ALLEN & OVERY

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# Litigation and Dispute Resolution

# *Review*

## EDITORIAL

In our first edition of 2016, we report on a number of decisions that were handed down at the end of last year. We also set out our selection of notable decisions and developments for financial institutions from 2015.

Questions of immunity seem to arise with increasing frequency, as commercial parties transact more regularly with states, international organisations and sovereign wealth funds. We report on an interesting immunity decision of Burton J in *Pearl Petroleum Co Ltd & ors v Kurdistan Regional Government of Iraq*. Burton J characterised a petroleum contract as a transaction involving the exercise of sovereign authority. The judgment contains a helpful analysis of the concept of "separate entity" for the purposes of the UK State Immunity Act, as well as a consideration of contractual immunity waiver language.

We report on two decisions in which the courts found for financial institutions. In the first case, the High Court looked again at the question of the scope of a bank's duties to its customers in the context of an interest rate swap. Moulder J dismissed a claim that the product had been missold, rejecting arguments that the bank owed any wider advisory duty (the court found the bank was only under a duty not to provide inaccurate or misleading information). Secondly, we cover an interlocutory decision in another interest rate swap misselling case, where the court refused the claimant's application for specific disclosure of similar complaints (see **Disclosure/Tort**).

Finally, we consider two decisions where the courts have grappled with jurisdictional rules concerning cross-border contribution claims (with differing results) (see **Conflicts of law**).

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# Arbitration

## ARBITRAL AWARD ENFORCED DESPITE *BONA FIDE* CHALLENGE AT THE SEAT:

*IPCO (Nigeria) Ltd v Nigerian National Petroleum Corp (No 3)* [2015] EWCA Civ 1144 & 1145, 10 November 2015

In this ground-breaking decision, the Court of Appeal agreed in principle to enforce an arbitral award subject to setting aside proceedings at the seat of the arbitration (in Nigeria) because of those proceedings suffering exceptional delay. The decision will be of particular interest to clients who are faced with arbitrations seated in jurisdictions suffering from judicial delays.

This action before the English courts stems from the efforts by IPCO (Nigeria) Limited (**IPCO**) to enforce a Nigerian arbitral award against Nigerian National Petroleum Corporation (**NNPC**). The award continues to be subject to setting aside proceedings before the Nigerian courts. Part of the challenge involves allegations of fraud.

The question before the Court of Appeal was whether the High Court judge (Field J) was right to refuse to lift a stay on enforcement that had been in place for nearly a decade. The Court of Appeal found that, due to an extraordinary delay before the Nigerian courts, the stay should be lifted subject to a determination by the High Court – for public policy reasons – of the fraud allegations raised by NNPC in Nigeria.

The underlying dispute between the parties concerns the construction of the Bonny petroleum export terminal in the Niger Delta. In October 2004, IPCO received an arbitral award in its favour of USD 152 million.[1] Soon thereafter, NNPC commenced setting aside proceedings before the Nigerian courts.

In parallel, IPCO started enforcement proceedings in England in 2004. Those proceedings were stayed in 2005 as a result of NNPC's challenge to the award in Nigeria.

In July 2007, Tomlinson J ordered partial payment of the award in light of the delays in Nigeria. Then new evidence came to light, suggesting that IPCO employees forged a number of documents relied on in the arbitration. By reference to this new evidence of fraud, NNPC applied for a stay of execution of Tomlinson J's order. This delayed enforcement further and the parties agreed to set aside parts of Tomlinson J's order and to further adjourn the enforcement of the award (the **Consent Order**). In Nigeria, NNPC applied to have the allegations of fraud included in its original motion. That application has not yet been heard by the Nigerian courts.

**High Court – No circumstances justifying re-consideration of stay and no reason to enforce the award**

In July 2012 IPCO issued a renewed application to enforce part of the award that it claimed was due on any view. Field J refused to reconsider the Consent Order because none of the changes alleged by IPCO were of sufficient significance and/or of causative relevance to the reasons for which the Consent Order had been made. Even if Field J had been persuaded that it was appropriate to re-consider lifting the stay, he would still have refused enforcement because NNPC had a good prima facie case in relation to its fraud challenge (which IPCO conceded by agreeing to the Consent Order). For IPCO to be successful, it would need to show a change of circumstances showing that the fraud allegations were hopeless and/or not bona fide. IPCO appealed.

**Court of Appeal – Enforcement consistent with the principles that underpin the New York Convention**

Christopher Clarke LJ, with whom Burnett and Sales LLJ agreed, delivered the lead judgment. He recognised that in a matter such as this the English court must, so far as possible, give effect to the principles underlying the New York Convention (the **Convention**). Those principles are intended "to foster international trade by ensuring a relatively swift enforcement of awards and a degree of insulation from the vagaries of local legal systems".[2] Considerations of judicial comity may need to give way to those principles.

His Lordship disagreed with Field J's assessment of the circumstances in which the court will re-open the exercise of its discretion. There was no need for IPCO to show that the fraud case was hopeless or not made *bona fide*. It was sufficient to show that "if the changed situation had been apparent when the original order was made, it would or might have led to a different result".[3] Changes can relate to matters such as: (i) the strength of the judicial challenge; (ii) the prospect of repayment by the award creditor (here IPCO); or (iii) delay in the proceedings. The first two types of changes were of no relevance on the facts but procedural delay had become significantly worse since the Consent Order; it became unlikely that the challenge would be resolved for another generation. In commercial terms, declining enforcement for such a period of time is absurd and "makes a mockery of the aim of the Convention".[4]

Christopher Clarke LJ lifted the stay on enforcement. However, it would be against English public policy – and therefore also impermissible under the Convention – to enforce an award potentially vitiated by fraud. In the circumstances, the enforcement was adjourned and the case sent to the High Court for a determination of the fraud allegations. In the words of Christopher Clarke LJ, the approach chosen was the only "way to cut the Gordian knot in a manner that does substantial justice to the parties".[5]

## COMMENT

While the High Court will hear the fraud allegations in full, it will not determine any of NNPC's other grounds of challenge. As a result, insofar as the non-fraud allegations are concerned, these will not prevent enforcement in England. This is the first reported judgment in which the English courts prioritised a claimant's interest in having the award enforced over the respondent's right to have the award reviewed by the courts of the seat.

The facts of the *IPCO v NNPC* case aptly demonstrate the severe impact (in both time and costs) that a protracted court challenge can have on the enforcement of an arbitral award, particularly if the party resisting enforcement resorts to delaying tactics. While the choice of the arbitral seat is an important factor in mitigating enforcement risk, that choice might be restricted, or altogether unavailable, when contracting with State-owned entities in the extractive sector. It is therefore not unusual for companies in that industry to hold awards that are subject to protracted challenges in jurisdictions where severe judicial delay is the norm. Those companies can now consider whether to follow in the footsteps of *IPCO* and seek to enforce the awards in England, provided that the respondent has assets in the jurisdiction and that the delay in the judicial challenge at the seat is sufficiently severe.

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1 The award interest was fixed at 14% per annum and the award's current value is over USD 340 million.

2 *IPCO (Nigeria) Ltd v Nigerian National Petroleum Corp (No 3)* [2015] EWCA Civ 1144, para. 170.

3 *Ibid.*, para. 86.

4 *Ibid.*, para. 167.

5 *Ibid.*, para. 185.

# Conflicts of law

## CONTRIBUTION CLAIMS: UNCERTAIN JURISDICTIONAL BASIS

*Iveco SpA & Iveco Ltd v Magna Electronics Srl* [2015] EWHC 2887 (TCC), 13 November 2015 and *XL Insurance Co SE v AXA Corporate Solutions Assurance* [2015] EWHC 3431 (Comm), 27 November 2015

An automotive component producer and an insurer have separately challenged the jurisdiction of the High Court to hear cross-border contribution claims with differing results. The analyses in the decisions highlight some uncertainty regarding the application of jurisdiction rules to these types of claims, and the inherent risk of a jurisdiction challenge being made.

**Jurisdiction under Brussels Recast**

The Brussels Recast Regulation (Regulation EU 1215/2012) governs jurisdiction over cross-border claims within the EU. Generally, a defendant must be sued in its home courts. Article 7 contains various exceptions to this rule, allowing a claim to be pursued in a member state other than that in which the defendant is domiciled in certain circumstances. Article 7(1) provides that in "matters relating to contract" a defendant may be sued in the courts of the place of performance of the "obligation in question". Article 7(2) provides that in "matters relating to tort" a defendant may be sued in the courts of the member state where the "harmful event" occurred.

These two concepts are not strictly analogous to "contract" and "tort" at English law. They have distinct meanings at European law which are similar but in certain respects wider.

***Iveco SpA & Iveco Ltd v Magna Electronics Srl* [2015] EWHC 2887**

The claimants in *Iveco v Magna*, the first (**Iveco SpA**) Italian-domiciled and the second (**Iveco Limited**) English-domiciled, respectively manufactured vehicles and distributed them in the UK. The Italian defendant had supplied to Iveco SpA under contract an electrical system which was incorporated into some vehicles during production in Italy and which was subsequently discovered to be faulty. The fault ultimately caused a number of Iveco vehicles which had been distributed by Iveco Limited in the UK to catch fire, damaging the commercial premises in which they were parked. The owners of these premises had brought the original actions and the claimants had settled them. The two claimants claimed contribution under the Civil Liability (Contribution) Act 1978 alleging that the defendant was jointly liable in tort to the original claimants. The defendant argued that the English court had no jurisdiction over the contribution claim.

The court considered whether the claimants' claims fell within either of the tort or contract exceptions. The court ultimately held that the defendant could be sued in England, but only by the English distributor, Iveco Limited. The Italian claimant, Iveco SpA, could only bring its contribution claim in Italy.

***Did the claimants' claims relate to a contract?***

The defendant said that the contribution claim was one "relating to a contract" (ie the contract between it and Iveco SpA) and so could only be pursued in the courts of the place of performance of that contract or the place of domicile of the defendant, both of which were Italy.

Edwards-Stuart J held that Article 7(1) will only operate where there is "a contract between the claimant and the defendant, or a situation very close to it". For Iveco Limited, this was not the case. Despite the obvious commercial connections between all three parties, Iveco Limited's claim was not a "matter relating to a contract"

as there was no contract between Iveco Limited (a distributor) and the defendant component supplier. While there was a contract for the supply of vehicles between the two claimants, this contract was not the basis for Iveco Limited's claim.

As the defendant had supplied the faulty components under contract to Iveco SpA, the claim by Iveco SpA against the defendant was a "matter relating to a contract" and the place of performance was Italy so any claim by Inveco SpA in relation to the contract would have to be brought in the Italian courts. The court only made passing reference to the contract in question and it is unclear what jurisdiction provisions it might have contained, if any.

**Tort**

Could Article 7(2), the tort exception, apply? It was common ground that "the place where the harmful event occurred" under Article 7(2) could be either the place where the event giving rise to the damage occurred or the place where the damage actually occurred. The defendant argued that the damage occurred when the faulty component was fitted to the vehicles during production in Italy, the fires in England being indirect or consequential damage. The court disagreed, holding that, where a faulty component is incorporated into a product, no tort is committed by the supplier of the component unless and until that component causes damage. Thus, the "place where the harmful event occurred" was the place where liability arose: England. Iveco Limited could therefore choose to pursue its claim in either England or Italy the domicile of the defendant. As for Iveco SpA, its claim did not relate to tort. Instead, for the reasons set out above, it related to a contract. As such, Iveco SpA could not rely on this exception.

***XL Insurance Co SE v AXA Corporate Solutions Assurance* [2015] EWHC 3431**

In this case the claimant (English-domiciled) and defendant (French) were co-insurers of a U.S. train operator which had settled multiple actions arising out of a crash by paying into a victims' fund. AXA (the defendant) had refused to pay into the fund on the basis that the wording of its policy relieved it of liability. The claimant (XL Insurance) alleged that it had paid more than its fair share and claimed contribution from the defendant in the English court. The defendant challenged jurisdiction.

Waksman J in the Commercial Court considered whether or not the claimant could rely on either the Article 7(1) contract exception or the Article 7(2) tort exception. There was no doubt that, broadly speaking, the matter related in some fashion to a contract, or as the court pointed out, two contracts: the insurance policies.

**Contribution claim not a matter relating to contract**

The court held that the contribution claim was not a "matter relating to contract" for the purpose of Article 7(1). The claimant was seeking an equitable contribution, a right which arises by operation of law (not contract) when a co-insurer pays out more than its share. Waksman J expressly rejected the Advocate General's opinion (which has yet to be confirmed by the ECJ) in *Ergo Insurance v P & C Insurance* Cases C-359 and 475/14 which held that a claim for equitable contribution between insurers falls within Article 7(1).

**Not a tortious claim either**

On the issue of Article 7(2), the court found that while there had been tortious behaviour on the part of the original defendant, the train operator, no such behaviour could be attributed to AXA, its insurer. Again, XL's claim was one for contribution, and its right to contribution arose by operation of law. The tortious behaviour in question had not given rise to the current claim. The court held that Article 7(2) had not been engaged, and therefore the defendant could only be sued in France, its country of domicile.

## COMMENT

The cases highlight some difficult jurisdictional issues in cross-border contribution claims. The result in *Iveco v Magna* means that the defendant stands to face virtually identical claims for contribution in both the Italian and English courts, unless it were to decide to submit to the jurisdiction of the English court for claims by both claimants.

Drawing settled points of law from these judgments is not easy. Amongst his conclusions in *XL v AXA*

Waksman J made the observation that while most claims will fall within either Article 7(1) or 7(2), not all will. While these two judgments provide helpful statements of the law in the area, whether one of the Article 7 exceptions applies to any particular contribution claim is likely to be difficult to determine in practice particularly given the contradictory Advocate General's opinion in *Ergo Insurance*. For the moment, pursuing a cross-border contribution claim in the English courts carries the risk of jurisdiction being successfully challenged.

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# Disclosure

## ALLEGED SWAPS MISSELLING: SPECIFIC DISCLOSURE OF SIMILAR COMPLAINTS REFUSED

*Claverton Holdings Ltd v Barclays Bank plc* [2015] EWHC 3603 (Comm), 17 November 2015

In an interest rate swap misselling claim, the claimant (Claverton) was refused specific disclosure of similar complaints which had led to admissions by the bank and findings by the Financial Conduct Authority (FCA) or the Financial Ombudsman Service (FOS). Any findings would not have been relevant, admissible or legally binding and it would have been disproportionate and oppressive to require the bank to undertake the search and disclosure exercise.

Claverton alleges that two former bank employees (the **Employees**) made numerous misrepresentations and, having assumed a duty to advise Claverton, provided negligent advice and recommendations about an interest rate swap and its suitability for Claverton's needs. Claverton seeks rescission of the swap and restitution of all monies paid under its terms or, alternatively, damages. The matter is scheduled for a five-day trial in June 2016. The bank denies all claims.

**Claverton applies for specific disclosure**

Claverton applied for specific disclosure of documents relating to other allegations involving the Employees regarding the misselling of swaps, including complaints to the FCA and the FOS, court proceedings and disciplinary processes.

Claverton contended that:

- the bank had been obliged to offer redress in almost 3,000 cases and that it could be inferred that some of these would relate to the Employees; and
- disclosure should be ordered on the basis that it would give rise to similar factual evidence, and oral statements made in other misselling claims could be used to support Claverton's claims.

At the hearing, Claverton limited its application to similar complaints that had led to admissions by the bank, or findings of fact by the FCA or the FOS.

**Test for similar factual evidence**

A party seeking disclosure of similar factual evidence faces a two-fold test:[1]

(i) Is the evidence relevant and probative (ie legally admissible)?

(ii) If it is legally admissible, are there good grounds why the Court should decline to admit it as a matter of discretion under its case management powers?

**Decision**

Phillips J dismissed the application and considered that Claverton did not meet either test.

The mere fact of other complaints was not probative of the alleged misselling in the instant case: the facts of each case would be different and the issues of breach, duty, reliance and causation would require specific determination. Phillips J did not accept the argument that Gloster J's approach in *JP Morgan Chase Bank v Springwell Navigation Corporation* [2005] EWHC 383 (Comm) was wrong and/or in any event pre-dated the flood of complaints in relation to derivative products from 2008 onwards and the general recognition that there had been systematic misselling of such products to unsophisticated customers (in that case Gloster J had struck out pleaded allegations that a bank official, engaged in selling a financial product to a defendant, had made similar statements to other shipping customers at the bank in a similar position). Furthermore, because Claverton did not intend to adduce evidence of similar facts but merely evidence that similar allegations had been made, to the extent that such evidence amounted to hearsay evidence of the underlying facts alleged, it would be of little, if any, relevance and probative value.

Phillips J considered that it was highly likely that any settlements entered into by the bank with interest rate swap customers would have been made without admission of liability, let alone an admission of specific factual allegations underlying any claim. Further, any determination by the FOS would not contain legally binding findings of fact. Findings of the Court, on the other hand, if there were any, would be readily accessible in any event.

Phillips J noted that to the extent that Claverton was permitted to adduce evidence of admissions or findings of the FOS, it would remain open to the bank to adduce its own evidence to contradict or distinguish them from the instant claim meaning that the trial would be derailed by satellite litigation.

Phillips J considered that the application had become a fishing expedition that would involve the bank having to analyse a large number of cases to determine what allegations had been made and whether those allegations were "similar" to the allegations in this case, and, further, the extent to which they had been admitted or the subject of a "finding". Phillips J held that such an exercise was wholly disproportionate in the context of the claim.

## COMMENT

Interest rate swap misselling claims continue to be bought, but this case provides useful authority for financial institutions seeking to resist onerous requests for specific disclosure of similar customer complaints, sometimes used as a tactic to strengthen a claim or embarrass an institution into settlement.

Phillips J dismissed the application and considered that Claverton did not meet either test. The case highlights that claimants are likely to face an uphill battle bringing specific disclosure applications for similar complaints in the misselling context. Claimants will need to know exactly what documents are being sought, why they are required, and to consider the difficulties posed by the two-fold test in *O'Brien v Chief Constable of South Wales Police*.

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[1] *O'Brien v Chief Constable of South Wales Police* [2005] UKHL 26.

# Enforcement

## ENFORCEMENT OF MORTGAGE CHARGE: VALID DEFENCE WAS TOO LATE

*Dickinson & anr v UK Acorn Finance Ltd* [2015] EWCA Civ 1194, 25 November 2015

Failing to assert diligently a defence to enforcement of a charge over property may preclude a borrower from relying on that defence. The Court of Appeal decided that a borrower, under a loan that was arguably unenforceable under the *Financial Services and Markets Act 2000* (the **Act**), could not rely on that unenforceability to resist repossession of the charged property. This was because reliance on the Act, more than two years after possession proceedings had started, was an abuse of process.

In November 2010, the defendant, UK Acorn Finance Limited (**Acorn**), lent GBP 630,000 to the Dickinsons. The loan was secured by a legal charge over property, with the loan and interest due to be repaid after six months. The Dickinsons failed to repay, so Acorn issued mortgage possession proceedings in September 2011. After an initial (but conditional) possession order was made permitting Acorn to repossess the mortgaged property, the Dickinsons challenged its right to do so on the basis, among others, that a sub-charge precluded the exercise of Acorn's rights. This challenge failed, so a warrant was issued and an eviction appointment made.

It was not until 29 October 2013 that the Dickinsons commenced proceedings, arguing that the mortgage was unenforceable under s26 of the Act. Section 26 and related provisions render unenforceable an agreement made in the course of carrying on certain "regulated activity" in contravention of the prohibition on carrying out a regulated activity unless the person is an "authorised person" (ss19 and 26).

The Dickinsons argued that the loan was unenforceable under the Act because Acorn was not authorised to offer a mortgage of this type. In dispute was whether the mortgage was a "regulated mortgage contract" (which depended on the percentage of the land used in connection with a dwelling).

In its defence, Acorn relied on (i) cause of action estoppel, (ii) issue estoppel, and (iii) abuse of process. The challenge in respect of estoppel failed, but both at first instance and in the Court of Appeal Acorn's challenge on the basis of abuse of process succeeded.

**Estoppel unavailable to defeat statutory protection**

Acorn argued that the borrowers were estopped from relying on s26 on the basis of a cause of action estoppel, or issue estoppel, in view of the procedural history of the matter. The Court of Appeal referred to *Kok Hoong v Leong Cheong Mines Ltd* [1964] AC 993, where the Privy Council expressed the view that, sometimes, public interest legislation must be given effect, so that an estoppel (being a rule of evidence rather than a substantive right) cannot be asserted against it. The Court of Appeal concluded that cause of action estoppel and issue estoppel cannot be used to defeat statutory provisions designed to protect vulnerable categories of person (such as consumers), or protect others who engage with such persons. Therefore, as s26 is consumer protection legislation, Acorn could not rely on an estoppel.

**Abuse of process available**

Acorn relied on the abuse of process principle in *Henderson v Henderson* (1843) 3 Hare 100: "… that a litigant should in general bring forward all his claims in one proceeding, rather than successively, otherwise a defendant will be doubly harassed by the litigation".

Acorn argued that the Dickinsons' reliance on s26 was an abuse of process because it was raised too late, and should have been made much earlier.

In deciding whether the Dickinsons' application was an abuse of process, Longmore LJ drew a distinction between a statutory provision that completely prohibits enforcement and a "nuanced" prohibition:

- An abuse of process argument cannot be used to defeat a blanket prohibition, because the effect would be to enforce an otherwise unenforceable agreement.
- An abuse of process argument could be used to defeat a "nuanced prohibition", which allows enforcement, but only in certain circumstances.

His Lordship noted that the s26 prohibition falls into the latter category of being a "nuanced" prohibition. This is because s28 of the Act permits enforcement of agreements that are otherwise rendered unenforceable by s26 of the Act in certain circumstances (including, for example, where the court is satisfied it is just and equitable).

Even if the agreement were held to be unenforceable, the Dickinsons would be required to repay the sum advanced anyway (s28 (7) of the Act requires that a person who receives money paid under an unenforceable agreement must repay it). Allowing Acorn's abuse of process application was thus not defeating a blanket prohibition on enforcement.

The Court of Appeal agreed that the Dickinsons' application was an abuse of process, so Acorn could proceed with the repossession.

## COMMENT

If a borrower relies on a statutory defence which, on public policy grounds, prohibits the enforcement of certain loan agreements, it is unlikely that it will be estopped from asserting that defence late in the proceedings. However, raising the statutory defence late in the proceedings may be an abuse of process where the defence is not a blanket bar to enforcement.

Conversely, a borrower will be entitled to assert valid statutory defences where the relevant defence imposes an absolute ban on enforcement of the underlying contract. This is consistent with the public policy underlying statutes of that type, but may mean that recalcitrant borrowers can refrain from asserting their "best" defences until a late stage as a delaying tactic.

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# Immunity

## KURDISTAN REGIONAL GOVERNMENT'S SOVEREIGN IMMUNITY PLEA FAILS IN ENGLISH COURT

*Pearl Petroleum Co Ltd & ors v Kurdistan Regional Government of Iraq* [2015] EWHC 3361 (Comm), 20 November 2015

The English High Court rejected immunity claims asserted by the Kurdistan Regional Government of Iraq (**KRG**) in the context of a dispute relating to a petroleum contract. It ordered KRG to comply with a peremptory order which an LCIA arbitral tribunal had issued after KRG had failed to comply with an earlier interim payment order. The judgment expressly characterises a petroleum contract as a transaction involving the exercise of sovereign authority within the meaning of the UK State Immunity Act 1978. It also contains an interesting analysis of the immunity waiver language in the petroleum contract. Finally, it is a good illustration of one way in which a party can seek to enforce interim relief ordered by an arbitral tribunal against a non compliant counterparty.

**Background**

In 2007, the claimants and the Kurdistan Regional Government of Iraq (**KRG**) entered into a contract (**Contract**) under which the claimants would exclusively exploit two gas fields in KRG for at least 25 years. A dispute arose in 2009, with KRG contesting the extent of the claimants' rights over the two gas fields and with the claimants alleging that KRG was underpaying for the hydrocarbons that they were producing.

In 2013, the claimants started an LCIA arbitration in England under the Contract. In response, KRG stopped paying the claimants altogether, although it still took hydrocarbons. KRG's failure to pay apparently threatened the solvency of one of the claimants. The claimants therefore applied, successfully, to the LCIA tribunal for interim relief. The tribunal ordered KRG to make payments to the claimants, on a provisional basis, at the prices that KRG had been paying before the dispute arose. The tribunal considered this order necessary to maintain the status quo because there was an "appreciable risk that Dana [ie, one of the three claimants] will become insolvent or at any rate suffer unnecessary loss through distressed sale of assets if payments are not resumed before the award".

KRG ignored the tribunal's order, so the claimants applied for, and obtained, a "peremptory order" under s41 of the Arbitration Act 1996 (**AA**) ordering KRG to pay to the claimants the sum of USD 100 million within 30 days. A peremptory order is an order that a tribunal may make when a party fails to comply with any tribunal order without showing sufficient cause. KRG also failed to comply with the peremptory order.

Under s42 AA, a party to an arbitration in England can apply to the English court for an order requiring a party to comply with a peremptory order, where either: (i) the parties agree (unlikely); or (ii) (more likely) with the tribunal's permission. The advantage of this route is that non-compliance with a court order opens up the prospect of sanctions for contempt of court.

**KRG's sovereign immunity plea under the State Immunity Act 1978 (SIA)**

KRG raised several defences to the claimants' s42 AA application. This article focuses on KRG's immunity defences. The court's analysis of these defences was complex, but three aspects in particular are of interest.

***Oil and gas contract is exercise of sovereign authority***

A first issue was whether the Contract was an exercise of sovereign authority, as opposed to a commercial

transaction. This issue was relevant in this case because (as explained below) KRG could only claim immunity as a "separate entity" of the Federal Republic of Iraq (**FRI**) if (among other things) it was exercising the sovereign authority of a State. The distinction is also relevant more generally because, under s3 SIA, a State is not immune in proceedings relating to a commercial transaction.

Previously, there was no decisive authority on this question under English law, although the Court of Appeal in *Svenska Petroleum Exploration AB v Government of the Republic of Lithuania (No 2)* [2005] EWHC 2437 (Comm) had suggested that a contract to exploit oil reserves in a State was likely to involve an exercise of sovereign authority. Burton J concluded that the Contract was entered into in the exercise of sovereign authority. Under the Iraqi Constitution, oil and gas resources are a sovereign asset, so a contract for their exploitation had to be a sovereign act.

***Whether KRG was exercising the sovereign authority of the Iraqi State***

KRG is not a State. It was common ground between the parties that it is a constituent region of FRI and therefore not a "separate entity" under s14 SIA. Whereas a State is automatically entitled to any immunities available under the SIA (subject to their exceptions), a "separate entity" is only entitled to immunity if (among other requirements) "the proceedings relate to anything done by it in the exercise of sovereign authority".

Although Burton J had held that the Contract was an exercise of sovereign authority, he held that immunity was only available to KRG under s14 SIA if KRG was exercising the sovereign authority of FRI. Based on an analysis of the Iraqi Constitution, he held that KRG was exercising its own sovereign authority (ie sovereign authority of KRG, the constituent region of FRI) rather than that of FRI itself. Burton J noted that it was common ground between the parties that there had been a dispute between FRI and KRG "as to who is entitled to control of Kurdistan's oil and gas resources". The judge appeared to have reasoned that, because FRI disputed KRG's authority to control KRG's oil and gas resources, KRG could not have acted in the exercise of FRI's sovereign authority. On this basis, the Court concluded that KRG did not enjoy the immunity protection under s14(2) SIA.

**KRG's waiver of immunity**

The Contract contained a short-form waiver of immunity clause as follows: "The KRG waives on its own behalf and that of [FRI] any claim to immunity for itself and assets". KRG argued that: (i) the interim payment order was in substance a mandatory injunction; and (ii) the clause did not waive its right to immunity from injunctive relief under s13(2)(a) SIA ("relief shall not be given against a State by way of injunction or order for specific performance or for the recovery of land or other property" – unless the State waives its immunity under s13(3)).

Contract drafters will be aware that immunity waiver clauses are construed strictly. We would not recommend the short-form language seen in this case. Nevertheless, Burton J held that, even if the interim payment order were regarded as a form of injunction, the waiver clause would be effective. He held that any waiver of immunity from suit should be sufficient to amount to a waiver of immunity from injunctive relief, and that the clause was sufficient to amount to waiver of immunity from suit. He was not concerned by the absence of a specific waiver in respect of injunctive relief. In any event, the issue did not strictly arise because, he held, the interim payment order was not a form of injunctive relief.

## COMMENT

This judgment dealt with the unusual relationship between KRG and FRI. Nevertheless, aspects of the sovereign immunity analysis are of broader interest to those contracting with sovereigns, states, territorial subdivisions of a state and/or state-owned entities. In particular:

- The judgment expressly characterises a petroleum contract as a transaction involving the exercise of sovereign authority within the meaning of the SIA.
- Any plea for immunity by a territorial subdivision of a state will be harder following this judgment, as a result of the judge's ruling that a separate entity can only assert immunity if it is exercising the

sovereign authority of the State (as opposed to any sovereign authority of the separate entity).

- While immunity waiver clauses should be drafted comprehensively, this judgment shows that the courts may be willing to construe them pragmatically if it is clear that, even in the absence of comprehensive waiver language, a general waiver of sovereign immunity is intended.

The decision is also a useful reminder of one approach that a party can take when the other side in arbitration fails to comply with a tribunal order. If a peremptory order of an arbitral tribunal is enforced by the English courts under s42 AA, non-compliance becomes a contempt of court rather than merely a failure to comply with a tribunal's order. This could bring significant pressure to bear on a recalcitrant party and increase the likelihood of compliance with the order.

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# Insolvency

## CLIENT MONEY AND POOR RECORDS: GUIDANCE FOR ADMINISTRATORS

*Allanfield Property Insurance Services Ltd & ors v Aviva Insurance Ltd & anr* [2015] EWHC 3721 (CH), 17 December 201

How to identify and distribute client money is a vexed question for insolvency practitioners, especially where a company's records are incomplete. Against the background of recent decisions in the administrations of Lehman Brothers International (Europe), MF Global UK Ltd, and Worldspread Ltd, this case provides further reassurance that, when administrators are faced with complex arrangements involving trust property and imperfect information, the English court will offer practical solutions.

The judgment does, however, also contain a strong warning from the court that the officeholders are expected to carry out their work efficiently and proportionately if they are to be paid in full. If they are in any doubt they should seek guidance from the court at an early stage.

**Introduction**

Administrators of two insurance intermediaries, Allanfield Property Insurance Services Ltd (**APIS**) and Industrial & Commercial Property Insurance Consultants Ltd (**ICP**), applied to the court for directions on how to distribute money held in certain client accounts. The money represented insurance premiums received but not yet passed on to insurers or other intermediaries but neither company kept proper records of the entitlement to the money in its client accounts.

**Jurisdiction**

His Honour Judge Keyser QC held that the court had jurisdiction to give directions to the administrators under paragraph 63 of Schedule B1 to the Insolvency Act

1986, even though the funds did not belong to the companies in administration but rather were trust monies which sat outside the estates. This applied even where the gaps in the administrators' knowledge meant that the proposed distributions might involve a breach of trust on the basis that the court has an inherent equitable jurisdiction to supervise and administer trusts.

**Application of CASS 5**

Chapter 5 of the FCA's Client Asset Sourcebook (**CASS 5**) lays down rules, pursuant to the Financial Services and Markets Act 2000 (and implementing Article 4.4 of the Insurance Mediation Directive (2002/92/EC)), as to how regulated insurance intermediaries should receive or hold money for a client. This includes premiums received from customers that are to be passed on to an insurer and funds received from an insurer that are to be distributed to a policyholder. The rules provide for two main mechanisms to protect policyholders: either for the intermediary to act as agent of the insurer such that the risk of the intermediary's default is transferred to the insurer; or for such money to be treated as "client money" in which case it must be segregated from the intermediary's assets and held on statutory trust. In this case the court gave directions as to how the administrators should apply CASS 5 to the companies' client accounts despite the lack of information available.

The administrators were directed to proceed on the basis that:

- The client accounts were subject to a statutory trust under CASS 5.3.2R and the money in each account had been pooled following each company's administration.
- No deductions from the client accounts should be made by the companies' estates for amounts not within the statutory trusts, ie (i) remittances that had a non-client-money element, (ii) commissions or payments due to the companies, (iii) interest, (iii) a payment made from APIS' office account, and/or (iv) premiums received as agent for the insurer where no risk-transfer agreement was in place (and hence the insurer has no claim to it). Since the accounts were now in shortfall, no deductions would have been possible under rule CASS 5.5.63R and none should be possible after insolvency.
- All clients whose money had been received on the statutory trust should be eligible for distribution and not just those whose specific contributions could now be identified (following *Lehman Brothers International (Europe) (in administration) v CRC Credit Fund Ltd* [2012] UKSC 6, which considered the substantially similar provisions in CASS 7).
- Where business was conducted on risk-transfer terms (ie the intermediary acted as the insurer's agent and insurance was effective from when the payment was received by the intermediary) the policyholder has no entitlement to the client money unless there is reason to believe that the relevant insurer had failed to put the insurance in place.
- Where the insurer may have gratuitously provided insurance cover (where it could otherwise have withdrawn cover or required payment from the policyholder) this should not prevent the policyholder from having a claim against the trust.
- For non-risk-transfer transactions the administrators should proceed on the basis that claims were for the benefit of the policyholder and not any intermediary (although if this was disputed the administrators should determine the issue, subject to an appeal to the court).
- When calculating the amount of a claim, the administrators should not deduct any commission relating to a premium being claimed back by a policyholder client. However, they should deduct commission relating to a premium that was to be forwarded to an insurer, provided that it had become contractually due to the intermediary company.

The court declined to direct that all claims by other intermediaries for commissions or fees should fail on the basis that only one such claim currently existed and it could be determined at reasonable cost.

**Scheme for distribution**

The court sanctioned the proposed schemes to distribute the funds held on the statutory trusts based on the schemes that were approved in *Re MF Global UK Ltd*

*(No 3)* [2013] EWHC 1655 (Ch), [2013] 1 WLR 3874 and *Re Worldspread Ltd* [2015] EWHC 1719 (Ch). Under the sanctioned schemes claimants will be required to submit claims by a bar date; the administrators will then accept or reject these claims, subject to a right of appeal to the court. Any surplus will then be available to the creditors of the companies (rather than being retained in case further beneficiaries of the trust come forward).

In order to elicit claims for the APIS trust, HHJ Keyser considered that an advertisement in the London Gazette and a national newspaper modelled on s27(1) of the Trustee Act 1925 would be sufficient. This was in light of the tiny number of claims received following a previous mailshot and the fact that most of the company's business was conducted on risk-transfer terms. The situation as regards ICP was simpler as the administrators had sufficient records to allow a preliminary calculation of entitlement and the notification of interested parties.

**Remuneration**

The administrators also requested that the court sanction the payment out of the statutory trusts of their costs of investigating, seeking the court's directions, and implementing the scheme for distributing the trust money. The court agreed that administrators can, in principle, recover their costs from trust monies on the basis that these are "costs properly attributable to the distribution of client money" and so recoverable under CASS 5.3.2R(4) (or alternatively under the court's general equitable jurisdiction following *In re Berkeley Applegate (Investment Consultants) Ltd* [1989] 1 Ch. 32).

However, HHJ Keyser was concerned by the amounts claimed by the administrators in this case, which already amounted to over 57% of the value of the trusts. He noted that officeholders should "devise at the outset a strategy for carrying out the work efficiently and with regard to the size of the trust fund so that expenditure is planned and controlled. Although an early application to the Court for directions is not itself a condition of the recovery of costs and disbursements, without such an application the office-holders run the risk that the work they have done will be regarded as unreasonable or disproportionate and of being unremunerated for significant parts of it". The issue of how much the administrators should recover was referred to the Registrar of the Companies Court for determination.

**Tracing**

Two unexplained payments (totalling GBP 370,000) had been made from the APIS client account to the ICP client account shortly before the administration commenced in December 2012. The administrators suspected that these payments may have been made in breach of trust, giving rise to a tracing claim by the APIS trust.

HHJ Keyser agreed that in principle there was no reason that one statutory trust could not trace into another. Although it had been held in *Lehman Brothers* that statutory trusts under the Client Asset Sourcebook had to be understood in terms of their regulatory scheme, this did not mean that the usual tools of equity were not available where they did not contradict the statutory scheme.

The administrators proposed a mechanism to settle whether there had in fact been a breach of trust and whether a tracing claim was available. The proposal was that one of the administrators should be authorised to act on behalf of each of the trusts. They would seek, with separate legal advice, to negotiate a settlement. The court ultimately agreed with this suggestion, subject to a cap on the administrators' costs.

## COMMENT

This case shows that the court is prepared to accept jurisdiction and give directions to assist administrators, even where the assets do not strictly form part of the insolvent estates. Administrators and creditors should be comforted that the court will allow a commercial approach to be taken when practical difficulties make a strict application of the client money rules impossible, provided that the interests of customers are adequately protected.

Insolvency practitioners, particularly when managing relatively small estates, should take heed of the costs advice. This may be difficult for officeholders who encounter a complex fact pattern and gaps in the company's documentation. They will be conscious that

applying to court is an expensive exercise in itself and that the court is likely to want the officeholders to have a reasonable grasp of the task required and the likely associated costs, before sanctioning a particular course of action. Nevertheless the message to officeholders here appears to be: if in doubt, err on the side of seeking directions sooner rather than later if you want to maximise your chances of getting paid.

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# Insurance/Limitation

## FRAUD CLAIMS NOT COVERED BY STANDSTILL AGREEMENT

*Hyundai Marine & Fire Insurance & anr v Houlder Insurance Services & anr* [2015] EWHC 378 (Comm), 27 January 2015

A standstill agreement that postponed claims that a party "has or may have against the other" did not cover fraud claims. The old epithet "fraud unravels all", although too general and inexact a phrase to be taken simply at face value, applied. The standstill agreement, between joint defendants, was reached against a known background of negligence. The second defendant's fraud was not known to the first defendant. The fraud claim was allowed to proceed.

The claimants brought negligence claims against the defendant brokers for the placing of reinsurance which turned out to be invalid. The defendants signed a standstill agreement, agreeing not to sue each other pending the conclusion of the proceedings brought by the claimants. When the standstill agreement was signed, the first defendant was not aware of an apparent fraud by the second defendant. The fraud involved falsifying documents in order to deceive the reinsured and reinsurer about the terms that each were prepared to agree. This fraud allowed the second defendant to benefit from a larger commission. Having discovered the apparent fraud, the first defendant sought to bring a claim against the second defendant. The issue was whether this should be permitted in light of the terms of the standstill agreement.

**Standstill agreement terms – wide definition of "claims"**

Under the terms of the standstill agreement, the defendants each agreed not to bring claims against the other pending the completion of the litigation brought against them by the claimants. "Claims" was defined as any alleged claims, rights or causes of actions that either party has or may have against the other either now existing or accruing before the date of termination of the standstill period. This wording, the judge, Cooke J, considered was undoubtedly wide.

The standstill agreement prevented the parties from raising any limitation defences in respect of any dispute between them. The terminology used for this differed, and applied to any such defences "whether known or

unknown" (as opposed to claims that a party "has or may have"). One issue that arose for consideration was whether the different wording had any bearing on the analysis.

The standstill agreement incorporated an "entire agreement" clause which precluded the parties from any rights or remedies other than as expressly set out in the agreement. That clause was expressed as not limiting or excluding any liability for fraud. It was accepted that the effect of this clause was to render the standstill agreement voidable in the event of fraud. Whether it had in fact been voided was in dispute.

**Approach to construction**

In deciding whether claims for unknown fraud were covered by the standstill agreement, Cooke J noted that it was clear from all the authorities that the court must approach the agreement with caution. Was the type of claim the first defendant sought to bring covered by the wide definition of claims?

The court rejected an argument that the absence of the wording "known or unknown" from the definition of claims meant that only known claims were covered. This interpretation would exclude unknown claims, including unknown fraud claims, from the type of claims covered by the standstill agreement. However, Cooke J considered that the definition of an existing claim that a party "may have" could encompass unknown claims as well as known ones.

Cooke J thought it was clear that, if the parties had been asked whether fraud claims could fall within the terms of the standstill agreement, then neither party would have said yes. On its proper construction, therefore, the agreement had no application to fraud claims. The old epithet, "fraud unravels all" is too general and inexact a phrase to be taken simply at face value. However it was of application in construing an agreement where at the time of entering into it, the parties had in mind the negligence claims being brought against them, not claims of fraud by one broker on another, or by one broker on the reinsured or the reinsurer. Another relevant factor was that, as the standstill agreement was expressly stated to be voidable if induced by fraud, it was highly unlikely that it was intended to encompass fraud claims.

Although the question of whether the standstill agreement was valid was not a matter before the court, it was relevant that its validity was in dispute. This factor appears to have impacted on the court's approach in terms of the considerations to be taken into account in deciding whether or not to give permission to bring an additional claim. These were the same questions of discretion that the court would take into account if one party had been seeking an injunction or specific performance. Such questions included: what justice required, whether damages were an adequate remedy, and whether, in the context of any injunction sought to restrain a claim brought against it, the second defendant had clean hands.

The court found that justice and proper case management required all claims to be heard together, as between the claimants and between the two defendants. This would limit costs, avoid extra litigation, and avoid the possibility of inconsistent judgments. On the other hand, there would be no prejudice to the first defendant if the second defendant's claim against it was pursued sooner rather than later.

## COMMENT

It has long been established that, in the absence of clear language, the court will be slow to infer that a party intended to surrender rights and claims of which it was unaware and could not have been aware. The same principle has, more recently, been confirmed to apply to fraud-based claims in the context of settlement agreements (S*atyam Computer Services Ltd v Upaid Systems Ltd* [2008] EWCA Civ 487).

In this case it was not a matter of settling or compromising a claim, merely postponing its pursuit under the terms of a standstill agreement. Cooke J, following the approach in *Satyam*, took as his starting point the question of whether the type of claim that it was proposed to bring was one that fell within the wide definition of claims in the settlement agreement. The resulting determination, that neither party would have intended the agreement to extend to unknown fraud

claims, is perhaps no surprise. In reaching that conclusion, two key factors were taken into consideration: the fact that the backdrop to the standstill agreement was the negligence claims being brought against the co-defendant brokers which did not include any suggestion of fraud; and the fact that the standstill agreement itself was voidable if induced by fraud.

Perhaps more contentious is the finding that, even if the allegations of fraud against the first defendant were not correct, the first defendant would suffer no prejudice if the second defendant were allowed to pursue its claim against it prior to the expiry of the agreed standstill period. It might be argued that allowing one defendant to pursue a claim against the other would in fact cause prejudice in that it would serve to undermine the united front against the claimants that the standstill agreement was intended to create, particularly if that claim was not ultimately substantiated.

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# Tort

## "A CASE BASED ON HINDSIGHT" – MISSELLING CLAIM REJECTED

*Thornbridge Ltd v Barclays Bank plc* [2015] EWHC 3430 (QB), 27 November 2015

The High Court has rejected an interest rate swap misselling claim for losses allegedly arising as a result of the defendant bank having acted negligently, in breach of contract or in breach of statutory duty. The court held that the bank had not assumed an advisory duty; it was only under a duty not to provide inaccurate or misleading information. In light of the historically low interest rates since the 2008 financial crisis, this case was considered to be a "case based on hindsight". The judge doubted whether the ruling in *Crestsign v Royal Bank of Scotland* [2014] EWHC 3043 (Ch) was correct, finding instead that "a salesman has no obligation to explain fully the products which it is trying to sell".

In May 2008 the claimant, Thornbridge Limited (a property investment business run by Mr and Mrs Harrison), entered into an interest rate swap with the defendant, Barclays Bank, to hedge its interest rate exposure on a real estate financing, worth GBP 5.7 million. The loan was for 15 years, with interest under the loan agreement accruing at a floating rate calculated by reference to Barclays' base rate plus a margin of 1.5%, payable quarterly. It was a condition of the loan that the claimant enter into an interest rate hedge for at least five years. The claimant therefore entered into a five-year interest rate swap with the defendant, under which the claimant paid a fixed rate of 5.65% and received from the defendant a floating rate calculated by reference to the base rate.

Following the 2008 financial crisis, interest rates fell to historically low levels and as a result the swap proved to be expensive for the claimant. The claimant subsequently requested a restructuring of the swap but was quoted breakage costs of GBP 565,000. The claimant did not want to pay the breakage costs and the swap continued to maturity.

The claimant issued proceedings against the defendant, claiming damages for losses arising as a result of the defendant allegedly having acted negligently, in breach of contract or in breach of statutory duty in respect of

information given and advice provided when the swap was sold to the claimant.

**Did the defendant assume an advisory role?**

Moulder J noted that a bank does not generally owe a duty of care to advise on the merits of transactions but if they undertake to do so they owe a duty to advise with reasonable skill and care (*Hedley Byrne v Heller* [1964] AC 465).

The judge considered telephone conversations and email exchanges between the parties, and concluded that the defendant had not assumed an advisory role on the facts of this case:

- The personnel with whom the claimant liaised at the bank were salespeople, not advisers, notwithstanding the fact that they worked in "Corporate Risk Advisory". They were very familiar with the distinction between execution only and advised transactions.
- The defendant had not received a fee for advice – a relevant factor in finding a non-advisory relationship.
- The defendant had provided information and made predictions in relation to the swap, but had not crossed the line from sales to advice.
- It was clear from the exchanges between the parties that the claimant had understood the interest rate hedging options that he was being offered by the defendant.
- Even if advice had been given in these communications, the giving of advice is not sufficient to establish a duty of care. Applying the dicta of Gloster J in *JP Morgan Chase Bank v Springwell Navigation Corporation* [2008] EWHC 1186 (Comm), the salesperson had not gone beyond the "normal recommendations…given in the daily interactions between an institutions sales force and a purchaser of its products".
- The defendant classified the claimant as a "retail client" and notified the claimant of such by a letter, which enclosed a copy of the defendant's terms of business. Although clause 3 of those terms stated that the defendant "may from time to time provide you with advice", this did not amount to a notification that the defendant was advising the claimant in relation to this specific transaction.

**Contractual estoppel**

The terms of the swap were contained in a written confirmation which incorporated the 1992 ISDA Master Agreement. The confirmation contained a mutual representation stating that each party "is not relying on any communication (written or oral) of the other party as investment advice or as a recommendation to enter into the Transaction…". The judge considered the effect of the clause and held that it created a contractual estoppel, such that even if the defendant had assumed an advisory role on the facts, the claimant would be contractually estopped from arguing that the defendant had assumed an advisory relationship (relying on the judgment of Gloster J in *Springwell*).

**Basis clause or exclusion clause?**

The judge also considered that the clause was a basis clause rather than an exclusion clause. The judge stated that the test for whether the clause was a basis clause or an exclusion clause is not whether the clause attempts to rewrite history, but rather as a matter of construction whether the terms defined the basis upon which the parties were transacting business (ie a basis clause), or whether they were clauses inserted as a means of evading liability (ie an exclusion clause). The judge held that in this case it was the former. Nothing turned on the fact that the confirmation was not received back from the claimant until some months after the deal was entered into.

As the clause was held to be a basis clause, it was not subject to the reasonableness test under Unfair Contract Terms Act 1977 (**UCTA**). However, even if it had been an exclusion clause (and therefore subject to UCTA 1977), the judge held that it would have been reasonable.

**FSA rules: claims in contract and for a breach of statutory duty**

The claimant also argued that the defendant was in breach of contract for failing to comply with the FSA rules (as applied at the time). The claimant asserted that such rules were incorporated into the contract by a

clause in the defendant's terms of business, which stated that the terms of business and all transactions were "subject to Applicable Regulations". "Applicable Regulations" was defined to include the FSA rules and any other rules of the relevant market or relevant regulatory authorities, together with all other applicable laws, rules and regulations.

The judge held that this clause did not incorporate the FSA rules into the contract. If the contract was interpreted to incorporate the FSA rules, it would also have to incorporate "all other applicable laws, rules and regulations" which would make the contract unworkable.

Furthermore, the court held that there was no direct right of action for any alleged breach of the FSA's COBS rules under s138D of Financial Services and Markets Act 2000 (**FSMA**) as the claimant was not a "private person" (the same also applies in respect of the FCA's COBS rules).

**Was there a broader duty on the defendant to provide information?**

Following *Hedley Byrne*, the court held that the defendant was obliged to ensure that any information it gave to the borrower was accurate and not misleading; the defendant did not by reason of that limited obligation also undertake a positive duty to provide full information about the competing advantages and disadvantages of the products. It was not, on the facts of this case, an advisory relationship.

On considering *Crestsign v Royal Bank of Scotland* [2014] EWHC 3043 (Ch), Moulder J stated that "each case must depend on its facts but to the extent that the Deputy Judge [in Crestsign] was making a point of general application… the Deputy Judge would in effect have elevated the duty of a salesman to that of an adviser…. in my view the duty of a salesman is not to mislead but in the absence of an advisory relationship, a salesman has no obligation to explain fully the products which it is trying to sell".

The judge considered whether or not the information provided by the defendant was inaccurate or misleading and concluded that it was not, except for a presentation which contained some incorrect information. On the facts, the judge held that this information was not relied upon and did not cause any loss.

## COMMENT

Although cases of this kind are heavily fact dependent, it is interesting to see the High Court applying previous misselling case law. Of particular note are:

- The absence of a fee paid by the claimant to the defendant for advice was relevant to the judge's decision that there was no advisory duty. The judge considered that the bank's salespeople were able to express views and predictions on interest rate movements, give explanations on how the interest rate swap worked, and even "endorse" the suggestion of an interest rate swap, without it resulting in the finding of an advisory relationship when taken in the context of the entire dealing (including, importantly, the absence of a fee).
- The judge seems to have doubted aspects of the ruling in *Crestsign v Royal Bank of Scotland* [2014] EWHC 3043 (Ch) where it was decided that if a bank undertook to explain a particular hedging product, it owed a duty to do so fully, accurately and properly. Moulder J seems to doubt whether "full" information is required in the absence of an advisory relationship, preferring instead the approach (as per *Hedley Byrne*) that banks are under no obligation to provide full and comprehensive information as regards interest rate hedging products. However, they must ensure that the information that is provided is not misleading or inaccurate.
- The basis clause protected the bank. Even if documentation is agreed after the transaction is entered into (as was the case here), such non-reliance wording may still be considered by the court to form the basis of the relationship between the parties.

In the conclusion to her judgment, Her Honour Judge Moulder stated that "this was a case based on hindsight". While interest rates have fallen to historically low levels since the financial crisis, it is easy to forget that in 2008 there was also opinion that interest rates would go up. In

those circumstances, an interest rate swap of the kind described in this case would have been very profitable to the claimant. It is interesting to see that the courts recognise that hindsight has been the driving factor behind much of this litigation.

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# Top finance litigation and regulatory developments in 2015

This is a summary of the most interesting banking litigation and regulatory developments in 2015. The selection is necessarily subjective and draws from a wide range of cases and developments that are of direct relevance to finance parties.

**Contract/misrepresentation**

***Disclaimers not effective to protect issuer from misrepresentation claim***

Market standard disclaimer wording (in investor presentation slides) did not protect the issuer in *Taberna Europe CDO II plc v Selskabet (formerly Roksilde Bank A/S) (In Bankruptcy)* [2015] EWHC 871. The issuer of subordinated notes was liable to a secondary market professional investor for misrepresentations about non-performing loans made in investor presentation/roadshow slides and a quarterly results announcement. Any failures by the investor to carry out sufficient due diligence were insufficient to justify a finding of contributory negligence.

The decision is important because: (i) representations made in promotional material may be actionable by secondary market purchasers; (ii) it provides a meaning for "non-performing loan". Eder J's approach of treating a loan as non-performing when it is in sustained default, and not merely when it is attracting a reduced interest rate following an assessment of inability to service full interest payments, is likely to be the starting point when the parties have failed to specify a contractual definition. The decision is also a reminder that it is necessary only to show that the misrepresentation played a real and substantial part in the relevant decision; it does not have to play a decisive role. Appeal due November 2016.

***New test for whether a provision is penal and therefore unenforceable***

The rule against penalties most obviously arises in the context of liquidated damages provisions but its impact is wider than that. The UK Supreme Court has provided a new test for whether a provision is penal and therefore unenforceable. The new test is whether "the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation".

We are producing a briefing on the practical impact of this lengthy and nuanced judgment (in addition to the case summary linked to below). The two key points are that the new test is more flexible and, in a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption will be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach. Liquidated damages are clearly secondary provisions under the new test. In practice a party's legitimate interest will rarely extend beyond compensation for the breach. In this sense, arguably nothing has changed and the old question of whether

there has been a genuine pre-estimate of loss will be a sufficient justification for a liquidated damages provision. However, the change from the previous position is that a party may, in certain circumstances, be able to point to a legitimate interest other than compensation to justify a provision. (*Cavendish v Makdessi; ParkingEye v Beavis* [2015] UKSC 67.)

***Contractual interpretation – increased certainty***

The Supreme Court in *Arnold v Britton & ors* [2015] UKSC 36 reasserted the importance in English law of the words used in the contract. It upheld the literal or "natural" meaning of the words used and rejected the argument that they should be given a different meaning in line with "commercial common sense" even where the consequence was a very harsh result for one of the parties. This decision improves contractual certainty for finance parties and lessens the chances of the court deciding what makes commercial sense.

***Implied terms – a reminder of how difficult they are to imply***

The UK Supreme Court has re-emphasised the stringent nature of the legal test which must be met before a term will be implied into a contract. The test is one of necessity. A more helpful way of putting it is that a term can only be implied if, without the term, the contract would lack commercial or practical coherence. Fairness or reasonableness alone will not be sufficient, even if, as claimed unsuccessfully here, the result can be harsh. This case will undoubtedly be the starting point, in place of Lord Hoffmann's test in the Belize case, when thinking about whether a term may be implied. On the one hand, this gives greater power to those who pay close attention to drafting their contracts, since the message from the Supreme Court in this case (as well as *Makdessi* above, and *Arnold v Britton*) points to upholding party autonomy and away from interfering with what the parties have said. On the other, this case means if a party does not have the benefit of an express term on a particular point of dispute it will be an uphill struggle to persuade the court to intervene on the basis of an implied term. (*Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd & anr* [2015] UKSC 72. Allen & Overy acted for the successful landlords in this case, the BNP Paribas companies as trustees for Britel Fund Trustees Ltd and WELPUT.) Click here for the article.

A claimant borrower failed to show that duties to achieve the best sale price possible should be implied into a contract for a bank's forced sale of the claimant's share in an oil field (*Rosserlane Consultants Ltd & anr v Credit Suisse International* [2015] EWHC 384 (Ch)). The claimant argued, unsuccessfully, that the share could have been sold at a higher price than that achieved by the bank. The ruling showed that courts will be very cautious before accepting that one commercial party owes implicit contractual duties to another commercial party, unless the contract gives good grounds for doing so, or there is a special form of relationship between them.

***Contractual discretion (eg valuation) – fetters on how you can act***

It has long been acknowledged that a party exercising a contractual discretion, for example to determine the value of something or to decide whether something is necessary, is not unfettered (almost regardless of what the contract says). This Supreme Court decision was a reminder that the party must make sure not only that a reasonable outcome is achieved, but also that the right matters have been taken into account in reaching the decision. To this, the Court added that "sufficiently cogent" evidence will be required to justify an unusual determination: *Braganza v BP Shipping Ltd & anr* [2015] UKSC 17. Although the decision was made in the employment context, it will apply in any situation where a commercial party is exercising a contractual discretion which affects both parties to a contract.

**Good faith**

***Parties are continuing to run good-faith arguments in litigation***

In *Dennis Edward Myers & anr v Kestrel Acquisitions Ltd & ors* [2015] EWHC 916 (Ch) the High Court refused to imply an obligation of good faith into a term allowing modifications of loan notes. The debtor had contractual rights to modify the notes and there was nothing to suggest that any modifications should be limited by a good-faith obligation.

Good faith arguments also failed in a project finance context in *Portsmouth City Council v Ensign Highways* [2015] EWHC 1969, where it was held that there was no implied duty owed by a public body to act in good faith when exercising its discretion under a service points regime in a long-term PFI contract. It had only to exercise its discretion honestly and on proper grounds, and not in a manner that was arbitrary, irrational or capricious. Service points regimes are a common feature of long-term PFI contracts and this case is the second (following *Mid Essex Hospital Services NHS Trust v Compass Group* [2013] BLR 265) to make clear that no obligations of good faith will be implied into their operation.

Following his judgment in *Yam Seng* holding that good faith applies in "relational contracts", Leggatt J further extended the remit of "good faith" in English law in *MSC Mediterranean Shipping Company SA v Cottonex Anstalt* [2015] EWHC 283 (Comm). In the face of a repudiatory breach, he held that the right to elect whether to terminate the contract or affirm and claim damages is not unfettered and the test is "essentially the same" as for the exercise of a contractual discretion, which must be exercised in good faith.

**Forum selection (or where you can sue/might be sued)**

At the disputes stage, ensuring that disputes are heard in our clients' forum of choice remains a challenge as counterparties continue to act tactically in this area. Ensuring that these issues are considered at the outset remains key to achieving the right outcome.

***Recast Brussels Regulation***

A key development in 2015 was the coming into force of the Recast Brussels Regulation. From 10 January 2015 Member State courts began applying Brussels I (Recast) (Regulation (EU) 1215/2012) to proceedings issued after that date. The Recast reforms the much criticised *lis pendens* rules and reverses the "first in time" rules where there is an exclusive jurisdiction clause in favour of a Member State court. This means that, where commercial parties have agreed that the English courts have exclusive jurisdiction to resolve their disputes, there is a reduced risk of their claim being "torpedoed" – they will no longer be prevented by the rules from proceeding in England because their counterparty has commenced proceedings first before the wrong court. To see more key changes for commercial parties please see our earlier article: http://www.allenovery.com/publications/en-gb/Pages/Brussels-Regulation-recast-an-update.aspx

***Hybrid jurisdiction clauses – further controversy in France***

We have seen further controversy over the enforceability of hybrid (also known as asymmetric) jurisdiction clauses. Earlier this year, in *ICH v Crédit Suisse*, No. 13-27264, the French Supreme Court found such a clause invalid under the Lugano Convention. The court followed its controversial 2012 decision, *Ms X v Banque Privée Edmond de Rothschild*, No 11-26.022, although its reasoning differed.

In November 2015, the French Supreme Court again considered an asymmetric jurisdiction clause, in *eBizcuss v Apple Sales International*, but in this case it found it to be enforceable as it was sufficiently foreseeable. The clause in question was different to the standard jurisdiction clauses generally seen in commercial documentation (and considered in *ICH* and *Rothschild*). It seems that the Supreme Court was willing to uphold it on the basis that it allowed the identification of the courts that would potentially have to resolve any dispute that may arise and that it therefore complied with the foreseeability principle.

Hybrid clauses are found in thousands of commercial contracts and these French decisions (while not binding on an English court) are likely to continue to have an impact on parties' analysis of their dispute clauses and litigation tactics.

***Uncertainty for banks about where they might be sued by secondary investors***

The risk of a tortious claim being brought by an investor in a variety of jurisdictions was shown in a Court of Justice of the European Union (Fourth Chamber) ruling on jurisdiction in a prospectus liability claim. The claim concerned index certificates issued by a UK bank, and purchased by an Austrian investor (consumer) via a professional intermediary (*Request for Preliminary*

*Ruling: Kolassa v Barclays Bank plc* [2015] EUECJ C-375/13, 28 January 2015). The court ruled that under Article 5(3) Brussels Regulation (now Article 7(2) Brussels Recast) the "place where the harmful event occurred" includes any place in which an investor suffers loss. The CJEU held that the court at the place where the investor is domiciled has jurisdiction, on the basis of where the loss occurred, particularly when the loss occurred in the investor's bank account in that jurisdiction.

**Who can sue?**

***Negligent underlying property valuation in non-recourse securitised loan:***

In *Titan Europe 2006-3 plc v Colliers International UK plc (in liquidation)* [2014] EWHC 3106 (Comm) the High Court ruled that 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. 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 can perhaps be most easily avoided by ensuring that there are agreed and clear provisions in the documents. This decision was upheld on appeal.

**Benchmark follow-on litigation**

Benchmark regulatory findings and settlements have led to a number of follow-on civil claims against banks involved in benchmark setting. Although these cases have generated numerous interlocutory skirmishes (unsurprisingly many of which involve disclosure), there has yet to be a judgment on the substantive issues. Given that many of these skirmishes are in the process of being appealed, it will be a while before we have any such substantive judgment. Also awaited is the European Commission's investigation into forex manipulation.

**Regulatory**

***Backdrop of regulatory investigation enough for privilege claim***

In this LIBOR follow-on case (*Property Alliance Group Ltd v The Royal Bank of Scotland plc* [2015] EWHC 3187 (Ch)), the defendant was able to claim legal advice privilege over confidential briefing memos produced by the bank's external lawyers for the bank on the progress and issues in the regulatory investigations (including factual summaries of matters which would not otherwise be privileged) and which were to form the basis of discussions between them on strategy and legal advice. The backdrop of the active regulatory investigations was sufficient legal context to found a claim for privilege. While not exclusively containing legal advice, the documents were part of the "continuum" of communications between lawyer and client, the object of which was the giving of legal advice as and when appropriate. The documents were therefore privileged in their entirety. The decision provides useful and timely clarification on the extent of legal advice privilege in the context of regulatory investigations; an area sure to be the subject of ongoing interest in the coming years.
The key message is that a claim to legal advice privilege depends on the relevance and purpose of the information contained in the broader context of the lawyers' advisory role.

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If you missed "Forum selection – should recent developments change your approach" by Sarah Garvey on 9 September 2015 and would like a copy of the slides, please email sarah.garvey@allenovery.com.

We also offer a full range of bespoke seminars in our Client Seminar Menu 2016 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 relation to this, please contact Sarah Garvey on +44 20 3088 3710 or sarah.garvey@allenovery.com.

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# Key contacts

If you require advice on any of the matters raised in this document, please call any of our Litigation and Dispute Resolution partners, your usual contact at Allen & Overy, or Sarah Garvey.

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