly by another tribunal such as the court) did not apply because the parties had expressly agreed that such a division was to occur.

It followed that the Greek proceedings fell within both the settlement provision and the indemnity provision and Burton J's decision was upheld.

Greek claims fell within the exclusive jurisdiction clauses in the Settlement Agreements

The Court of Appeal ruled that it followed from the fact that the Greek claims fell within the settlement and indemnity provisions of the Settlement Agreement, that the Greek claims also fell within the exclusive jurisdiction clause of the settlement agreements. The *Fiona Trust* decision must apply to jurisdiction clauses just as much as arbitration clauses. The Greek claims should, therefore, have been brought in England.

Claims for damages for breach of jurisdiction clause do not infringe EU law

The owners argued that these claims for damages interfered with the jurisdiction of the Greek court to determine its own jurisdiction and, if appropriate, the merits of the owners' claims, relying on *Turner v Grovit* [2004] 2 Lloyds Rep 169. The Court of Appeal found this reliance to be misplaced because *Turner v Grovit* related to anti-suit injunctions, not damages. The vice of anti-suit injunctions is that they render the mechanisms which the Brussels Regulation provides for dealing with *lis alibi penden* and related actions ineffective. There is no infringement of EU law, nor is there any need for a reference to the Court of Justice of the European Union on this point.

Summary judgment for damages (to be assessed) for breach of the jurisdiction provisions

The Court of Appeal ruled that the owners are acting in breach of the jurisdiction provisions, and Burton J was right to give judgment for damages to be assessed pursuant to CPR Part 24 (noting that damages were awarded in similar circumstances in *Ellerman Lines Ltd v Read* [1928] 2 KB 144). The owners' breach of contract was in the bringing of the claims. Whether they succeed in Greece or would have failed in England is irrelevant.

Settlement agreements cover claims against third parties

In the same Greek proceedings, Starlight and OME also sued, not only the named Insurers and Underwriters, but also their employees, individual underwriters, a law firm and individual lawyers and a firm of loss adjusters, including more named individuals (**Third Parties**). Flaux J had to decide whether these claims also breached the settlement agreements.

Under the two main settlement agreements Starlight and OME agreed to receive a sum in full and final settlement of all claims against the Underwriters. Underwriters was defined as a list of named insurance companies and Lloyds syndicates.

Starlight and OME argued the claims against the Third Parties were not covered because they, the Third Parties, did not fall within the definition of Underwriters.

Who was covered by the settlement?

Flaux J answered the question, firstly, by a process of contractual construction:

- The definition of "Underwriters" was to be considered, but was not decisive.
- Applying the Supreme Court's analysis in *Rainy Sky v Kookmin Bank* [2011] UKSC 50, it would be contrary to business common sense for the insurers to have signed up to an agreement, leaving themselves exposed to claims from these Third Parties (such claims would inevitably be made as indemnity claims if the Third Parties had incurred liability to Starlight and OME). This cannot have been what was intended.
- The wording of general release "full and final settlement of any and all claims" was intended as a "clean break" – there was a clear objective intention of general release.
- The parties were legally advised when they entered into the settlement agreement, and would be taken to have understood that settling with one joint tortfeasor meant settling with them all. Neither of the exceptions to this rule applies: (1) Starlight and OME could have insisted on an express reservation against the Third Parties, but had not done so; (2) the wording was of general release, not a mere "covenant not to sue".
- The applicability of the joint tortfeasor rule was further support for a construction of the settlement agreements that construed "Underwriters" as including the Third Parties.

In any case, regardless of construction, the joint tortfeasor rule would have had the same effect anyway – ie by settling with the Underwriters, Starlight and OME would have been taken to have settled with anyone jointly liable with them, namely the Third Parties. It was irrelevant that Greek law had no equivalent to the English Law concept of joint tortfeasors.

Therefore, the settlement agreement had been breached *vis-à-vis* the Third parties too, and the Third Parties were entitled to declaratory relief to that effect.

Sanctions for breach of the settlement

Flaux J stated that a "full and final" settlement release is a continuing promise to accept the settlement sum and not to sue in return. Such a promise can be enforced by a decree of specific performance. Whilst an anti-suit injunction is inconsistent with EU law (*West Tankers*), such a decree is not as it does not usurp the jurisdiction of another Member State court, it merely "assists" the other court. Such an order would provide clarity to the Greek court on the English law position. Another reason for exercising the court's discretion to grant decree of specific performance is that damages was an inadequate remedy for breach of the settlement agreements.

The court ordered Starlight and OME to:

- do "*all such things and sign all such documents as necessary to carry the settlement into effect*" including a "Receipt and Recognition of the Release Agreement" to be signed by the assureds, or on their behalf by the court;
- pay more money into an "indemnity" fund to cover the insurers' costs relating to the Greek proceedings, and any liability to the Third Parties. This was to support the indemnity obligation in the settlement agreements.

Third Party claim for damages

Some of the Third Parties sought damages to reflect their costs (of GBP 225,000) incurred in the Greek proceedings.

Flaux J allowed this on three separate bases:

- Under the Contract (Rights of Third Parties) Act 1999, which allows a third party to enforce a term provided certain requirements are met. Flaux J ruled they were met as:
  - The definition of Underwriters included these Third Parties – thus a benefit was purported to be conferred on them; and
  - The Third Parties were therefore expressly identified as a class.
- As damages in lieu of an injunction, that would otherwise be available were it not for the ECJ's ruling in *West Tankers*; and
- Insurers could claim damages on their behalf. This was a rare example of a contracting party being allowed to recover a third party's loss, on the basis that there was an intention to benefit those servants and agents (applying *St Martin's Property Corporation v Sir Robert McAlpine* [1994] 1 AC 85, and *Offer-Hoar v Larkshore* [2006] EWCA Civ 1079).

COMMENT

The Court of Appeal ruling is helpful in its confirmation that the reasoning from *Fiona Trust* applies just as much to jurisdiction provisions as it does to arbitration clauses. This makes it very difficult for a party to argue that claims related to an agreement containing an exclusive jurisdiction clause can be brought elsewhere. The Court of Appeal's finding that a claim for damages for breach of a jurisdiction clause is not a breach of EU law is also another boost for the efficacy of English law governed English court jurisdiction clauses.

Flaux J's decision confirms how important it is to give full consideration to who is covered by a settlement agreement. The rule about settling with joint tortfeasors means that settling with some means that all are covered, unless there has been an express reservation of rights, or the settlement is construed as a "covenant not to sue" rather than a release. The wording of general release in this case, against a backdrop of the joint tortfeasor rule, gave Flaux J the confidence to construe the settlement agreements in such a way as to include the Third Parties.

Flaux J's ruling also shows a willingness to make robust orders to enforce a settlement, even where a Member State court is also involved. Whilst Flaux J acknowledges that an anti-suit injunction is a step too far as far as EU law is concerned, the alternative sanctions of a decree of specific performance, and a damages award are available.

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CONDITIONS PRECEDENT

Tullow Uganda Ltd v Heritage Oil and Gas Ltd & anr [2014] EWCA Civ 1048, 23 July 2014

A clause intended to be a condition precedent should be drafted clearly. In refusing to construe a notification clause as a condition precedent to a tax indemnity claim, Beatson LJ relied upon a significant body of case law advocating a cautious approach to labelling contractual requirements as conditions precedent. Furthermore, any amendment which is made to an underlying contract must clearly state the intended amendment in a way which is precise and unambiguous if the amendment is to have the intended effect.

Background

The claim centred on USD 313,477,500 tax that Tullow Uganda Ltd (**Tullow**) paid to the Ugandan Government to gain consent for the purchase, by Tullow, of a petroleum exploration licence from Heritage Oil and Gas Ltd (**Heritage**). The tax was owed by Heritage as a result of the sale and purchase agreement (**SPA**) with Tullow. Heritage disputed the tax and therefore did not pay it. Under Ugandan tax law, Tullow was made liable for Heritage's tax. Despite Tullow having paid substantial consideration to Heritage, the SPA could therefore not take effect until the tax had been paid. Given this, Tullow negotiated and settled the tax liability with the Ugandan Government.

There was a tax indemnity in the SPA in Tullow's favour, but Tullow failed to give the contractually stipulated notice of claim to Heritage. The notice provision required written notice to be given to Heritage within 20 days of the claim arising. Heritage argued that, as the notice provision was a condition precedent to the indemnity, and was breached, no indemnity payment was due. Further, Heritage explained that the SPA was varied through a Supplemental Agreement stating that responsibility for settlement of the tax dispute lay solely with Heritage, and that this was also a condition precedent. Heritage had not agreed the settlement amount paid by Tullow to the Government so this condition precedent was also not satisfied.

Condition Precedent Construction

Agreeing with the decision of Burton J at first instance, the Court of Appeal found that Heritage was liable to indemnify Tullow, in spite of Tullow's failure to give Heritage notice of the tax claim. Beatson LJ held that while classifying a contractual requirement as a condition precedent may provide certainty, it can also deprive a party of a large contractual right because of an insignificant breach causing little or no loss to other parties. There was no prejudice caused to Heritage as it was aware of the tax demands issued by the Ugandan Government, so the notice from Tullow was a mere formality. Beatson LJ relied upon a significant body of case law advocating a cautious approach to labelling contractual requirements as conditions precedent.[1]

The SPA indemnity was mutual. Given this, Beatson LJ felt it would have been unlikely that the parties would have intended a breach of the notice provision to invalidate the indemnity right. Such a valuable right would have been intended to have survived contractual breach. A later clause in the sale agreement supported this interpretation – it stipulated that indemnities contained within the agreement would apply "*irrespective of cause and notwithstanding the negligence or breach of duty…of the indemnified party*".

In the SPA, the clause containing the notice provision also contained another sub-clause that the court ruled was not capable of being a condition precedent. The Court of Appeal cautioned that if a sub-clause is to be treated as a condition precedent, it should fit purposively into the wider clause. Beatson LJ ruled that if multiple sub-clauses are introduced by the same sentence, making them conjoined limbs, each limb must alone be capable of being a condition precedent for any limb to be considered as such. Only if they are "separate and free-standing" can sub-clauses be ruled to be of different significance. In this respect, the decision in *Aspen Insurance UK Ltd v Pectel Ltd* [2008] EWHC

2804 (Comm) was distinguished. *Aspen* ruled that two parts of a contractual provision can have separate significance. The notice provision was not, therefore, to be treated as a condition precedent.

Beatson LJ further ruled that if appropriate condition precedent wording is used in one clause and not another, this may demonstrate the commercial intention of the parties. In Tullow and Heritage's sale agreement a clause (7.4) within the wider indemnity clause (7) contained sufficient wording to be a condition precedent. Given this, the notice provision clause (7.5) was deemed not to be a condition precedent – it was clear to Beatson LJ that the draftsmen were capable of using clear condition precedent wording when they intended.

Amendment Agreements

The court also considered whether the clause in an amending Supplemental Agreement acted as an overriding condition precedent. The Court of Appeal ruled it did not, finding that there were no express words which made Tullow's right to an indemnity dependent on compliance with the Supplement Agreement.

Importantly, the wording used before the alleged amendment clause, "notwithstanding any provision in the Sale and Purchase Agreement", was deemed to be insufficient for amending the specific clauses in the underlying contract. This was especially true when express language had been used elsewhere in an amendment agreement to alter wording of the underlying contract, as was the case in other clauses of the Supplemental Agreement.

COMMENT

This case is a potent reminder of the importance of accuracy when drafting a contract. The court confirmed that if parties want a clause to be a condition precedent, then this intention needs to be conveyed by clear words such as "[*conditional clause*] shall not apply unless".

In respect of clauses where the breach would not cause any, or any material, damage, this clear intention is even more important. A breach where the clause is not a condition precedent will normally only permit normal breach of contract claims. This damage will not, in many cases, equal the amount of an indemnity so as to nullify it (a party with back-to-back indemnity insurance arrangements is one notable exception). Breach of a notice provision, therefore, is unlikely to prevent an indemnity claim. If such a clause is to be a condition precedent, especially in relation to an indemnity, it should be explicitly stated where possible.

The case also raised the point that, if an amendment agreement is to amend a clause in an underlying contract, it should state the amendments explicitly, rather than relying on broad language to override previous specific contractual agreements.

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[1] *For example Hong Kong Fir Shipping Co Ltd v Kawasaki Kissen Kaisha Ltd* [1962] 2 QB 26. "Notification of loss" provisions in insurance contracts were highlighted in particular as a situation where the court is reluctant to classify a notice clause as a condition precedent (*Alfred McAlpine plc v BAI (Run Off) Ltd* [1998] 2 Lloyd's Rep 694).

RECOVERING MONEY UNDER AN ILLEGAL CONTRACT WHERE PERFORMANCE IS FRUSTRATED

Patel v Mirza [2014] EWCA Civ 1047, 29 July 2014

Public policy considerations do not prevent the recovery of money paid under an illegal agreement in circumstances where the claimant has neither repudiated nor withdrawn from the contract prior to its performance, but where performance has been frustrated, a point on which there appears to have been no previous direct authority.

The claimant sought to recover GBP 620,000 paid to the defendant under an illegal contract, the performance of which had been frustrated. The claimant paid the money to the defendant for the purposes of an illegal agreement for insider dealing in shares. It later transpired that the agreement could not be, and was not, carried out because the expected inside information was not forthcoming.

In his particulars of claim the claimant relied upon the illegal agreement and asserted rights to be repaid the money in trust, contract and restitution. The trial judge, Mr David Donaldson QC (sitting as a Deputy High Court judge) found that the claim was barred because it was based on an illegal agreement, even though the agreement had not been performed. However, by virtue of the *locus poenitentiae* (place of repentance) doctrine, he observed *obiter* that there would have been no such bar to recovery had the claimant withdrawn from the contract before its performance was frustrated, but no such withdrawal had taken place.

The claimant appealed on two grounds, submitting that:

- he did not need to rely on the illegal agreement in making his claim (this ground of appeal failed, Gloster LJ dissenting); and
- his failure to withdraw from the contract before its performance was frustrated was no bar to his *locus poenitentiae* claim.

The claimant's second ground of appeal succeeded (the Court of Appeal finding unanimously on this issue), and is the focus for the remainder of this article.

Could the claimant recover money paid under an illegal agreement whose performance had been frustrated?

Rimer LJ, in his leading judgment, observed that the authorities show that if the claimant had repudiated and withdrawn from the illegal agreement *before* he became aware that the agreement had been frustrated, the claimant would have been entitled to recover the money paid under the agreement, even though he would have had to plead the illegal agreement (*Taylor v Bowers* (1876) 1 QBD 291).

The question before the court, however, was whether the claimant could recover money paid under an illegal agreement where the claimant had neither repudiated nor withdrawn from the agreement before it was performed, but where the agreement's performance had become frustrated.

The court was not shown any authorities that were closely comparable to this scenario.

Rimer LJ ruled that the claimant should be able to recover. It would be unattractive to distinguish between cases of withdrawal from an illegal agreement that: (a) was no longer needed for the purpose for which it was designed; and (b) cannot be, or was anyway not going to be, performed. Such a distinction would depend on holding that "*genuine repentance*" on the part of the withdrawer is required. Following Miller LJ in *Tribe v Tribe* [1996] Ch 107, such repentance is not required. Rimer LJ considered that if, as in *Tribe*, voluntary

withdrawal from an illegal agreement when it was no longer needed is sufficient to entitle a claimant to recover, it would be an odd distinction if a claimant was not entitled to recover by relying on an illegal agreement that was not performed nor could be performed. To recognise such a distinction would require proof of a "*true sense of penitence*" which was not required or expected of the successful claimant in *Tribe*. Provided that no part of the illegal agreement had been carried into effect, the claimant could rely on it and recover.

Vos and Gloster LJJ agreed with Rimer LJ's conclusion on this issue. Gloster LJ also added that a claimant's entitlement to recover under the *locus poenitentiae* principle "*cannot depend upon some questionable analysis of the reasons why the illegal transaction did not proceed, or upon the vague and subjective concept of genuine* "*repentance*" *or* "*withdrawal*"" before performance of an illegal agreement becomes frustrated as this is inconsistent with the authorities and would be problematic to apply in practice.

The Court of Appeal therefore unanimously allowed the appeal on the second ground, confirming that it is possible to recover under an illegal agreement whose performance has been frustrated, and ordered the repayment of the disputed sum to the claimant.

COMMENT

It is an established principle that where a claimant voluntarily withdraws from an illegal contract *before* it comes into effect, he is entitled to rely on the illegal contract and to recover sums paid under it. This decision is significant as it reaches further than previous authorities by confirming that a claimant who has paid money under an illegal contract that has been frustrated should not be treated differently to claimants in situations where a contract is no longer needed or they have changed their minds, and is therefore also entitled to recover. The decision for the court is whether any part of the illegal contract has been brought into effect before such a claim is commenced. Whilst the Court of Appeal unanimously allowed the appeal on that ground, Rimer LJ acknowledged that he had not found the issue an easy one to answer.

The defendant has applied for permission to appeal the decision to the Supreme Court, so we will have to wait and see whether the Supreme Court provides further clarification on these issues.

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INCORPORATING TERMS FROM ONE CONTRACT INTO ANOTHER

Northrop Gruman Mission Systems v BAE Systems (Al Diriyah C4I) Ltd [2014] EWHC 2955 (TCC), 8 September 2014

A software licence agreement between BAE and Northrop was "governed by" an enabling agreement between a related BAE entity and Northrop. This meant that the terms of the enabling agreement, including termination provisions, were incorporated into the licence agreement. The court was prepared to construe the terms of the enabling agreement so that they worked within the context of the licence agreement. This decision illustrates the way in which the courts will interpret the relationship between agreements, and highlights the difficulties that can arise.

The defendant (**BAE**) and another company in the BAE Systems plc group (**Insyte**) engaged the claimant (**Northrop**) to supply software products and computers as part of a system to be supplied by BAE to a customer. Insyte and Northop entered into an agreement (the **Enabling Agreement**) which governed purchase orders placed by Insyte with Northrop for these products. BAE also entered into an agreement with Northrop (the **Licence Agreement**) to obtain licences for deployment of the software.

BAE subsequently relied on the terms of both agreements to terminate the Licence Agreement with Northrop. Northrop commenced Part 8 proceedings against BAE, seeking (amongst other things) a declaration that BAE had not been entitled to terminate the Licence Agreement.

Relevant contractual terms

A term of the Licence Agreement provided that it "*shall be governed by the terms contained within the Enabling Agreement*". A term of the Enabling Agreement stated that "*This entire Agreement and/or any or all Purchase Orders may be terminated for convenience at any time by the PURCHASER serving on the CONTRACTOR notice of twenty (20) calendar days of termination*".

Meaning of "governed by"

One of the issues in dispute was the meaning of the phrase "*governed by*" in the Licence Agreement. Ramsey J held that where the terms of one agreement "govern" another agreement (the **governing agreement**), they are incorporated in that other agreement. Further, the terms of the governing agreement rule or regulate the other agreement and generally prevail over its terms.

In considering the incorporation of the terms of one contract into another related contract between different parties, Ramsay J referred to *AIG Europe SA v QBE International Insurance Ltd* [2001] 2 Lloyd's Rep 268, which states that the court must decide which terms of the governing contract the parties intended to incorporate and which terms they did not. In the absence of specific language, the Court will not be able to infer that the parties intended to incorporate any terms other than those which are relevant to their own contract.

Effect of the Enabling Agreement on the Licence Agreement

Northrop argued that there were a number of difficulties in determining which terms in the Enabling Agreement would apply to the Licence Agreement if the Licence Agreement was governed by the Enabling Agreement. There were some provisions which were specific to the Enabling Agreement which could not have any governing influence over the Licence Agreement. In particular, Northrop submitted that the right to terminate for convenience under the Enabling Agreement could not apply to the obligations under the Licence Agreement since the granting of licences and associated intellectual property rights over software on a perpetual and transferable basis was not consistent with a right to terminate for convenience. However, Ramsay J held that there was nothing in the admissible factual background which showed that the Licence Agreement could not be terminated for convenience, as the parties were free to agree the circumstances in which termination could occur.

Although BAE was not a party to the Enabling Agreement, Ramsay J considered that there was little difficulty in BAE, which was the Purchaser under the Licence Agreement, becoming the Purchaser under the Enabling Agreement. Northrop was the Contractor under both the Licence Agreement and the Enabling Agreement. This was necessary and appropriate to give effect to the clear intention of the Licence Agreement as being governed by the Enabling Agreement.

Ramsay J held that the reference to "*Purchase Orders*" in the Enabling Agreement should be construed as being a reference to the Licence Agreement. This was because in light of the admissible background evidence as to how the Licence Agreement came about, Ramsay J considered that the Licence Agreement was governed by the Enabling Agreement in the same way as a Purchase Order was governed by the Enabling Agreement.

Ramsay J concluded that the relevant term of the Enabling Agreement should be construed so as to give BAE the right to terminate the Licence Agreement for convenience on 20 calendar days' notice.

COMMENT

This decision illustrates the way in which the courts will interpret the relationship between one contract and another contract when there are a number of agreements in place between the parties, particularly the meaning of the phrase "*governed by*". It also demonstrates the difficulties which can arise in such situations when deciding which terms of the governing agreement are relevant to the secondary agreement and the extent to which those terms apply to and are consistent with the obligations under the secondary agreement. The same issues arise more generally when considering which terms of one agreement should be incorporated into another agreement and how the two agreements will work together. Ramsay J was largely able to avoid such issues in this case by focusing on a very small number of terms.

The courts will go to substantial lengths to give effect to the intention behind a contractual structure, even where that results in a change in the wording of one contract which it is not immediately apparent should be made. In this case, a party was able to rely on a contract to which it was not a party in order to terminate another contract to which it was a party. A further difficulty may arise if the governing agreement were modified after the secondary agreement was signed – there may be a question as to which version of the governing agreement applies and whether someone who is not a party to an agreement should be bound by it even after changes that they did not agree to and may not have been aware of. Contracting parties (and their advisers) should keep firmly in mind the relationship between each contract which forms part of the agreement between them and ensure that this is expressed clearly and consistently in those contracts.

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CONTRACTUAL TERMS EXCLUDE LIABILITY FOR NEGLIGENT ADVICE

Crestsign Ltd v National Westminster Bank plc and Royal Bank of Scotland plc [2014] EWHC 3043, 26 September 2014

Liability for negligent advice provided by banks in respect of interest rate swaps sold to a retail customer was successfully disclaimed by the contractual terms of business which stated that the banks had a non-advisory role. This was despite the advice pre-dating the parties entering the swap. *Obiter* the court ruled that whilst the banks did not have a "duty to educate", they did have a duty to give full and accurate information on products which the banks chose to present.

Mr and Mrs Parker owned and were directors of Crestsign Ltd (**Crestsign**), a property investment company. Crestsign financed its investments through interest-only bank loans secured against the investment properties. In 2007 Crestsign sought to refinance the loans and, after discussions with National Westminster Bank plc (**NatWest**), entered into a five year, GBP 3.5 million loan facility. One of the conditions for the loan was for Crestsign to agree to an "Interest Rate Management" product provided by The Royal Bank of Scotland plc (**RBS**, an associated company of NatWest). Mr Parker, who took responsibility for discussions with the banks, was unfamiliar with such products.

Mr Parker discussed the potential swap structures with Mr Gillard, an interest rate risk manager for RBS, and Mr Flack, a relationship manager for NatWest. Mr Parker then received a number of documents. The "Risk Management paper" set out four potential structures, emphasising that two in particular were suitable for Crestsign. It warned that potential break costs could be "substantial". Further, a number of documents included the terms on which business was to be entered into. In particular, the Terms of Business for Retail Clients included the following disclaimer, in bold:

> "*We will not… provide you with advice on the merits of a particular transaction or the composition of any account… in relation to any transaction or account.* "

Crestsign entered into a callable swap on 6 June 2008 for ten years (the **Swap**) by way of a "trade call". A written acknowledgment was sent to Crestsign and contained wording to the same effect as the terms of business.
By 5 February 2009, the Bank of England's base rate had fallen to 0.5% and Crestsign benefitted from the initial variable rate.

However, under the terms of the Swap, after the second anniversary, and for the remainder of the Swap, Crestsign had to pay RBS the difference between the base rate and fixed swap rate of 5.65% on a "debt profile" of GBP 3.5 million, on top of interest of 2% on the underlying loan. When Mr Parker attempted to refinance Crestsign's borrowings with another lender, the Swap's break costs were prohibitive.

Crestsign claimed it had suffered economic loss as a result of negligent advice given or statements made by the banks. At the time of the case, Crestsign was also seeking redress through the banks' internal complaints procedures and the Financial Conduct Authority's review into interest rate hedging products, although the judge noted that this did not affect his decision making.

Did the banks owe a duty to use reasonable skill and care in giving advice about the suitability of the swap?

First, Mr Tim Kerr QC, sitting as a Deputy Judge of the High Court, found that the banks, represented by Mr Gillard and Mr Flack, had provided "advice" in a series of meetings and communications with Crestsign. This was primarily on the basis that Mr Gillard recommended specific swap structures for Crestsign's business, guiding Mr Parker towards certain choices by choosing not to provide information about products other than fixed-rate swaps. Moreover, Mr Gillard was brought in specifically as an expert on potential products with the task of explaining them to Crestsign.

The judge found that the banks owed a duty to use reasonable skill, relying on the established principles set out in *Hedley Byrne v Heller & Partners* [1964] AC 465. As the judge noted, "*the disparity in knowledge and expertise and the respective roles of the two men was such that it was reasonably to be expected that Mr Parker would rely on Mr Gillard's skill and judgment and… it would be reasonable for him to do so*."

However, as held in *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, "*an assumption of responsibility may be negatived by an appropriate disclaimer*." In Crestsign the banks had successfully disclaimed responsibility for the advice they provided because it was "*unequivocal*" that the disclaimers were "basis" clauses rather than exclusion clauses; "*they defined the relationship as one in which advice was not being given*". These clauses had been drawn to Mr Parker's attention in a cover letter to the Terms of Business for Retail Clients and Standalone Derivate Terms documents sent to Crestsign two days before the transaction completed; they were also repeated in other transaction documents. The cover letter stated that the terms would apply to all dealings between the banks and Crestsign. Mr Parker understood that the terms were intended to have legal effect.

The judge made two interesting comments in *obiter*. First, had the disclaimer been found to be an exclusion clause, challengeable under s2 Unfair Contract Terms Act 1977 (**UCTA**), the judge would have found it to be an "unreasonable" exclusion of liability for negligence. This was because the market for derivative products was complex and poorly understood by inexperienced customers such as Crestsign, and expert advice was not readily available to Crestsign. Secondly, if the judge had not found that the duty of care in relation to the giving of advice had been successfully disclaimed, there would have been a breach. It was obvious that, at the time of discussions, any of the proposed structures bore an unacceptable risk of locking Crestsign into a ten year swap with potentially very high interest payments and potentially prohibitive break costs, when the loan was for only five years. The judge considered whether the regulatory regime applying to Mr Gillard and Mr Flack, namely the Financial Standards Authority's (as it was then) Conduct of Business Sourcebook (**COBS**), assisted the court in assessing whether the common law duties of care asserted by Crestsign arose and, if they did, whether they were breached. However, the judge held there was a breach without a detailed analysis of the COBS rules. The judge also said that common law duties and COBS duties are not to be treated as co-terminous and that breach of a COBS duty is not necessarily common law negligence. This is in line with case law where courts have been reluctant to import regulatory standards into common law in non-advised sales by banks (see *Green v Rowley v Royal Bank of Scotland* [2013] EWCA Civ 1197).

What duty did the banks owe when giving information about the swap?

The judge, noting that the specific duty would depend on the circumstances of the person giving the information, found that Mr Gillard's duty was to explain fully and accurately the nature and effect of the products which he selected to present.

The banks did not owe a duty to explain other products that Crestsign might have wanted to purchase, but which the banks did not want to sell, nor did the banks owe a "duty to educate" Mr Parker about the products they did want to sell. Both of those would stray into the territory of advice giving, which was excluded under the documents. However, the bank's duties did extend to correcting any obvious misunderstandings of Mr Parker and answering any reasonable questions he might ask about the products that the banks had chosen to provide information about.

Did the banks breach their duty when giving information about the swap?

The banks did not act in breach of this duty. The judge considered the correspondence between the banks and Crestsign, and the documents provided. The judge found that Mr Gillard's communications were not inaccurate or misleading. Further, the banks were not under a duty to explain the obvious, for example that the bank may cancel the Swap if it was no longer valuable to them. Importantly, the judge noted that there were multiple occasions on which Mr Parker could have asked reasonable questions but did not.

Contractual estoppel

The banks' alternative argument was that the terms of business in the post-contract acknowledgement contractually estopped Crestsign from asserting the existence of the duty of care on which it then relied, applying *Raiffeisen Zentralbank v Royal Bank of Scotland Plc* [2010] EWHC 1392 (Comm). Crestsign argued that the terms attempted to "*rewrite history*" (see *Raiffeisen*) by trying to define the relationship as one in which advice was not given, when in fact the advice had been given, and therefore could not contractually estop Crestsign from relying on the duty of care owed to it by the bank not to provide negligent advice. Whilst Crestsign argued that it was clear that the banks were providing advice contrary to the terms of business, the judge found that it was not always clear when the provision of information became the giving of advice, and as such it would be incorrect to say the terms attempted to "rewrite history". The judge supported the banks' contractual estoppel argument; however, given the finding that the terms of business disclaimed any assumption of responsibility by the banks, this finding was *obiter*.

COMMENT

This was a pyrrhic victory for Crestsign: it won in principle but was defeated by the facts. The court found that the banks had given negligent advice, but the "basis clauses", which had been drawn to the claimant's attention, saved them. This was so, despite the fact that, by the time the contract was entered, the negligent advice had already been given.

For banks to successfully disclaim responsibility for any advice given, it is important for basis clauses to clearly define the non-advisory relationship and be drawn to the customer's attention before the contract is entered, although it should be noted that each case is highly fact dependent.

The ruling is also interesting for its confirmation that, when acting in a non-advisory role, banks do not have a duty to:

- "educate" their clients;
- explain other products that a client might want to purchase; or
- explain the obvious.

A bank must, however, correct any obvious misunderstandings and answer any reasonable question. Any information that a bank provides must be accurate and not misleading.

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UP TO SPEED: THE CONCEPT OF GOOD FAITH UNDER ENGLISH LAW

Our popular "Up to Speed" series continues with a look at whether the application of the concept of good faith in long term commercial agreements may be changing following some recent cases.

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Disclosure

HIGH PRICE PAID FOR ERRORS IN DISCLOSURE: COURT OF APPEAL PERMITS USE OF INADVERTENTLY DISCLOSED PRIVILEGED DOCUMENTS

Rawlinson and Hunter Trustees S.A. & ors v Director of the Serious Fraud Office [2014] EWCA Civ 1129, 31 July 2014

The Court of Appeal has held that the inadvertent disclosure of a privileged document must be an obvious mistake in the eyes of a reasonable recipient before the court will refuse permission to use it. The mere fact that a document is privileged is not evidence of such an obvious mistake having been made, notwithstanding the scale of the disclosure process, nor the attempted reservations of the SFO's right to claim privilege. The case operates as a warning: the risk that a recipient will be able to rely on inadvertently disclosed documents is high. The main protection for parties will be to ensure that such documents are not disclosed. Appreciating the potential costs of the outcome of the case, Longmore LJ favourably commented on the potential adoption of the more simplistic Australian approach.

Robert and Vincent Tchenguiz (and certain associated parties) (the **Tchenguiz parties**) are claiming damages from the Serious Fraud Office (the **SFO**) for financial loss and reputational damage caused by its execution of arrest and search warrants (in the course of the investigation into the collapse of the Icelandic bank Kaupthing Bank hf) that were subsequently quashed in judicial review proceedings.

Given the existence of the antecedent investigation and judicial review proceedings and consequent volume of documents, it was a "*very onerous exercise*" for the SFO to undertake its disclosure in defending the damages claim. The process involved a team of over 100 reviewers. In providing each electronic tranche of disclosure the solicitors for the SFO stated in the covering letter that "*the SFO* [did] *not intend that there should be any waiver of the SFO's rights to withhold from disclosure and/or inspection documents or information…which may have been inadvertently disclosed in these Proceedings*".

After disclosure and inspection had simultaneously occurred, the SFO claimed privilege over four particular documents inadvertently disclosed: three on the basis of legal professional privilege (**LPP**), and one on the basis of public interest immunity (**PII**). The Tchenguiz parties applied to the court under CPR 31.20 for permission to use the privileged documents. CPR 31.20 provides that "[w]*here a party inadvertently allows a privileged document to be inspected, the party who has inspected the document may use it or its contents only with the permission of the court*."

At first instance, Eder J refused permission to use any of the four documents, finding that that it would have been obvious to a reasonable solicitor (standing in the shoes of the solicitor who read the documents) that they had been disclosed by mistake. The judge's conclusion, in part, was based on the size and complexity of the disclosure (which meant that mistakes were inherently likely) and the reservation of rights in the covering letters.

When is there an obvious mistake?

The Court of Appeal allowed the appeal (in part) and permitted the Tchenguiz parties to use the three inadvertently disclosed documents the subject of the SFO's claim for LPP.

The Court noted that legal professional privilege is a private right capable of waiver, and that it therefore could not be assumed that production of a privileged document was "*inevitably*" inadvertent. Rather, the "*starting point*", developed in the pre-CPR context, is that a party permitted to inspect documents is entitled to

assume that those documents were voluntarily produced. Use of those documents would only be restrained where a production had been obtained by fraud or where it was obvious to the recipient of the disclosure that the document had been disclosed by mistake.

Per *Al-Fayed v Commissioner of Police for the Metropolis* [2002] EWCA Civ 780, a mistake is likely to be held to be obvious where a solicitor in receipt of documents in fact appreciates that a mistake has been made before making some use of the documents; or "*where it would be obvious to a reasonable solicitor in his position that a mistake has been made*". If the recipient solicitor had in fact given detailed consideration to the issue of whether or not the documents had been made available by mistake, and had honestly concluded that they had not, this would be a relevant and important (though not conclusive) factor against the Court finding that there had been a mistake that would have been obvious to a reasonable solicitor. In the present case, the lawyers for the Tchenguiz parties had read the three documents in question, and had concluded in each case that the document had been intentionally disclosed. Applying Al-Fayed, the Court commented that "*once it is accepted that the person who inspected a document did not realise that it had been disclosed by mistake, despite being a qualified lawyer, it is a strong thing for the judge to hold that the mistake was obvious*".

Emphasis was placed on the two-stage enquiry: first, whether the document was privileged; second, whether, even if privileged, it had obviously been disclosed by mistake. Of course, it is necessary for the document to be privileged. However, the privileged nature of the document alone will often not be enough to demonstrate that an obvious mistake was made in disclosing it – although the Court accepted that the sensitive nature of a document may be enough in "*some cases*". The "*general assertions*" of privilege contained in the covering correspondence in this particular case were not sufficient to make it "*obvious*" that any privileged documents had been disclosed by mistake.

Finally, the Court noted that parts of the documents had been redacted for relevance and/or privilege which suggested that they had been considered by a lawyer for the SFO, and that a decision had been taken to disclose the remaining contents.

Accordingly, overturning Eder J, the Court of Appeal found that there was no obvious mistake in the disclosure of the three LPP documents, and that they could be relied upon by the Tchenguiz parties.

Different Approach to Public Interest Immunity

The Court of Appeal considered itself not to be bound by the comments on PII in *Al-Fayed*, since it had not been the specific subject of argument or decision. PII was recognised as a "*public duty*" (rather than the private right to claim LPP) concerned with maintaining the confidentiality of documents which would harm the public interest if in the public domain.

The Court held that, given the fundamentally different basis of PII, if a document which is the subject of a claim of PII is inadvertently disclosed, it is not necessary for the party seeking to restrain use of the document to show that the disclosure of the document occurred because of an obvious mistake. Rather, the Court should simply consider, in accordance with well-established principles, where the balance of the public interest between confidentiality and due administration of justice lay in the circumstances of each case.

In light of the unchallenged certificate issued by the Director of the SFO (after the inadvertent disclosure had occurred) stating that he considered the public interest to be in favour of maintaining confidentiality of the document, Eder J's decision to refuse permission to use this document in the proceedings was upheld by the Court of Appeal.

COMMENT

With the Court of Appeal setting such a high bar for an "*obvious mistake*" sufficient to justify refusing a party permission to use an inadvertently disclosed document, the responsibility will fall more keenly on parties to ensure that inadvertent disclosure of privileged documents does not occur at the outset. This will likely incentivise parties to undertake their review for disclosure in a way that is cautious and error-free (rather than proportional to the scale of the required disclosure, which was expressly recognised as irrelevant in the case) and increase the time and associated cost of disclosure.

While proportionality may not be relevant when considering the documents in the eyes of the recipient solicitor under the traditional test, it is difficult to reconcile this overall approach with the focus and overarching spirit of the Jackson reforms. Lord Justice Longmore recognised this discrepancy, and commented favourably on the more simplistic Australian approach to cases of inadvertent disclosure. In *Expense Reduction Analysts Group Pty Ltd v Armstrong Strategic Management and Marketing Pty Ltd* [2013] HCA 46, the High Court of Australia declined to follow the English authorities on obvious mistake. Instead, relying on case management powers directed at the "*just, quick and cheap resolution of the real issues*", the court held that where a privileged document was inadvertently disclosed, the court should ordinarily permit the correction of the mistake and order the return of the document. Such a rule would prevent costly satellite litigation as occurred in this case, generate certainty around solicitors' obligations in such cases and encourage a more proportionate approach to review in the disclosure process more generally due to the reduced penalty of any inadvertent disclosure.

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Employment

WHEN IS A DECISION A DISCRETION? HIGH COURT GUIDANCE AND IMPACT FOR DOCUMENTATION AND BONUS DISPUTES

Brogden & anr v Investec Bank plc [2014] EWHC 2785 (Comm), 6 August 2014

The High Court ruled in favour of the employer in this high-profile bonus litigation. The most interesting aspect of the ruling is the judge's guidance on when a party can be regarded as exercising a contractual discretion which is fettered by implied terms. This has drafting implications and could also bolster the arguments of claimants looking to challenge bonus decisions.

Limitations on the exercise of contractual discretion

It is well established in case law that a contractual discretion that is conferred on one party to make decisions that affect both parties must be exercised honestly and in good faith, for the purposes for which it was conferred, and must not be exercised arbitrarily, capriciously or unreasonably (in the sense of irrationally) (*Abu Dhabi National Tanker Co v Product Star Shipping Ltd (The "Product Star")* [1993] 1 Lloyd's Rep 397). However, no such constraints apply if the discretion is whether or not to exercise an absolute contractual right (*Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (trading as Medirest)* [2013] EWCA Civ 200).

In an employment context, these limitations on the exercise of contractual discretion are underpinned by an overarching duty also implied at common law for an employer not, without reasonable and proper cause, to conduct itself in a manner calculated and likely to destroy or seriously damage the relationship of trust and confidence between employer and employee (the "duty of mutual trust and confidence").

Bonus litigation trends: discretionary bonuses back in the spotlight?

These limitations on the use of discretion were first applied to bonuses in *Clark v Nomura International plc* [2000] IRLR 766, in which the High Court established that employers, when deciding whether to award discretionary bonuses, must not behave irrationally or perversely. This paved the way for a string of (mostly successful) claims challenging the non-payment of discretionary bonuses.

However, the tide turned in *Commerzbank AG v Keen* [2006] EWCA Civ 1536 when the High Court raised the bar for claimants to succeed by requiring them to demonstrate an "overwhelming case" of irrationality, before an employer could be required to justify its award decision. Cases on discretionary bonuses have since petered out and disputes have instead shifted to the contractual status of undocumented bonus promises and to the operation of specific arrangements.

The latest case, *Brogden*, indicates that cases challenging the employer's exercise of discretion could, however, continue notwithstanding the need for claimants to overcome the high evidential hurdle established in *Commerzbank*. This is because, in the light of guidance given by the High Court as to when a discretion arises, it will be relatively easy for claimants to argue that most bonus schemes have a discretionary element.

Brogden: the facts and arguments

Brogden and Reid worked as head and deputy head of equity derivatives at Investec. Their employment contracts provided for payment of a bonus calculated as a set percentage of the "Economic Value Added" (**EVA**) generated by the bank's equity derivative business. However, Investec calculated that the available bonus pool for 2010/2011 was zero so that they were not entitled to a bonus. They brought proceedings for damages for breach of contract to recover a combined GBP 6.3 million in unpaid bonuses.

There was lengthy argument as to how "EVA" should have been calculated. The claimants alleged that Investec had made assurances in pre-contractual negotiations that a more favourable formula would apply.

A central argument for the claimants was that to the extent that Investec had any discretion in relation to the calculation of EVA, it had a duty to exercise that discretion rationally and was in breach of that duty. Investec's counter-argument was that, although preparing accounts necessary to calculate the bonus pool involved questions of judgment about which reasonable people may differ, this did not involve the exercise of a discretion.

High Court confirms parameters for discretion

The Court rejected Investec's counter-argument, finding that the bonus clause gave the bank a discretion "in the relevant sense" to determine the EVA for the bonus pool; this determination involved numerous and substantial exercises of judgment and, as a result, was subject to implied requirements of good faith and rationality. However, as the method used by Investec to determine the EVA could not be regarded as irrational and there was no evidence of bad faith, the claimants had no right to any bonus for 2010/2011 and their claims were dismissed.

Leggatt J distilled a long line of previous case law authority into certain criteria which determine when a decision is to be properly regarded as an exercise of discretion (and therefore subject to the implied constraints that it must be taken in good faith, for proper purposes and not in an arbitrary, capricious or irrational manner). He said that, unless there is clear language to the contrary, this is where the following factors are present:

- a contract gives responsibility to one party for making an assessment or exercising judgment on a matter which materially affects the other party's interests;
- the matter is one about which there is ample scope for reasonable differences of view; and
- the decision is final and binding on the other party such that a court would not substitute its own judgment for that of the party who makes the decision.

Managing risks in documentation

These broad parameters pointing to a discretion suggest that it will be difficult for a party to argue that it is not exercising contractual discretion where it can determine a matter which will affect the other's interests. Investec's counter-argument was a tenuous one and was, perhaps unsurprisingly, rejected. Provisions which refer a matter for final determination by a third party such as an expert would negate any argument that a party has exercised a discretion in breach of the implied constraints.

When reserving an absolute discretion for a party in documentation, agreeing a detailed formula for making a decision should reduce the possible areas of dispute. However, unless the formula is entirely objective, that party is likely to find it difficult to establish that it is exercising no discretion at all. This is particularly relevant in bonus pool and award decisions which inevitably involve some subjective assessment on the employer's part. Documentary evidence of bonus decisions and the reasons for them will help to manage the risk of successful claims.

The ruling suggests that parties could potentially contract out of the constraints on their discretion using clear language. However, such an exclusion is likely to prove very difficult to negotiate, and it remains to be seen whether the courts would be willing to uphold it on policy grounds. In addition, an employer who has operated a contractual right unreasonably in reliance on such an exclusion would still risk being found to have breached its duty of mutual trust and confidence.

More generally, this case highlights that it is important for documentation to define terminology used in bonus formulae (or in formulae determining payments to be made under commercial contracts) to reduce the scope for disputes. This dispute related to the interpretation of "EVA" but there are many abbreviations or acronyms that that may be understood in context within a particular industry, for example, "ROCE", "ROA", "ROE", "ROI" and "IRR" in the banking sector, which may not be fully understood or may be interpreted differently outside it.

Future trends in bonus litigation?

Bonus litigation will no doubt continue to be a risk area given the often large amounts at stake and the existence of commercially savvy and well-resourced claimants. This ruling will give claimants more ammunition to challenge discretionary bonus decisions, by giving them greater scope to point to discretionary terms, although the evidential hurdle of "irrationality" that they face is high.

The bonus cap (which from 1 January 2015 caps bonus payouts for material risk-takers) will impact on the value of claims in the financial sector. However, we expect to see satellite litigation stemming from the use of so-called "fixed pay allowances" that have been awarded by many banks in lieu of bonuses to mitigate the impact of the bonus cap; the European Banking Authority has recently confirmed that such allowances can be used provided that they are properly structured.

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Enforcement

ENFORCMENT OF ARBITRATION AWARD BY EQUITABLE EXECUTION OVER FOREIGN ASSETS

Cruz City Mauritius Holdings v Unitech Ltd & ors [2014] EWHC 3131 (Comm), 2 October 2014

In this strongly worded judgment, Males J allowed the application of the claimant for the appointment of receivers by way of equitable execution over the foreign assets of two foreign defendants, Unitech Ltd, and its wholly owned subsidiary, Burley Holdings Ltd (together, **Unitech**). The order was sought to assist Cruz City in enforcing an arbitral award made in its favour against Unitech and now worth over GBP 350 million (the **Award**).

Background

The application, which was brought under s37 Senior Courts Act 1981, was the latest instalment in long-running proceedings in which Cruz City has repeatedly sought to enforce a London LCIA arbitration award obtained in July 2012. In the words of Males J, Unitech had "*made clear by words and conduct that it will do whatever it can to avoid having to meet its liabilities*". Cruz City had commenced enforcement proceedings in numerous jurisdictions, including the Isle of Man, Mauritius, Cyprus and India. It had also obtained from the English courts a worldwide disclosure order and an *ex parte* worldwide freezing order. It was not until the day before the return date of the freezing order that Unitech finally gave disclosure of its assets (a move that Flaux J described as "*evidently tactical*" [2014] EWHC 1323).

Unitech's disclosure provided only a limited understanding of the manner in which Unitech holds its assets, including their location and value. Cruz City argued that this posed a continued obstacle to its enforcement and asked the court to appoint receivers over Unitech's shareholdings in four companies, two of which were Cypriot, one Indian and the other from the Isle of Man. It also sought ancillary orders requiring Unitech not to impede the receivers from acting.

The appointment of receivers under s37(1) Senior Courts Act

Section 37(1) Senior Courts Act gives the court jurisdiction to appoint a receiver by final or interlocutory order in all cases in which it appears to the court to be just and convenient to do so. The appointment of a receiver does not confer proprietary rights transferring ownership of the assets to the receiver. Rather, it acts *in personam*, and has effect as an injunction restraining the judgment debtor from receiving any part of the property that it covers.

Males J confirmed that receivers can be appointed to exercise the judgment debtor's rights over its shareholdings (including the sale of shares, exercise of voting powers, appointment of directors and seeking the winding up of subsidiary companies) and that the English court will do what it can to render the appointment of receivers effective. That, Males J held, must include the making of appropriate ancillary orders to assist the receivers in the performance of their functions, including to assist the receivers in the exercise of the judgment debtor's rights as a shareholder of subsidiary companies.

The judgment examines in detail the case law on the exercise of the discretion under s37(1) and provides a useful summary of the English courts' position. The overriding consideration is the demands of justice, which includes promotion of the policy of English law that judgments of the English court and English arbitration awards should be complied with and, if necessary, enforced. While the jurisdiction will not be exercised unless there is some hindrance or difficulty in using the normal processes of execution, there are no rigid rules as to the nature of the hindrance or difficulty required, which may be practical or legal. Further,

because equity does not act in vain, a receiver will not be appointed if the court is satisfied that the appointment would be fruitless. However, a real prospect that the appointment will serve a useful purpose is likely to suffice.

The decision

Males J accepted Cruz City's submission that this was a "classic case" for the appointment of receivers. He did so for four primary reasons:

(1) Unitech holds its assets through multiple chains of companies located in a variety of jurisdictions, many of which do not afford transparency as to the value of the Unitech shareholdings or how that value could be realised. Without that information, processes of legal execution open to Cruz City would at best be a "*blunt and ineffectual instrument*".

(2) Recovery of the award debt by other processes of execution in the countries where Unitech holds assets would not be practicable in any reasonable timescale (particularly given Unitech had made clear it would do everything it could to frustrate enforcement).

(3) The appointment of receivers would not be fruitless. Rather, there was a real prospect that such an order would side-step the multiple obstacles Unitech was determined to place in the way of other means of enforcement.

(4) The appointment of receivers would be a valuable support for the freezing order in place and, without such appointment, there would be a real concern given Unitech's previous conduct that it would disobey the freezing order if it thought it could do so undetected.

The Judge then addressed, and dismissed, the four specific arguments advanced by Unitech. First, he held that in circumstances where Unitech was determined to resist enforcement abroad by any means available to it, it was not open to it to argue that ordinary means of enforcement were not impossible or impracticable. Second, a receivership order would not be fruitless just because it would not be recognised by the courts abroad. The sanction of contempt proceedings in the English courts would remain and "[i]*n circumstances where directors of the defendants may wish to come to this country on business or for pleasure, the prospect that their next visit may be for a more extended duration and in less comfortable accommodation than anticipated should provide a real incentive to comply with an order*".

Unitech's third objection was that the ancillary orders sought went too far and would put Unitech in a position where it was either in contempt or could not resist enforcement in foreign jurisdictions with arguments properly open to them. That, Males J held in dismissing the objection, amounted to an argument that it is unfair to Unitech that it should be faced with sanctions for contempt of court in this country if it acts in ways that would frustrate and render ineffective the appointment of receivers. He accepted Cruz City's submission that the contempt sanction was precisely what was needed to ensure compliance with an order that (*ex hypothesi*) it was just and convenient to make. Finally, Males J rejected Unitech's submission that the orders should not be made because payment of the Award could infringe Indian exchange control regulations. Unitech's evidence on this point was described as "*weak*" by the judge, who was not persuaded that a serious effort to obtain permission from the Reserve Bank of India would be refused.

COMMENT

It is a policy of the English courts that arbitration awards should be satisfied notwithstanding that it may be open to a respondent to resist enforcement in its home state or elsewhere. This judgment confirms and advances that policy by making it plain that the courts will, in appropriate cases, appoint receivers by way of equitable execution to promote the enforcement of outstanding awards. Males J's judgment emphasises that the jurisdiction to do so will be "*responsive to the demands of justice in the contemporary context*" and that the English courts' contempt jurisdiction provides a powerful means by which to coerce compliance.

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Injunctions

FORTIFICATION OF CROSS-UNDERTAKINGS

Energy Venture Partners Ltd v Malabu Oil & Gas Ltd [2014] EWCA Civ 1295, 9 October 2014

The applicable test for deciding whether to order a fortification (ie security) of cross-undertakings, given in the context of interim injunctions, has been heard for the first time at appellate level and affirms the test set out in *Harley Street Capital v Tchigirinski* [2005] EWHC 2471 (Ch).

The question arose when the subject of a worldwide freezing order (the **Freezing Order**), Malabu Oil and Gas Ltd (**Malabu**), sought a further fortification of the cross-undertaking provided by the applicant, Energy Venture Partners Ltd (**EVP**). Whilst the substantive judgment was handed down in late 2012 *[2013] EWHC 2118 (Comm)*, the Court of Appeal heard an appeal in respect of the Freezing Order as this affected, in part, the parties' recovery of costs.

Background

When the court grants an interim injunction, including freezing orders, it usually requires the applicant to give a cross-undertaking to compensate the respondent if it is subsequently found that the applicant was not entitled to the injunctive relief. In certain circumstances the court may require the applicant to provide security for the cross-undertaking, also known as "fortification".

EVP obtained the Freezing Order up to the value of USD 215 million over the assets of Malabu. EVP was required to fortify its cross-undertakings to the court in the sum of USD 150,000 by way of a written guarantee. The level reflected the fact that the sum of USD 215 million under the Freezing Order had not yet been paid into court.

After USD 215 million was paid into court out of funds frozen by the Freezing Order, Malabu applied for further fortification of the cross-undertaking. Malabu argued that it was entitled to further fortification because of the losses caused to it by being kept from the use of the substantial sum of money in court. Malabu put its claim on the basis that the likely borrowing cost to it if it had borrowed the sum of USD 215 million on the international market from a bank would have been the U.S. Prime Rate, then 3.25%. This was considerably more than the 0.15% interest applied to money held at court. Therefore, Malabu argued, if EVP lost at trial and was required to make good on the cross-undertaking, Malabu would still have suffered considerable loss.

EVP appealed against an order granted in the first instance by Hamblen J for further fortification of its cross-undertaking.

Decision

EVP's appeal against further fortification was dismissed. The Court of Appeal affirmed the approach taken in *Harley Street Capital v Tchigirinski* [2005] EWHC 2471 (Ch) that a defendant seeking fortification must show:

- that the court can make an intelligent estimate of the likely amount of loss which a defendant might suffer because of the injunction;
- a sufficient risk of loss; and
- that the loss was caused, or would be caused, by the grant of the injunction.

The court must be able to make an intelligent estimate of the likely amount of any loss which might result from the injunction

It was possible to make an intelligent estimate of the likely amount of any loss to Malabu which might result from an injunction. If EVP lost its claim Malabu would be out of pocket by millions of pounds given the significant sums involved.

The potential loss represented the "time value" of money as a consequence of not being able to use the money paid into court. No precise figure of loss was necessary; Tomlinson LJ stated that an intelligent estimate will be one that is informed and realistic although it may not be entirely scientific. It was a different exercise from evaluating a complex damages claim involving intricate issues of causation and remoteness.

The court also considered the amount of fortification. Whilst there might be issues regarding the appropriate rate of interest to be applied, the court was experienced in dealing with quantifying losses for loss of the use of money. The appropriate rate for an international company operating in U.S. dollars would be the U.S. Prime Rate, the rate at which lending would be provided to the most creditworthy companies. Fortification was therefore based on the U.S. Prime Rate of 3.25%, adjusted to reflect that, in court, the sum attracted interest at 0.15% to which Malabu was entitled.

The applicant must show a sufficient level of risk of loss to require fortification

It was clear that Malabu had a reasonable prospect of successfully defending the substantive claim and Hamblen J had observed, at first instance, that there was a sufficient level of risk that EVP would be unable to pay under the cross-undertaking.

The Court of Appeal held that it was not necessary for Malabu to provide actual proof of loss. The fact that Malabu had been required to make the payment into court was sufficient to ground a prima facie claim for loss of use of the money. Further, there was no need to show that Malabu needed to or would borrow the USD 250 million.

The court must be satisfied that the loss has been or is likely to be caused by the grant of the injunction

It is sufficient for the court to be satisfied that the making of the order or injunction was a cause without which the relevant loss would not have been suffered. This is also known as the "but for" test, and in this case "but for" the order Malabu would not have had the money paid into court and would not have suffered loss of use of the money.

The court will not consider causation of loss in great depth. Hamblen J stressed that it is undesirable for the court to conduct a "mini-trial" on such an issue.

COMMENT

When an interim injunction is granted the applicant is almost always required to give a cross-undertaking. An applicant for an interim injunction is not automatically required to fortify the cross-undertaking, as it may be possible to evidence that the applicant would be able to pay under the cross-undertaking.

However, where an applicant is not able to show sufficient assets within the jurisdiction to provide substance to the cross-undertaking, for example if they are insolvent, they may be required to fortify their undertakings. The court has discretion as to how and when fortification will be given, taking into account factors such as the nature of the applicant's business and the amount frozen.

This is an important confirmation of the principles that have been used previously in High Court cases regarding the test for whether fortification of cross-undertakings should be granted, providing clarity to both applicants and respondents on what needs to be proved.

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Procedure

DON'T DELAY: COURT OF APPEAL CONFIRMS THAT APPLICATIONS TO SET ASIDE DEFAULT JUDGMENTS ARE SUBJECT TO THE *MITCHELL* PRINCIPLES

Dexia Crediop S.p.A. v Regione Piemonte [2014] EWCA 1298, 9 October 2014

Piemonte's application to set aside a default judgment was rejected on the grounds that it had delayed in engaging with two sets of English High Court proceedings. The extent and character of the delay alone would have constituted grounds to refuse to set aside the judgment even if Piemonte's defence had had a real prospect of success. The Court of Appeal ruled that the principles laid down in *Mitchell v News Group Newspapers Ltd* [2014] 1 WLR 795 (**Mitchell**) and *Denton v TH White Ltd* [2014] EWCA Civ 906 (**Denton**) apply to applications to set aside default judgments.

The dispute relates to an interest rate swap transaction entered into by the parties on 16 November 2006 (the **Swap**). The Swap was governed by English law and subject to the exclusive jurisdiction of the English Courts. In 2012 Piemonte stopped payments under the Swap, based on a 2011 report from an Italian lawyer and a financial expert that the Swap violated a number of provisions of Italian law. The report had been produced in response to a direction given in October 2010 by the Italian Corte dei Conti (akin to a local authority auditor) for further investigation into a number of Piemonte's financial transactions including the Swap.

The Commercial Court proceedings

The procedural background is relevant to the court's assessment of delay.

2011 Proceedings

In August 2011, following press reports that Piemonte was to commence action against Dexia in Italy, Dexia commenced Commercial Court proceedings seeking declarations that the Swap was valid (the **2011 Proceedings**). Piemonte did not file an Acknowledgment of Service and focused instead on self-redress proceedings in Italy, which it believed would enable it to declare the Swap void without the need for a court declaration (the **Self-Redress Proceedings**). In 2012, Dexia challenged the validity of the Self-Redress Proceedings in the Regional Administrative Court (the **TAR**). Dexia also made an application for default judgment in the 2011 Proceedings and, in July 2012, the High Court awarded default judgment (the **Default Judgment**).

2013 Proceedings

In December 2012, the TAR held that it had no jurisdiction and that the matter should be decided by the English courts. While Dexia continued to perform its obligations under the Swap, Piemonte ceased making payments.

In March 2013, Dexia served new proceedings claiming the sums owed under the Swap (the **2013 Proceedings**). Piemonte acknowledged service but did not file a Defence. In April 2013, Dexia applied for summary judgment for the sums allegedly due, contending that the Swap was valid, binding and enforceable as confirmed by the Default Judgment. Piemonte issued two application notices to set aside the Default Judgment and the orders awarded in the 2011 Proceedings.

In July 2013, Eder J refused to set aside the Default Judgment and gave a monetary judgment in favour of Dexia. The question facing the Court of Appeal was whether the High Court was in error.

Application to set aside default judgment

Under rule 13.3 of the Civil Procedure Rules 1998 (the **CPR**), the Court may set aside a default judgment where:

> "*(a) the defendant has a real prospect of successfully defending the claim; or*
>
> *(b) it appears to the court that there is some other good reason why –*
>
> > *(i) the judgment should be set aside or varied; or*
> >
> > *(ii) the defendant should be allowed to defend the claim.*"

In considering whether to set aside or vary a default judgment, the court must also consider whether the person seeking to set aside the judgment made an application to do so promptly. For Christopher Clarke LJ, CPR 13.3:

> "*makes clear (i) that the power to set aside is discretionary; (ii) that the conditions specified in CPR 13(1)(a) or (b) are necessary, but not necessarily sufficient, conditions for the exercise of the discretion; and (iii) that the question as to whether the application has been made promptly is a mandatory and obviously, therefore, important consideration*".

As a result of this analysis, Christopher Clarke LJ concluded that an application may be refused even if the defendant shows a real prospect that he may or might succeed in his defence at trial.

The effect of *Mitchell* and *Denton*

On 1 April 2013, the CPR was amended to implement the Jackson and civil litigation reforms, designed to control costs and promote access to justice. A key focus has been the court's case management powers. In particular, reform has removed the checklist of factors in CPR 3.9 to be considered when granting a party relief from sanctions for non-compliance with any rule, practice direction or court order. In deciding whether to grant relief, the court will consider all the circumstances of the case, including the need: (a) for litigation to be conducted efficiently and at proportionate cost; and (b) to enforce compliance with rules, practice directions and orders.

The Court of Appeal decisions in *Mitchell* and *Denton* interpreted these reforms and in particular the approach to delay by parties. Although the application of CPR 3.9 is highly fact sensitive, recent case law is unified by a robust approach to compliance with court rules. In the view of Christopher Clarke LJ, the three-step test in *Denton* requires that any application for relief against sanctions involves considering: (i) the seriousness and significance of the default; (ii) the reason for it; and (iii) all the circumstances of the case. At the third stage of the test, factors in CPR 3.9 paragraphs (a) and (b) are of particular, but not paramount importance.

Application by the Court of Appeal

Piemonte argued that the *Mitchell/Denton* principles did not apply to an application to set aside a default judgment under CPR 13.3 and that the reference to promptness in CPR 13.3 should be regarded as a factor only, rather than being given particular prominence within the framework of CPR 3.9. Christopher Clarke LJ disagreed. In his view, since the court is required to manage cases justly and at proportionate cost, in compliance with rules, practice directions and orders (CPR 1.1(2)(f)), the considerations set out in CPR 3.9 are to be taken into account.

Decision

Christopher Clarke LJ confirmed that the High Court had been correct to refuse Piemonte's application to set aside the Default Judgment. He agreed with Eder J's conclusion that Piemonte's delay in making its application was both significant and serious and, of itself, sufficient to justify its dismissal. The claim forms in the 2011 Proceedings were served 17 months before the July 2013 hearing and Piemonte had deliberately ignored the 2011 Proceedings for the majority of the intervening period.

To this the Court of Appeal added an analysis based on weighing the delay against the merits of the defence. Leaving aside the analysis of matters of Italian law which are specific to this case, Christopher Clarke LJ considered the following factors to be significant in informing his view that the defence was lacking in merit sufficient to counteract the delay:

- Piemonte failed to provide a draft defence. Its arguments were "*advanced in a most unsatisfactory way*" and "*were inchoate and tentative*".

- A number of its putative defences were held not to "*establish any sufficiently arguable case*".
- A number of the representations on which Piemonte sought to rely were not put in evidence appropriately (ie no draft defence with a statement of truth or witness evidence had been filed).

On the contrary, for Christopher Clarke LJ, a defence of "*some considerable cogency, based on pretty convincing evidence*" would be required to justify setting the default judgment aside. Indeed, in the view of the Court of Appeal: "*the extent and character of the delay alone afforded, in this case, good grounds to refuse to set the judgment aside, even if the defence had a real prospect of success*".

COMMENT

The decision has clarified the court's approach to a number of factors considered when assessing delay, with important considerations for participants in English court litigation. It is clear that post-Mitchell, "*delay is now a much more potent factor*" than in the past. Indeed, Christopher Clarke LJ expressly distinguishes the current approach of the courts from the approach adopted in *JH Rayner (Mincing Lane) Ltd v Cafenorte S.A. Importadora e Exportadora S.A.* [1999] 2 Lloyd Rep 750, where the Court of Appeal upheld a decision setting aside a judgment after a delay of seven and a half years.

The decision is of particular relevance to litigation involving parties and proceedings in a number of jurisdictions. The Court of Appeal approved the view expressed by the High Court that "*a defendant who deliberately ignored duly instituted proceedings did so at his peril, especially where the defendant had expressly agreed on English law and jurisdiction to govern the relationship*". The message of the Court of Appeal is clear: regardless of the perceived tactical advantage of pursuing proceedings and remedies in other jurisdictions, litigants involved in English proceedings must comply with their rules, practice directions or court orders.

Of particular relevance to participants domiciled outside of the jurisdiction is the Court of Appeal's emphatic statement that a lack of familiarity with English court procedure and requirements is no excuse for non-compliance.

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European developments

"RECAST" BRUSSELS REGULATION

Readers should note the revised "Recast" Brussels Regulation will be applied by Member State courts from 10 January 2015.

To read our review of the key changes see:

WHERE ON THE WEB

http://www.allenovery.com/publications/en-gb/Pages/BRUSSELS-REGULATION-(RECAST)-ARE-YOU-READY.aspx

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Forthcoming client seminars

The client seminars listed below can be viewed, and registered for, online at www.aoseminars.com.

We also offer a full range of bespoke seminars in our Client Seminar Menu, from which clients can choose a seminar topic of interest which will be delivered by Allen & Overy LLP specialists at a client's premises. If you are a client and have a query in this regard, please contact Sarah Garvey on +44 20 3088 3710 or sarah.garvey@allenovery.com.

(All events in A&O office at Bishops Square unless otherwise stated)

European Account Preservation Orders (EAPOs)

Thursday 4 December 2014, 9.00 – 10.00am

Mona Vaswani, Partner – Litigation and Sarah Garvey, Counsel – Litigation

This seminar provides an update on the new legislation providing for a pan-European Freezing Order. Mona and Sarah explain the key provisions, assess the risks for commercial parties and highlight some of the practical implications for banks that will have to administer such orders. The UK Government has not opted into this Regulation but for commercial parties (especially banks) operating across Europe and with bank accounts in Member States this new legislation will be of relevance.

Registration and buffet breakfast will take place from 8.30am; the seminar commences at 9.00am.

New Recast Brussels Regulation

Thursday 11 December 2014, 12.30 – 1.30pm

Sarah Garvey, Counsel – Litigation and Karen Birch, Counsel – Litigation

The new Recast Brussels Regulation (the Recast) comes into force in January 2015. The Brussels Regulation sets out the key rules on jurisdiction and enforcement applied by Member State courts. In this seminar we explain the key changes to this important legislation.

Registration and buffet lunch will take place from 12.00pm; the seminar commences at 12.30pm.

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