ALLEN & OVERY

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Litigation and Dispute Resolution

Review

EDITORIAL

Bonus/commission litigation is a risk for both banks and corporates. In 2015 the Supreme Court ruled in *Braganza v BP Shipping* that when a contractual discretion is exercised, not only must a reasonable outcome be achieved, the right matters must also have been taken into account. Two recent cases apply this ruling in the employment context: one involving a banker's bonus (*Patural v DG Services (UK) Ltd*) and the other involving a corporate sales manager's commission (*Hills v Niksun*). We highlight practical steps that can be taken by an employer exercising contractual discretion to mitigate the risk of a successful subsequent challenge.

We cover two Court of Appeal decisions involving public tenders or contracts involving public funding. *R (on the application of London Borough of Enfield) v Secretary of State for Transport* is a rare example of a judicial review challenge by a local authority. This case related to the rail specification in an invitation to tender sent out to rail operators by the Department of Transport (see **Public law**). *R (Sky Blue Sports and Leisure Ltd) v Coventry City Council* concerned the grey area between legitimate public funding and illegitimate state aid (see **State Aid**). Both decisions highlight a counterparty risk when dealing with public authorities.

Finally, two important changes to insurance law come into effect in August this year concerning an insured's duty of disclosure and direct rights of action against an insurer of an insolvent defendant. We consider these changes and highlight further changes coming into effect in May 2017, including a new law penalising insurers for any unreasonable delay in paying claims (see **Insurance**).

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Anti-bribery and corruption

SFO SPELLS OUT WHAT IS MEANT BY "COOPERATION"

In a speech[1] on 18 May 2016 Matthew Wagstaff, Joint Head of Bribery and Corruption at the Serious Fraud Office, spoke about what the Serious Fraud Office regards as proper cooperation. This article considers what we can take from the speech, and highlights some of the tricky issues that remain concerning witness accounts and acceptance of wrongdoing.

Cooperation matters because a company that is seen to be genuinely and unequivocally cooperating stands a better chance of avoiding a criminal outcome to an investigation. The question of what is and what is not cooperation has, according to Matthew Wagstaff, "*caused much confusion*" since the first s7 Bribery Act conviction (Sweett Group[2]) and DPA[3] last year.

Cooperation is not…

The SFO does not expect a company to waive a genuine claim to privilege. But, it does definitely expect to see first witness accounts. The SFO regards these as "*factual narrative*" and not privileged.

Cooperation is…

As well as providing notes of witness interviews, the SFO also expects corporates to:

- Help to uncover the full extent of wrongdoing – including telling the SFO about something *it does not already know*. The company telling the SFO about something it already knows from a whistleblower, disgruntled competitor or journalist is not going to count towards cooperation credit.
- Accept that wrongdoing has occurred.
- Provide the SFO with its independent investigation report. Any DPA needs to be approved by a judge who will want to know that the SFO has checked the company's version of events and that the investigation has uncovered the full extent of criminality.
- Not trample on the crime scene. Examples given included not tipping off "data custodians" who may be potential suspects, and providing access to witness accounts – these are of "crucial importance".

Witness accounts

There has long been controversy around first witness accounts. Many practitioners regard them as privileged, yet the SFO disagrees, and expects them to be disclosed. In the Standard Bank investigation (which lead to the first DPA) the Bank provided oral summaries of evidence from key individuals.

The DPA Code of Practice[4] states that in order to be offered a DPA there must be full cooperation, including providing copies of witness accounts. Some have interpreted this as an expectation that privilege will be waived, but as Wagstaff's speech confirms, the SFO does not regard these notes as privileged anyway.

What about the SFO's concern about corporates "trampling on the crime scene"? It's a catchy phrase but the SFO has developed little guidance on what amounts to "trampling" and how the SFO's expectations about what a company may and may not do when faced with allegations of wrongdoing interface with a company's obligations relating to good corporate governance. Companies must surely be allowed to investigate promptly allegations of wrongdoing by their management or employees and provided this is done responsibly it should not "trample" on the evidence. It typically takes the SFO many years to complete an investigation.

Accepting wrong-doing – a balancing act

The speech made clear that in order to count towards cooperation, a company must accept in any self-report that there has been some wrongdoing. This may be advisable to do in a clear-cut case where there is obvious evidence of criminal liability at an early stage. Where the evidence is not yet sufficient but a company still chooses to self-report and cooperate with the SFO, it is unclear why that self-report should not count towards cooperation credit.

Matthew Wagstaff's speech may make the SFO's position clear but the reasons why the SFO has adopted certain positions still lack clarity.

There is no one size fits all in internal investigations. The differing expectations of national agencies and those based in other jurisdictions means that companies, and their lawyers, must take a tailored approach to each investigation.

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[1] https://www.sfo.gov.uk/2016/05/18/role-remit-sfo/.

[2] http://www.allenovery.com/publications/en-gb/Pages/Lessons-from-the-first-s7-UK-BriberyAct-case.aspx.

[3] http://www.allenovery.com/publications/en-gb/Pages/First-UK-deferred-prosecution-agreement-between-the-SFO-and-a-bank.aspx.

[4] https://www.cps.gov.uk/publications/directors_guidance/dpa_cop.pdf.

Arbitration

DIRECT ACCESS INSURANCE CLAIMS AND ANTI-SUIT INJUNCTIONS

Shipowners' Mutual Protection and Indemnity Association (Luxembourg) v Containerships Denizcilik Nakilyat Ve Ticaret AS ("Yusuf Cepnioglu") [2016] EWCA Civ 386, 20 April 2016

A claim by a time charterer, arising under foreign legislation providing a right of direct action against an insurer, was contractual in nature and therefore subject to the terms of the underlying insurance policy, including an agreement to arbitrate disputes. The decision addresses a conflict between two previous Court of Appeal decisions, and clarifies that, where foreign direct access proceedings are brought in breach of an arbitration clause, an anti-suit injunction will be granted unless there are good reasons for not doing so; there is no need to demonstrate that such proceedings are vexatious or oppressive.

In March 2014, the *Yusuf Cepnioglu* (the **Vessel**) ran aground while carrying cargo containers being carried under bills of lading issued by the time charterers, Containerships (the **defendant**). The proper law and jurisdiction of the bills was Turkish. Containerships commenced arbitration proceedings in London against the Vessel's owner (the **Owner**) under the time charter. The Owner was a member of the claimant P&I Association (the **Club**) and was thus covered by insurance against third party claims (the **Insurance Contract**). The terms of that cover provided for English law and London arbitration, cover being subject to the pay-to-be-paid rule (ie for the Club only to be liable if the Owner had paid the claims against it) and that an arbitration award was a condition precedent to the Club's liability.

In May 2014, Containerships also commenced proceedings in the Turkish courts seeking to attach the Club's assets in Turkey as security for an intended claim

under Turkish direct access legislation (the **Turkish Proceedings**). This direct access legislation provided a direct right of recourse between a time charterer and the owner's insurer. The Club sought an anti-suit injunction in England in respect of these proceedings and the intended proceedings on the basis of the terms of the Insurance Contract. At first instance, Teare J granted the injunction and Containerships subsequently appealed to the Court of Appeal. Two significant questions were raised on appeal.

Characterisation of the claim

A key issue was the characterisation of the claim in the Turkish Proceedings – was it a contractual claim arising out of the Insurance Contract governed by English law (in which case, *prima facie*, there was a basis for the anti-suit injunction) or was it a separate claim arising out of Turkish statute (in which case the anti-suit injunction should be dismissed)?

At first instance, Teare J had made a finding of fact that Containerships' right to claim was essentially contractual. The Court of Appeal agreed with Teare J, on the basis that the claim was, to a large extent, circumscribed by and reflected in the terms of the underlying Insurance Contract. It followed from this that Containerships was essentially enforcing the Insurance Contract for its own benefit and was therefore bound to accept that its claim was governed by English law and must be arbitrated in London.

Granting of anti-suit injunction

The Court of Appeal had to determine whether, given that Containerships had themselves never agreed to London arbitration under the Insurance Contract (which was between the Owner and the Club), it was necessary to establish that the Turkish Proceedings were vexatious or oppressive before an injunction could be granted. This arose because of the two conflicting decisions of the Court of Appeal in *Schiffahrtsgesellschaft Detlev von Appen GmbH v Voest Alpine Intertraind GmbH (The Jay Bola)* [1997] 2 Lloyd's Rep. 279 and *Through Transport Mutual Insurance Association (Eurasia) Ltd v New India Insurance Co (The Hari Bhum) (No. 1)* [2005] 1 Lloyd's Rep. 67.

In *The Jay Bola*, the Court of Appeal applied the principles set out in *Aggeliki Charis Compania Maritima S.A. v Pagnan S.p.A (The "Angelic Grace")* [1995] 1 Lloyd's Rep. 87 and granted an anti-suit injunction restraining foreign proceedings commenced by subrogated insurers of voyage charterers who had brought foreign proceedings against the disponent owners. The insurers were not a party to the underlying contract of carriage but, by virtue of their rights of subrogation, were entitled under the law of the insurance contract to sue the time charterers directly. The basis of the court's decision was that such proceedings infringed rights arising under the voyage charterparty arbitration clause; whether the proceedings were vexatious or oppressive was irrelevant.

In *The Hari Bhum (No. 1)*, however, an anti-suit injunction restraining foreign direct access proceedings was refused, notwithstanding that the right asserted was essentially contractual and therefore subject to the arbitration agreement in the underlying contract. The court held that, on the facts, the foreign proceedings could not be said to be vexatious or oppressive and, noting that the third party was not a party to the arbitration agreement, it would therefore not be just and convenient to grant the injunction.

The Court of Appeal preferred *The Jay Bola* and rejected *The Hari Bhum (No. 1)* The court held that it was irrelevant that the charterers were not a party to the relevant arbitration agreement. It was only by way of injunction that Containerships could be required to recognise the Club's contractual right (to have its liability decided by arbitration). Thus, the correct approach was to apply the usual *Angelic Grace* principles and ask whether there were good reasons why an injunction should not be granted; there were none in this case.

In maintaining the injunction, the court dismissed issues of comity raised by Containerships, stating that "*questions of comity in the established sense do not arise in a case such as this*" and making it clear that any party pursuing a claim under direct access legislation must

"*accept what the legislation gives him, including* [if applicable] *the obligation to pursue any claim in arbitration*".

COMMENT

Whether claims arising out of statutory rights of direct action are subject to an arbitration agreement contained in the underlying insurance contract will depend on the characterisation of the underlying right in question. In this respect, this most recent decision is in line with previous case law covered in this Litigation Review (*see, eg* *The London Steamship Owners' Mutual Insurance Association Ltd v The Kingdom of Spain & anr* [2015] EWCA Civ 333). This case is a useful reminder that direct access legislation will rarely create an unfettered, independent right to litigate in the courts, but will usually be subject to the constraints of the underlying contract (including any arbitration agreement in that contract).

In resolving the conflict between *The Jay Bola* and *The Hari Bhum (No. 1)*, the Court of Appeal has now made clear that where a third party seeks to enforce rights that are subject to an arbitration (or jurisdiction) clause, any proceedings brought in breach of that clause will be restrained on usual *Angelic Grace* principles. The fact that the third party was not itself a party to the original contract is irrelevant and there is no need for a claimant to go further and demonstrate that the foreign proceedings are vexatious or oppressive.

The Court of Appeal was clear that comity played no part outside the scope of its application under *Angelic Grace* principles; namely whether there has been a delay in applying for an anti-suit injunction and/or whether the foreign proceedings which the applicant seeks to restrain are too far advanced. However, the English High Court has, in a few recent cases, shifted towards a strict approach in respect of any perceived delay by an applicant seeking an injunction. For example, in *Essar Shipping Ltd v Bank of China Ltd* [2015] EWHC 3266 (Comm) Walker J held that a delay by an applicant in applying for an anti-suit injunction could, in and of itself, prevent relief being granted regardless of whether or not the proceedings were at an advanced stage. This approach has been followed in *The Magellan Spirit* [2016] EWHC 454. While the Court of Appeal in the case discussed here did confirm that the "*right approach is to apply The Angelic Grace*", unfortunately it did not address the issue raised by the *Essar* decision. It therefore remains to be seen how the *Essar* approach will be assessed if and when the issue properly comes before the Court of Appeal – which may be persuaded that the better approach to the test in the *Angelic Grace* is to factor in to the assessment of delay the progress of the foreign proceedings. Until then, any party considering an application for an anti-suit injunction should issue and serve those proceedings as soon as possible and regardless of the progress of the foreign proceedings.

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Contract

CONTRACT FORMATION – PRESCRIBED MODE OF ACCEPTANCE CAN BE WAIVED BY CONDUCT

Reveille Independent LLC v Anotech International (UK) Ltd [2016] EWCA Civ 443, 6 May 2016

The Court of Appeal ruled that a binding contract can be made by the parties' conduct even when a written "Deal Memo" stated that it was not binding until it was signed by both parties, and it had been signed by one party only.

A U.S. television company (**Reveille**) brought a claim against a UK-based cookware distributor (**Anotech**) for breach of contract. The claim was based on an alleged agreement that Reveille would integrate and promote Anotech's products in episodes of the MasterChef U.S. television series and license to Anotech certain rights to use the MasterChef brand.

The parties started to negotiate a short form agreement known as the "Deal Memo". The Deal Memo stated that it would "*not be binding on [Reveille] until executed by both [Anotech] and [Reveille]*". Anotech amended, signed and returned Reveille's Deal Memo to Reveille (therefore making a counter-offer). Reveille did not sign the Deal Memo. Negotiations over the long form agreements, which were intended to replace the Deal Memo, later broke down and were never completed.

The trial judge held that the Deal Memo was binding on the basis that Reveille had accepted the contract by conduct. The Court of Appeal unanimously upheld the trial judge's decision that, notwithstanding the fact that Reveille had not signed the Deal Memo, Reveille had accepted the terms of the amended Deal Memo by its conduct and therefore a legally binding contract had been formed.

The Court of Appeal summarised the relevant contract law rules as follows:

- Consent to a contract is found in the acceptance of an offer, and acceptance can be by conduct provided that conduct, is objectively intended to constitute acceptance (*Brogden v Metropolitan Railway Co* (1877) 2 App Cas 666).
- An offer in the form of a draft agreement can be accepted when it was never signed (*Brogden v Metropolian Railway*).
- If a party has a right to sign a contract before being bound it can, by using clear and unequivocal words or conduct, waive the requirement and conclude the contract without signature (*Oceanografia SA de CV v DSND Subsea AS (The Botnica)* [2006] EWHC 1360 (Comm)).
- A party can waive a prescribed mode of acceptance if it acquiesces in a different way provided that acceptance has not prejudiced the other party (*Chitty on Contracts 32nd ed* at [2-066-67]; *MSM Consulting Ltd v United Republic of Tanzania* [2009] EWHC 121 (QB)).
- Where parties have not complied with a signature requirement a draft agreement can still be binding if essentially all the terms have been agreed and the parties' subsequent conduct indicates this (*RTS Flexible Systems v Molkeroi Alois Muller GmbH* [2010] UKSC 14).
- The subsequent conduct of the parties is relevant in proving the existence of a contract and its terms (*Chitty* at [13-129]).

These contract law rules take effect against the background of recognised legal polices, in particular:

- The need for certainty in commercial contracts (*Cobbe v Yeoman's Row Management Ltd* [2008] UKHL 55).
- In commercial dealings "*the reasonable expectations of honest sensible business persons must be protected*" (*RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH* approving dicta of Steyn LJ in *G. Percy Trentham Ltd v Archital Luxfer Ltd* [1993] 1 Lloyd's Rep 25).

The Court of Appeal found that Reveille had waived the provision that there would be no binding contract in absence of its signature on the Deal Memo, and there was no prejudice to Anotech. Reveille accepted the terms of the Deal Memo by conduct, which led to a binding contract. In particular, Reveille: (i) integrated Anotech's products into episodes of MasterChef; (ii) approved Anotech's request to deploy the MasterChef brand at a show; and (iii) treated Anotech as one of its licensees by jointly emailing it and other licensees and inviting it to join Reveille 's weekly licensee calls.

Subsequent conduct by both parties confirmed the existence of the contract. Reveille performed its obligations under the Deal Memo and Anotech also acted as if it was bound. While Reveille's failure to sign the contract was at the expense of certainty as to the precise date the contract was formed, Reveille had performed all its obligations in the Deal Memo with Anotech's involvement and to Anotech's benefit.

COMMENT

While the Court of Appeal's decision applies well-established contract law principles to a fact-specific finding, the decision sets out a helpful summary of the law and policies in this area, including the principle that "*the reasonable expectations of honest sensible business persons must be protected*".

This case serves as an important reminder that, in the interests of certainty, where possible, all parties should sign an agreement before work starts. Even where an agreement includes formal requirements for acceptance, the parties' conduct may show that these requirements have in fact been waived.

The decision reinforces the fact that, whatever has been stated in writing, parties can agree something different orally or by conduct. This is what happened in *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd*[1] [2016] EWCA Civ 396 (covered in the May 2016 Litigation & Dispute Resolution Review) in which the Court of Appeal made *obiter* comments that a "no variation except in writing" clause did not stop a contract being varied orally.

Ultimately these decisions underline a commercial risk. Despite the best efforts of lawyers to draft certainty into commercial contracts (eg not binding until signed, no variation unless in writing) the actions of those acting or appearing to act on behalf of a contracting party can still end up agreeing to things outside the constraints of these provisions.

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[1] http://www.allenovery.com/publications/en-gb/Pages/No-variation-clauses-weakened-by-Court-of-Appeal.aspx.

Employment

CHALLENGING BONUS DISCRETION POST-*BRAGANZA*: RECENT DECISIONS

Patural v DG Services (UK) Ltd [2015] EWHC 3659 (QB), 13 November 2015 and *Hills v Niksun Inc* [2016] EWCA Civ 115, 1 March 2016

The case of *Braganza v BP Shipping Ltd*[1][2015] UKSC 17 established that courts may look into the process that is undertaken by employers when reaching decisions that involve the exercise of discretion. Prior to *Braganza*, when determining the reasonableness of an exercise of bonus discretion, the courts have tended to focus on the outcome. Two recent cases, *Patural* and *Hills*, are the first to consider *Braganza*-based arguments in a bonus/commission context where employees were challenging the process behind their awards as well as the awards themselves.

Breach of contract claims challenging inconsistent discretionary bonus awards

Patural (**P**), a trader at DG Services (UK) Ltd (**DG**), was awarded discretionary bonuses of approximately 1% of his profits in 2008 (worth EUR 1.3 million) and 2009. He sued DG for breaches of contract after discovering that his colleagues, M and B, had received significantly higher bonuses in 2008 – approximately 8% (EUR 38 million) and 11% (EUR 84 million) of the profits that they had generated.

Of significance in the *Braganza* context was P's claim that DG had breached the implied term to exercise its discretion in his case in good faith and in a manner that was not irrational or perverse. P relied on *Braganza*, in which the Supreme Court applied the public law concept of *Wednesbury* reasonableness – which focuses on both the decision-making process and the decision itself – to employment relationships. He argued that the bonus decisions in his case were irrational and/or perverse, taking into account the profits he had made and the sums awarded to M and B, and that there had been no meaningful or rational analysis of the amounts that should be paid.

Insufficient evidence to establish breach of implied terms

The High Court allowed DG's summary judgment application on the basis that there was no reasonable prospect of P's claims succeeding and no other compelling reason to proceed to trial.

P had failed to overcome the high evidential bar set by the Court of Appeal in *Commerzbank v Keen AG* [2007] ICR 623 requiring him to demonstrate an "overwhelming case" of irrationality in DG's award decision. On the evidence, DG's decision to pay M and B on a guaranteed formulaic basis and to distinguish them from P was rational, in particular to incentivise them not to leave. Furthermore, P had pleaded the *Braganza* aspect of his claim insufficiently as he had not alleged a *Wednesbury* error in the process adopted by DG, only irrationality in relation to the outcome (ie the second limb of *Wednesbury*). P's other claims alleging breach of an express term and of the implied term of trust and confidence also failed.

As an aside, Singh J expressed caution about applying *Wednesbury* reasonableness in a private law context, stating that the fundamental basis of public law is that public bodies only have those powers given to them by law, and that they must behave in the public interest, while private companies do not necessarily have the same duties.

Claim for underpaid commission where contractual discretion reserved

Mr Hills (**H**) was employed as Niksun Inc's regional sales manager in the UK. His contract provided that his participation in commission plans would be at Niksun's absolute discretion and that compensation would be set at a level which "is fair and reasonable under the circumstances, and is in the best interest of Niksun". H negotiated a large deal from the UK office, but the U.S. office was also involved in negotiations. Niksun decided to allocate only 48% of the commission to the UK office (and, in turn, to H) and the rest to the U.S. office. H sued Niksun for breach of contract for underpaid commission, alleging that it had failed to exercise its discretion rationally or reasonably when deciding what amount of commission was "fair and reasonable".

In light of the contractual provisions, the nature of the deal and the evidence of H's manager (which included an assurance given that the UK would be "looked after" in terms of commission for the deal), the County Court judge concluded at first instance that it would not be "fair and reasonable" to award the UK team any less than two-thirds commission.

Claim successful on account of lack of evidence as to decision-making process

The Court of Appeal upheld this finding. In Vos LJ's opinion, post-*Braganza*, once H had demonstrated that there were grounds for concluding that Niksun's decision was not reasonable, the evidential burden shifted to Niksun to show that its decision was reasonable. Niksun had produced no evidence as to the decision-making process nor had it called evidence from the decision-maker. In these circumstances, the judge could not assume that the decision was taken rationally without knowing what was actually taken into account. Otherwise, as had been argued, "the commission level might have been picked by throwing darts at a dart board – or perhaps by tossing coins".

The relevance of *Braganza* in future bonus case law

Singh J's note of caution about the application of *Braganza* in a private context suggests that some courts may be reluctant to apply public law principles to bonus claims. After all, the facts of *Braganza* were different; they did not relate to the exercise of an employer's discretion but to a factual judgment made by the employer as to the cause of an employee's death, in turn determining whether an exclusion clause precluded the payment of death-in-service benefits to his widow.

However, the Court of Appeal did not add a similar caveat in finding in favour of the claimant in the *Hills* ruling, and it seems that *Braganza* does leave the door open for courts to take a more interventionist approach to an employer's decision-making process. Employers should therefore be ready to defend process-related arguments.

Managing the risk of bonus litigation

Bonus litigation will no doubt continue to be a risk area for employers given the often large amounts at stake and the existence of commercially savvy and well-resourced claimants. *Braganza*-based arguments will give claimants more ammunition to challenge discretionary bonus decisions, although the evidential hurdle of "irrationality" that they face remains high.

In practice, from an employer's perspective, the overlay of *Braganza* principles – requiring the courts to consider the bonus decision-making process as well as the outcome – may not significantly increase the risk of successful claims, given that a process that takes irrelevant considerations into account would in any event be unlikely to lead to a reasonable outcome.

However, to ward off *Braganza*-based arguments, the *Hills* decision demonstrates how important it is for employers to adduce evidence of rationality in relation to the decision-making process. Where the burden of proof has shifted to the employer, the absence of such evidence will enable a judge to substitute his or her own view of reasonableness for that of the employer. A paper trail showing an objective and rational exercise of discretion in bonus decisions will be the most effective form of evidence, and is therefore vital at every stage of the decision-making process.

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[1] http://www.allenovery.com/publications/en-gb/Pages/Contractual-discretion-how-to-get-it-right.aspx.

Insurance

NEW INSURANCE LAWS: A FIELD DAY FOR POLICYHOLDERS?

A raft of new legislation related to the insurance sector is due to come into force in the coming months that will usher in some of the most significant changes to the basic framework of commercial insurance law for a century. These changes represent a shift to a more balanced playing field from what is traditionally perceived to be a pro-insurer legal landscape, where the less savvy policyholder can all too easily find itself without coverage for its insurance claims. However, both insurer and insured alike would do well to take note of the changes as there are still plenty of traps for the unwary.

Insurance Act 2015 - a new disclosure duty from 12 August 2016

Underpinning these changes is the Insurance Act 2015 which, replacing certain provisions of the Marine Insurance Act 1906, will apply to new insurance policies from 12 August 2016. The big change relates to a new duty of fair presentation of risk which will require the insured to disclose to the insurer every material circumstance which the insured knows or ought to know, and to do so in a manner which would be reasonably clear and accessible to a prudent insurer.

This replaces the previous duty to disclose every material circumstance which had significant downsides for both parties. For the insured, the draconian remedy of avoidance of the policy in the event a material circumstance was not disclosed, led to the insurer's all too inevitable raising of a defence to any claim of material non-disclosure. For the insurer, it was faced with the unenviable choice between sifting through the mountains of data provided by an insured in an attempt to avoid that eventuality or of electing to price the risk without doing so.

The new regime seeks to remedy this by requiring the disclosure to be presented to the insurers in a reasonably clear and accessible way, and also by introducing proportionate remedies for any failures in the duty of fair presentation that were neither deliberate nor reckless. For example by the deemed inclusion in the policy of terms that would have been included by the insurer had they been made aware of the particular non-disclosed fact from the outset.

However welcome these changes are, they put an increased onus on both parties at the time of entering into the policy. It is up to the insured to give consideration to what they "know or ought to know" which extends to carrying out a "reasonable search", and subsequently to presenting that information to insurers in an organised and user-friendly way. This collation and presentation of information may require the development of systems and processes to ensure that the relevant knowledge has been captured and considered, and that the steps taken can subsequently be verified. For their part, insurers would be advised to document how the risks as presented informed their underwriting decisions so they can substantiate future arguments that had an additional risk been made known to them it would have affected the terms on which they entered into the policy.

It is not clear how ready either insurers or insureds are to adapt to these changes, nor whether there will be resistance to their implementation. Insurers for example may instead look to take advantage of the parties' ability to contract out of these terms of the Insurance Act 2015, which is permitted so long as the insurer draws any disadvantage to the insured to its attention.

Damages for the late payment of insurance claims

Another aspect of the new changes that benefits policyholders but which again insurers may seek to contract out of relates to damages for the late payment of insurance claims.

The Enterprise Act 2016, which comes into force on 4 May 2017, will bring in a legal requirement for insurers to pay out on insurance claims within a reasonable time, and to permit claims for damages based on the consequences of a failure by them to do so.

These measures, geared towards small and medium sized businesses in particular, are being introduced with the aim of enabling them to recover more quickly from insured losses, such as fires and floods. The late payment of insurance claims can have serious consequences for such businesses, including insolvency. Originally intended to be included within the Insurance Act 2015, they were dropped in the face of resistance from the insurance industry but subsequently resurfaced as part of the Enterprise Act 2016. When that Act comes into force next spring, it will introduce these provisions as new sections to the Insurance Act 2015, and in so doing, bring the London insurance market into line with many other jurisdictions that already permit the recovery of damages in these circumstances.

The key feature of this legislation is the creation of an implied term that insurance claims must be paid within a reasonable time, taking into account all relevant circumstances including the type of insurance and the size and complexity of the claim. The apparent victory for the policyholder may be short lived, however, if insurers take advantage of their ability to contract out of this implied term in non-consumer contracts, which they are able to do if the delay is neither reckless nor deliberate.

Third Parties (Right against Insurers) Act 2010

Some six years after receiving Royal Assent, the Third Parties (Rights against Insurers) Act 2010 (the **2010 Act**) finally comes into force on 1 August 2016. This act is designed to simplify the process for bringing claims against the insurer of an insolvent defendant. Its implementation was delayed because of issues in its original drafting which will be rectified by the Insurance Act 2015, thereby enabling it to be brought into force.

Currently claims against the insurers of insolvent defendants can be brought under the Third Parties (Rights against Insurers) Act 1930, which the 2010 Act replaces. What the new legislation changes is the need to have established the insolvent insured's liability as a prerequisite to the bringing of proceedings against the insurer. Instead, both the insured's liability to the third party and the insurer's liability under the policy can be determined by the court in a single set of proceedings as a result of the automatic transfer of the insured's rights to the third party.

This is a welcome change from the existing regime under which, if the insolvent defendant had been dissolved, it was necessary for the third party first to restore the dissolved company to the register and bring proceedings against it, before commencing a second set of proceedings against the insurer on the back of a successful judgment or award establishing liability.

All change or business as usual?

On the whole, the many changes that will be coming into force over the coming months have been welcomed by insurers and insureds alike. Their impact however remains to be seen, and depending on the extent to which the insurance market looks to exercise its right to contract out of some of these changes, on one view there is the possibility that it may end up simply being business as usual.

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Privilege

TRAINING SLIDES CAN ATTRACT LEGAL PROFESSIONAL PRIVILEGE

Ministry of Justice v The Information Commissioner & Joanna Shaw (EA/2015/0160), 18 March 2016

The Information Commissioner held that a set of training slides provided to a public authority were not protected by legal advice privilege. However, this decision was overturned by the Tribunal, meaning that, in certain circumstances, training materials provided by external lawyers will attract legal advice privilege.

Request for MOJ training materials

The second respondent, an individual, submitted a request for information to the Ministry of Justice (**MOJ**) under the Freedom of Information Act 2000 (**FOIA**) (the **FOIA Request**). The second respondent requested a copy of "*any training notes or additional guidance*" held by the MOJ regarding the application of exceptional case funding under the Legal Aid Scheme. The FOIA Request was made to the MOJ because the Legal Aid Agency (the **LAA**) (which administers the Legal Aid Scheme) is an executive agency of the MOJ.

Decision to withhold legally privileged training materials

The MOJ provided the second respondent with some information in response to her FOIA Request. However, the MOJ declined to provide a set of training slides (the **Training Slides**) that had been prepared by external counsel in order to advise the LAA on the application of the rules governing exceptional case funding under the Legal Aid Scheme. The MOJ asserted that the Training Slides were subject to legal professional privilege and therefore exempt from disclosure under s1(1) of the FOIA (which does not require the disclosure of items protected by legal professional privilege where the public interest is in favour of maintaining this protection).

The second respondent requested an internal review of the MOJ's decision to not provide her with a copy of the Training Slides. She argued that the MOJ's approach to her FOIA Request meant that a public authority could "*exempt itself from almost any request for information by using the services of Counsel or a solicitor to provide advice on… government matters, thereby exempting itself from any obligations under FOIA*". The second respondent argued that this could not have been the impact that FOIA was intended to have.

The Information Commissioner's decision

The Information Commissioner held that the MOJ could not rely on s 42 FOIA (legal professional privilege exemption) in order to withhold a copy of the Training Slides because the Training Slides did not appear to have been produced for the "dominant purpose" of providing legal advice. Rather, the purpose of the Training Slides appears to have been to provide generic training to LAA caseworkers regarding the determination of applications for exceptional case funding under the Legal Aid Scheme. As a result, the Information Commissioner held that Training Slides were not covered by legal advice privilege and should be disclosed.

Appeal

The MOJ appealed to the First Tier Tribunal General Regulatory Chamber (Information Rights) (the **Tribunal**).

The Tribunal upheld the MOJ's appeal. It held that the Training Slides were privileged and it was not in the public interest that they should be disclosed. In support of its decision, the Tribunal noted that:

- The Training Slides contained legal advice relating to the obligations of the LAA under public law.
- There was a clear legal context relating to the Training Slides, in as much as LAA caseworkers were being advised by external lawyers as to what the law requires and on how best to discharge their legal duties in respect of exceptional case funding applications. It is reasonable to expect privilege to apply where external lawyers were providing materials as the basis for the training session and would need to be able to do so in an environment of "*not holding back in… imparting what would be prudent and sensible*".
- It was not persuaded that, as the Information Commissioner had argued, training sessions could not constitute legal advice for the purposes of privilege. The Tribunal noted that 'advice' can include telling the client the law and may also include advice as to what should prudently and sensibly be done in the relevant legal context.

COMMENT

The Tribunal's decision is likely to be a welcome one for the MOJ, as well as other public bodies who frequently find themselves in receipt of requests made under the Freedom of Information Act 2000. However, this decision is unlikely to mean that all training materials will attract legal advice privilege. Rather, the content of such materials will need to be considered carefully in order to determine whether legal advice is actually being provided and, in the FOIA context, it is in the public interest to withhold these materials from disclosure. The principles set out by the Tribunal in this case should also be considered by firms when requesting training from external lawyers, if there is a desire to ensure that the content of any training materials provided by external lawyers will attract legal advice privilege.

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TO WHOM DOES PRIVILEGE BELONG IN INSOLVENCY?

Mikhail Shlosberg v Avonwick Holdings Ltd & ors [2016] EWHC 416 (Ch), 7 March 2016

The Court ordered a law firm to stop acting for the main creditor of a bankrupt individual in circumstances where it had reviewed documents privileged to that individual. The law firm, which also acted for the trustees in bankruptcy, claimed that the privilege had transferred to the trustees such that the individual could no longer assert privilege over the materials. Arnold J rejected this argument, holding that privilege will only be transferred where the legal advice is *about* property which forms part of the bankrupt's estate. The mere fact that the legal advice is *stored* in property (ie documents) that is part of the estate is not sufficient to transfer the privilege over the advice itself.

The background to this judgment is complicated, involving various finance arrangements and business deals between Russian and Ukrainian businessmen and webs of companies under their control, and a protracted series of proceedings in the Chancery Division. For present purposes, it suffices to note the following:

A partner at Dechert LLP (**Dechert**) acted for:

(i) the trustees in bankruptcy for Mikhail Shlosberg (**Mr Shlosberg**);

(ii) the liquidators of Webinvest Ltd (**Webinvest**), a company of which Mr Shlosberg was the beneficial owner; and

(iii) Avonwick Holdings Ltd (**Avonwick**), which is the creditor for around 95% of the debts owed by both Mr Shlosberg and Webinvest.

Dechert was first retained to act for Avonwick, to seek statutory demands against both Mr Shlosberg and Webinvest in relation to a USD 100 million loan made by Avonwick to Webinvest. The loan was personally guaranteed by Mr Shlosberg. After judgment was obtained, Avonwick obtained a bankruptcy order and a winding up order against Mr Shlosberg and his company. Once appointed, the trustees in bankruptcy and liquidators then instructed Dechert to act for them too.

Mr Shlosberg brought this application seeking an order that Dechert should cease acting for Avonwick. The basis for the application was that Dechert had in its possession, and had reviewed, a large number of documents which were either privileged and confidential to Mr Shlosberg or privileged and confidential to Mr Shlosberg and Webinvest jointly.

These documents were relevant to a further claim for unlawful means conspiracy which Avonwick had commenced against Mr Shlosberg and others, on which Dechert was also instructed. As this claim had been issued after Mr Shlosberg had entered bankruptcy, Avonwick had successfully applied to lift the stay on new proceedings being brought against him. Further, because of the fraudulent nature of the claims being made against Mr Shlosberg, those claims would survive his eventual discharge from bankruptcy.

The respondents did not dispute that the documents in question were subject to legal professional privilege but contended that, on bankruptcy, the privilege in the documents had passed from Mr Shlosberg to the trustees in bankruptcy. The trustees had waived the privilege, allowing the documents to be passed onto Avonwick.

Privilege and personal insolvency

The respondents noted that, under the Insolvency Act 1986, the trustees in bankruptcy had acquired ownership of all of Mr Shlosberg's property (subject to certain specific exceptions that are not relevant for present purposes, such as clothes and other personal effects) at the date of bankruptcy. "Property" is widely defined under the 1986 Act and, the respondents contended, should include the privilege attaching to the documents in question as well as the documents themselves.

Arnold J rejected this argument, holding that privilege does not pass when title to property recording the privileged information is transferred to the trustee in bankruptcy. Rather, privilege would only transfer to the trustee where the legal advice in fact related to a particular piece of property which now formed part of the bankrupt estate held by the trustee. On the facts, the trustees had not acquired the privilege because they had not acquired title to any property to which the legal advice related.

The judge considered that this decision was right as a matter of principle. For instance, a client can claim privilege over information even if the paper recording hard copy advice or servers holding soft copy advice belong to the solicitors. Arnold J also considered that previous authorities supported this point, where emphasis had been placed by the court on the nature of the information held by documents rather than the status of the document itself. By way of example, in *Haig v Aitken* [2001] Ch 110, Rimer J held that a bankrupt's personal correspondence was excluded from the estate, because of their peculiarly personal nature, notwithstanding that they were chattels in the possession of the individual when entering bankruptcy.

Privilege and corporate insolvency

The position on privilege is different in the corporate insolvency context and was common ground between the parties in this case. Nonetheless, for completeness, it is useful to summarise it here.

In a corporate insolvency process, unlike personal insolvency, property is not *automatically* transferred from the company to the insolvency officeholder. Rather, the liquidator or administrator takes over control of the company and therefore takes the benefit of the privilege already belonging to the company.

On the facts in this case, some of the documents held by Dechert were jointly privileged to Mr Shlosberg and Webinvest. Mr Shlosberg could not therefore assert privilege as against the liquidators. However, because the privilege was jointly held as between Mr Shlosberg and Webinvest, the liquidators could not waive the privilege and disclose the documents to Court without

the consent of Mr Shlosberg (which was obviously not forthcoming).

The Court's discretion to order solicitors to cease to act due to their review of privileged information

Arnold J was satisfied that, in the circumstances, it was appropriate to order Dechert to cease to act for Avonwick. Among other things:

(i) Avonwick had an adverse position to Mr Shlosberg;

(ii) Avonwick's ongoing claim (for unlawful means conspiracy) would survive Mr Shlosberg's discharge from bankruptcy;

(iii) Dechert had reviewed the privileged documents in detail and had done so deliberately;

(iv) Avonwick had made it clear that it intended to use the information, if possible, in pursuing its conspiracy claim against Mr Shlosberg; and

(v) the cost and disruption from Avonwick having to instruct new solicitors would be a little more than the otherwise necessary cost and disruption of creating a strict information barrier with Dechert.

COMMENT

This case highlights an interesting interplay between privilege and the different forms of insolvency processes. At the heart of bankruptcy (ie personal insolvency) is a transfer of property from the bankrupt individual to the trustee in bankruptcy. This case has clarified the test for when privilege over legal advice will also be transferred. In contrast, in liquidations and administrations (ie corporate insolvency), there is no such transfer. The liquidator (or administrator) simply takes over control of the company, its assets and liabilities, and the benefit of any privileged legal advice which the company has received.

One issue that seems not to have been raised before Arnold J – and one that is relevant to both bankruptcy and administration/liquidation – is that insolvency officeholders have duties to act in the interest of creditors as a whole. In some cases, it will not be in the interests of creditors as a whole for the insolvency officeholder to waive privilege over the legal advice given to an insolvent individual or company. In this case, even if the right to assert privilege over the legal advice had been transferred, it may not have been in the interests of *creditors* as a *whole* to waive privilege to facilitate a claim brought by *one creditor* to increase his share in the insolvent estate. However, there may have been some difficulty with Mr Shlosberg raising such a breach of duty argument in his defence because this duty was owed to creditors, not to himself.

The other interesting point to come out of this case relates to the multiple retainers taken on by Dechert. While it is neither unusual nor necessarily objectionable for a single law firm to act both for the insolvency officeholder and a major creditor of the insolvent individual or company, this needs to be managed carefully. Consideration needs to be given at the point of instruction as to whether separate teams should act for each client and whether information barriers should be set up in case the interests of an insolvent estate and its main creditor were to diverge. The fact that Dechert did not take these steps seems to have weighed heavily on Arnold J in favour of ordering it to cease to act for Avonwick.

While the trustees in bankruptcy in this case had appointed independent solicitors to advise them on any issue of conflict, this did not take place early enough and, crucially, only after Dechert had taken possession and had reviewed the privileged material.

Permission to appeal has been sought.

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Public Law

PROCUREMENT CHALLENGE TO RAIL FRANCHISE TENDER PROCESS FAILS

R (on the application of London Borough of Enfield) v Secretary of State for Transport [2016] EWCA Civ 480, 24 May 2016

This is a rare example of a judicial review challenge to the way in which a public body decided to set out minimum specifications in an invitation to tender. The Court of Appeal dismissed the appeal and upheld the High Court's finding that the local authority in question did not have a legitimate expectation that the tender document would specify a minimum level of train service for an area of regeneration. The Court of Appeal held that the broader public interest in proceeding with the public competition for the rail franchise took precedence over the particular interest of the claimant. It also dismissed the claim that the Department for Transport had acted irrationally.

The Department for Transport (the **DfT**) conducted a competition to select a train operating company to take over the East Anglia Rail Franchise (the **EARF**) which serves 131 train stations from London Liverpool Street. The Council wanted a 4 train per hour ("tph") service to serve an area in the Borough of Enfield that was due to be regenerated in order to provide 8,000 residential homes. The DfT had carried out a public consultation in December 2014 on the specification for the EARF prior to commencing the competition. Following that consultation, certain assurances had been provided by DfT officials, by email, to the Council that a 4 tph service would be included in the service specification for the franchise. However, in September 2015, when the DfT issued an Invitation to Tender (**ITT**) to bidders for the franchise, a lower level of service was specified.

The claimant Council alleged that the decision to issue an ITT breached its legitimate expectation that it would be provided with an opportunity to make further representations as to the need for the 4 tph service. It also argued it was irrational for the DfT not to take into account the benefits of and potential harm to the regeneration scheme when deciding on the service requirements.

The court held that the emails by the official in question were clear and unambiguous representations as to the level of service to be provided. However, they were not sufficient to generate expectations on the part of the Council upon which it was reasonable to rely, given the significance of what was at stake and the informal nature of the email correspondence. Finally, even if the emails did create a legitimate expectation, the DfT would have been entitled to depart from it given the wider public interest in adhering to the modelling methodology adopted by the DfT which took into account all the other users of the West Anglia Main Line. Even though the DfT did not expressly take into account the particular development project in question, there was nothing irrational in the use of the economic modelling it used.

The legitimate expectation test

The court confirmed that a public authority may create a legitimate expectation (substantive or procedural) by making a clear and unambiguous representation upon which it is reasonable for a member of the public to rely. Detrimental reliance is not a pre-requisite to a successful claim based on legitimate expectations. But the lack of any or significant reliance nevertheless is highly significant in the overall assessment by the court as to whether defeating the legitimate expectation is unfair.

The court noted that the Council had already spent or committed GBP 70 million to the regeneration project before the emails were sent. Furthermore, the Council's

case was that the emails had created a procedural legitimate expectation of a right to make further representations. However, the Council had already had the opportunity to present its case about the minimum level of train service as part of the formal consultation. The delay to the competition for the rail franchise would have been significant if a further round of consultation took place and that would have been prejudicial to public administration.

Irrationality

The Council argued that the DfT had promised to comply with the duties set out in the Public Services (Social Value) Act 2012. Those require public authorities to have regard to economic, social and environmental well-being in connection with public services contracts. Although local regeneration was an express objective of the EARF, and the particular project in question had not been taken into account, the Court considered that the modelling methodology was nevertheless appropriate and would be bound to further the objectives and social goals set out in the 2012 Act. The DfT enjoyed a wide discretion in the selection of appropriate modelling methodology in a "complex, technical, quasi-commercial" field.

COMMENT

The award of rail franchises has been hotly contested in the courts over the last three or four years. In 2012, the DfT decided not to contest a judicial review sought by Virgin Trains against the decision not to award it the West Coast Mainline franchise. This challenge to this particular franchise came perilously close to succeeding: the emails from the official in question met the "clear and unambiguous representation" test, but fortunately for the DfT the court held that it was not reasonable for the claimant authority to rely on those. In doing so, the court criticised the performance of the DfT and the way its officials had communicated. The court also saw "undoubted attraction" in the argument that the DfT could not rationally have failed to take into account the major regeneration project in question in its assessment of the benefits of the EARF.

However, ultimately the Court of Appeal seems to have been influenced by the fact that if the Council's challenge were upheld it would result in a complete re-run of the entire consultation process. This may be one of the reasons why it ultimately took a reasonably generous and deferential approach to the decision by the DfT to adopt the particular transport modelling in question.

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Settlement

RELEASE CLAUSE IN SETTLEMENT AGREEMENT INCLUDES FRAUD-BASED CLAIMS

Tchenguiz & ors v Grant Thornton UK LLP & ors [2016] EWHC 865 (Comm), 20 April 2016

This case helpfully considers the circumstances in which the court may be prepared to conclude that a party intended to release fraud-based claims. A settlement agreement in respect of earlier proceedings was held to cover potential claims of conspiracy, malicious procurement and execution of search warrants, and malicious prosecution relating to an SFO investigation. Although a court will be very slow to infer that a party intended to surrender rights and claims of which he was unaware and could not have been aware, or that a party intended to release fraud-based claims, the words used in the settlement agreement were sufficiently express to cover the claims.

The case is part of a long-running dispute arising out of the investigation carried out by the Serious Fraud Office (**SFO**) into the affairs of Vincent Tchenguiz.

After the collapse of Kaupthing Bank HF (**Kaupthing**) in 2008, Mr Tchenguiz and related parties sued certain Kaupthing parties in England and Iceland. However, in September 2011 a settlement agreement was reached between the claimants and the Kaupthing parties which contained various releases (the **Settlement Agreement**).

However, in 2014 the claimants sued Johannes Johannsson (a member of the winding up committee at Kaupthing) in England (the **Claims**) arising from what they allege to be his involvement in instigating, encouraging and/or directing an SFO investigation into the collapse of Kaupthing and Mr Tchenguiz and others.

Mr Johannsson's defence was that the Settlement Agreement precluded the Claims. Even though he was not a party to the Settlement Agreement, he was entitled to rely on the Settlement Agreement under the Contracts (Rights of Third Parties) Act 1999. There was no further reference to this in the judgment.

The Settlement Agreement

The Settlement Agreement contained wide-ranging releases in favour of the Kaupthing parties:

- Kaupthing was released from "any claim arising out of or in connection with the Dispute, whether known or unknown, howsoever and whenever arising, and whether presently existing or arising in the future". Dispute was defined to include "all actual or potential claims…based upon any act or matter…prior to the execution of the Settlement Agreement, including, but not limited to, the Specified Disputes".
- Kaupthing was also released from "any claim arising out of or in connection with Specified Disputes". Amongst other matters, Specified Disputes included claims concerning "the [Tchenguiz parties] Icelandic and London claim…investigations carried out by any authorities in relation to the [Tchenguiz parties] or the affairs of Kaupthing or its counterparties…and the provision of any documents or information to any authority" (emphasis added).

Approach to construction of releases – *BCCI v Ali*

The claimants argued that the Claims should be treated as, or in the same way, as fraud-based claims, and that that should take them outside the scope of the releases. The claimants also argued that the releases did not extend to claims, the existence of which was not known and could not have been known to the claimants.

Knowles J referred to the guidance in *BCCI v Ali & ors* [2001] UKHL 8 where Lord Bingham said that a party might, in a compromise agreement, agree to release claims or rights of which he was unaware and of which he could not have been aware, even claims which could not, based on the facts known to the parties, have been imagined, if appropriate language is used to make plain that this was his intention. Knowles J also referred to Lord Bingham's "cautionary principle"; that in the absence of clear language, the court will be very slow to infer that a party intended to surrender rights and claims of which he was unaware and could not have been aware.

According to *Satyam Computer Services Ltd v Unpaid Systems Ltd* [2008] 2 CLC 864, the same principle applied to fraud-based claims and express words would be necessary for such a release.

Express release wording covers unknown claims and SFO investigation

Knowles J held that the words in the Settlement Agreement were sufficiently express and the parties had chosen to expressly state that the Specified Disputes released were "unknown" as well as "known".

The Specified Disputes also included "investigations carried out or actions taken by any authorities" and there could be no doubt that this included the SFO investigation commenced some six months before. Although there was no reference in the Settlement Agreement to claims based on misconduct or deliberate wrongdoing, Knowles J considered that this reflected the fact that the parties had chosen to use language directed at a subject area rather than a cause of action. In the subject area of investigations or actions by the SFO, an

allegation of misconduct or deliberate wrongdoing would be what, objectively, the parties would have in contemplation. By including this in the drafting, the parties were putting out of reach claims in that subject area even if and when they found out more.

Knowles J considered that the Settlement Agreement, on its true interpretation, compromised the Claims and Mr Johannsson was entitled to a summary judgment.

Alleged "sharp practice"

The claimants argued that, if on its true interpretation, the Settlement Agreement did compromise the Claims, they still had a remedy because there had been "sharp practice". In *BCCI v Ali*, Lord Hoffmann stated that a person would not be allowed to rely on a release in general terms if he knew that the other party had a claim and if he knew that the other party was not aware that he had a claim. Knowles J considered that these comments only applied to a general release, whereas here there was a specific release covering investigations and actions by authorities.

COMMENT

The decision follows another recent judgment on release clauses in Khanty-Mansiysk Recoveries Ltd v Forsters LLP [2016] EWHC 522 (Comm) (covered in the May Edition of the Litigation Review), where a settlement agreement was found to have had a much wider scope than the invoice payment dispute which existed between the parties when it was executed. Both cases serve as good reminders of how important it is to consider the drafting of a release clause and claims definition when entering into a settlement.

It is important to understand what is and what is not being released and parties should be aware that widely drafted clauses, identifying a specific subject area, can include a release of fraud-based claims. Any desire for the final resolution of a dispute needs to be balanced against the risk of unintentionally settling potential future claims.

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State Aid

COURT OF APPEAL UPHOLDS APPLICATION OF THE PRIVATE INVESTOR PRINCIPLE IN STATE AID

R (Sky Blue Sports and Leisure Ltd) v Coventry City Council [2016] EWCA Civ 453, 13 May 2016

In a decision of particular relevance to parties involved in projects which receive public funding, the Court of Appeal has considered for the first time the application of the private investor principle in a state aid challenge. State aid is a risk area for projects which receive public funding because the consequences of unlawful state aid are drastic: the amount paid plus any interest has to be recovered by the state from the recipient. The Court of Appeal ruled that public bodies are allowed the same wide range of discretion when taking entrepreneurial decisions as would be available to a private investor. The relevant test is whether a prudent investor could have been *prompted* to enter into the transaction, as it is only where that is "inconceivable" that the only plausible explanation for the provision of the public funds is state aid.

On 15 January 2013, Coventry City Council (**CCC**) resolved to make a loan of GBP 14.4 million to Arena Coventry Limited (**ACL**), the operating company of the Ricoh Arena. At the time of making the loan, CCC indirectly owned a 50% stake in ACL. ACL was experiencing financial difficulties because Coventry City Football Club (**CCFC**) which had a licence to use the ground and a sub-lease of the offices at the stadium had defaulted on its rental obligations to ACL. This meant that ACL was not able to service a loan of GBP 22 million from Yorkshire Bank (the **Bank**).

ACL was accordingly vulnerable. The Bank had extensive security and step-in rights pursuant to which the operating sub-lease of the Arena was at risk. The owners of CCFC (companies in the SISU group) also sought to gain control of ACL by purchasing the Bank's debt. In these circumstances CCC loaned ACL the sum required to pay off its loan from the Bank. SISU alleged that this amounted to state aid.

At a judicial review Hickinbottom J concluded that the making of the loan by CCC fell within the wide ambit extended to public authorities in that area and did not constitute State aid under article 107 of the TFEU. The relevant test was whether, in similar circumstances, a hypothetical investor, with the same characteristics as that particular public body, might have made that decision.

For a more in-depth analysis of the first instance decision please see our earlier Litigation Review article.[1]

Private investor or state aid?

The Court of Appeal considered whether Hickinbottom J's assessment that the private investor principle had been satisfied was vitiated by demonstrably wrong findings of primary fact or whether his assessment fell outside the generous ambit of reasonable decision making afforded to a judge.

The court restated the principle that a public authority has a "*wide margin of judgment*" when considering whether or not to make an investment. Public undertakings, like private undertakings, exercise entrepreneurial skills when analysing the risk of an investment. This means there will often be a wide spectrum of reasonable responses to a specific commercial situation.

Lord Justice Tomlinson approved Hickinbottom J's summary of the relevant legal principles which govern the private investor test. The court stated that the test was not whether a prudent investor would ordinarily be expected to have entered into the transaction, but rather whether he could have been *prompted* to do so, because it was only when such conduct could be entirely ruled out as inconceivable that the only remaining plausible explanation for the provision of public funds was that it had to be regarded as State aid.

The comparator private investor should be given the same characteristics as the public body. In this case, that means it: (a) is the freeholder of the Arena; (b) has invested in the development of that Arena; and (c) has a 50% shareholding in ACL which was not without reasonable prospect of acquiring value and delivering a return in the future. The court recognised that a shareholder in the relevant undertaking may be more likely to have long-term objectives and to be less focused on making a short-term profit. A hypothetical private investor is permitted a degree of optimism as to future profits and an existing shareholder may be more likely to invest in a business which is experiencing financial difficulty if it believes there is a reasonable likelihood that the business will become profitable again.

Investment decision should be based on economic valuation

The court refined the formulation of Hickinbottom J and concluded that a public body should (like a private investor) base its investment decision on an economic valuation, although this does not need to be prepared by an independent expert. In the present case the Council's own officers could (and did) provide this economic analysis to the elected members of the Council. Where an independent expert is appointed, this may corroborate the credibility of the assessment. However, the court should not conduct an examination of the public body's judgment in choosing the source from which it took advice.

When conducting its economic valuation the public body is entitled to have regard to a contemporaneous offer of

funding by a bank or other lender. Even an exposed bank is unlikely to put forward restructuring terms which it believes its customer will be unable to comply with.

A public body is entitled to have regard to its policy objectives when taking a decision. That is the case even where the decision is a commercial one. It is only when considering whether a transaction is state aid that the public body must ignore matters of policy. A hypothetical investor must not therefore take any public policy considerations into account as it is motivated by profit rather than policy.

COMMENT

This decision is of particular relevance to parties involved in projects which receive public funding. State aid is a risk area for these projects because the consequences of unlawful state aid are drastic: the amount paid plus any interest has to be recovered by the state from the recipient. There is also a risk that damages actions may be brought by competitors. This is a significant public law decision as it is the first time the Court of Appeal has considered the application of the private investor principle in a state aid challenge.

The Court of Appeal has confirmed that a public body has a wide margin of discretion when applying the private investor principle. This means that there is a high hurdle for claimants to overcome when seeking to establish there has been unlawful state aid. It is only necessary for a public body to establish that a hypothetical investor, *with the same characteristics* as that particular public body, could have been prompted to make that decision. The hypothetical private market investor is not unduly prudent and is entitled to take calculated risks unless the risk is one that no rational investor could conceivably countenance.

The Court upheld the principle that not all private market operators invest for the same reasons. Indeed some investors are willing to retain and restructure investments because they consider there is a realistic prospect of longer-term profits. An existing shareholder might be more likely to invest in a business which is experiencing financial difficulty because of the potential for future returns. The different economic considerations and motivations of different public bodies should be reflected in the status of the hypothetical investor.

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[1] http://www.allenovery.com/publications/en-gb/european-finance-litigation-review/northern-europe/Pages/Application-of-the-private-investor-principle-in-state-aid.aspx.

Tort

THE LIMITS OF NEGLIGENT MISSTATEMENT

Playboy Club London Ltd & ors v Banca Nazionale Del Lavoro Spa [2016] EWCA Civ 457, 18 May 2016

The house always wins - except, it seems, at the Court of Appeal. The appellant bank did not owe a duty of care to Playboy Club's casino for a negligent misstatement as to a gambler's creditworthiness

made to a sister company. In reversing the first instance decision, the Court of Appeal sets out the boundaries of negligent misstatement and highlights the need for caution when relying on a statement made to a group company or an intermediary.

Playboy Club Limited (Playboy), operated a casino in London. Playboy granted a customer (Mr Barakat) a GBP 1.25 million cheque cashing facility in October 2010. This facility operated as a line of credit whereby Mr Barakat was able to draw down against cheques he supplied to Playboy before those cheques had cleared. Before granting this facility, Playboy sought a financial reference for Mr Barakat from Banca Nazionale Del Lavoro Spa (the **Bank**).

Playboy made the reference request through an intermediate services company: Burlington Street Services Limited (**Burlington**), which was owned by the same ultimate parent company as Playboy. Playboy stated it was standard practice to make such requests through Burlington to ensure a level of discretion for customers. A Bank employee supplied the reference to Burlington, confirming Mr Barakat had the means to support a financial commitment of up to GBP 1.6 million in any given week. Burlington in turn provided the reference to Playboy.

After two very unsuccessful nights on the casino tables, Mr Barakat disappeared. The cheques he had used to secure the facility were counterfeit.

The elements of negligent misstatement

Playboy sought recovery of Mr Barakat's debts from the Bank. It argued that the reference provided to Burlington was a negligent misstatement on which it had relied. This required Playboy to show: (i) the Bank owed Playboy a duty of care; (ii) the Bank breached that duty; and (iii) the loss resulting from that breach.

Elements (ii) and (iii) were established at first instance and the Court of Appeal did not seek to revisit the points. There was some discussion as to whether the Bank employee giving the reference had authority to bind the Bank. However, once HHJ Mackie QC held that Playboy could at least rely on the employee's apparent authority, there was little doubt that the reference provided to Burlington was negligent: Mr Barakat's account was, as it had been since opening, empty. The Bank had accordingly breached its duty of care to Burlington by stating Mr Barakat could meet a weekly financial obligation of GBP1.6 million. The employee who gave the reference was subsequently dismissed for unrelated but similar conduct.

The scope of the duty of care

Where the Court of Appeal and trial judge differed was on the scope of the Bank's duty of care.

The Bank clearly owed Burlington a duty of care as it was the addressee of the reference. However, the Bank argued that it did not owe Playboy a similar duty as it was not aware of Playboy's existence when making the reference. Indeed, Playboy had deliberately used an intermediate company to conceal its existence.

Playboy, on the other hand, argued that knowledge of the ultimate recipient of the reference was not a requirement to establish liability for negligent misstatement. Playboy cited *Hedley Byrne v Heller* [1964] AC 465 as an example of a bank making a financial reference without knowledge of who the ultimate recipient of the statement would be.

HHJ Mackie QC at first instance held that the Bank did owe Playboy a duty of care. The reference was simply marked "given in strict confidence" and otherwise did not purport to disclaim the Bank's liability to other parties. He noted "*there is nothing out of the way in a principal having this request or any other administrative task carried out by another member of the same group of companies*".

Longmore LJ, giving the leading judgement for the Court of Appeal, disagreed. Noting the classic test for establishing a duty of care in *Caparo v Dickman* [1990] 2 AC 605, Longmore LJ distinguished the present case from *Hedley Byrne*:

- First, in *Hedley Byrne*, the bank knew that its reference related to a client's creditworthiness for an advertising contract. In this case, the true purpose of the reference (for a gambling company) had not

been revealed and accordingly, it could not be said the Bank had assumed responsibility for the reference in circumstances where it did not know the purpose for which the reference would be used nor the party who would use it. Moreover, the natural meaning of the words "given in strict confidence" was that the reference should not be passed on to a third party.

- Secondly, there was a distinction between a disclosed, albeit unnamed principal (as in *Hedley Byrne*) and a completely undisclosed principal (as in the present case).
- Finally, in circumstances where Playboy concealed its interest in the Bank's reference to preserve customer's confidentiality, it was not fair, just or reasonable for Playboy to assert it was also owed a duty of care.

COMMENT

For companies who are frequently asked to give statements which may be relied on by third parties, the case is a welcome expression of the limits of a branch of negligence which has always been of potentially vast scope. The fact that noting a reference was "strictly confidential" was held sufficient to limit the duty of care to the addressee alone is of comfort in situations where detailed disclaimer wording has not been used.

For those who often request such references, the Court of Appeal's decision shows the dangers of wider reliance. While it will be a rare case where a company is actively seeking to hide its identity, the facts, following on from *Argos Ltd v Leather Trade House Ltd* [2012] EWHC 1348, make clear that simply being part of the same group of companies (as Burlington and Playboy were) is not sufficient for a duty of care to arise. As a practice point, the case suggests it would be desirable when making a request to specify that the statement may be relied on by the addressee and/or related companies.

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EU Developments

POST-BREXIT: A BRIEFING FOR COMMERCIAL PARTIES ON EXIT MECHANISMS AND OPTIONS FOR THE UK'S RELATIONSHIP WITH THE EU

Allen & Overy has published a paper to provide clients with a high level overview of EU exit mechanisms and the range of potential post-Brexit regimes. The paper considers the impact of some of the options (eg including examining how other States have forged a relationship with the EU without being full members - eg Norway, Switzerland, Turkey and Canada). It also flags some areas where there may be a post-Brexit legislative overhaul. Understanding these issues will assist commercial parties in their contingency planning. Commercial parties will be following developments closely given the historic vote in favour of Brexit so that, as matters begin to become clearer, appropriate steps can be taken to mitigate any risks and take advantage of any opportunities.

For hard copy – Link to: http://www.allenovery.com/SiteCollectionDocuments/Potential%20mechanisms%20for%20a%20UK%20exit%20mechanisms.pdf

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Civil Procedure

COURT OF APPEAL REFORMS

In an effort to tackle the increasing delays in the Court of Appeal, the Civil Procedure Rules Committee is consulting on a number of proposed reforms to the Court of Appeal's appeal process.

The key proposals are:

(1) to raise the threshold for permission to appeal to the Court of Appeal from "a real prospect of success" to "a substantial prospect of success";

(2) to remove the automatic right for oral renewal for applications for permission to appeal in the Court of Appeal, replacing it with a discretion for the court to decide whether to hold a hearing or to determine an application to appeal on the documents; and

(3) similarly, to remove the automatic right to an oral hearing for reconsideration of decisions on other applications made in the course of proceedings in the Court of Appeal, replacing it with a discretion for the court to decide whether to hold a hearing or to determine an application on the documents.

The consultation closes on 24 June 2016 and we will be responding to this consultation.

WHERE ON THE WEB?

https://www.judiciary.gov.uk/publications/moj-consultation-appeals-to-the-court-of-appeal-proposed-amendments-to-civil-procedure-rules-and-practice-direction/

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Client seminars can be viewed online at www.aoseminars.com.

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

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Key contacts

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