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Litigation and Dispute Resolution

Review

EDITORIAL

A number of the decisions covered in this month's Review involve commonly used terms in commercial contracts and will be of interest to both transaction lawyers and commercial litigators.

We report on the Court of Appeal's decision in *Bristol Rovers (1883) Ltd v Sainsbury's Supermarkets Ltd* which considered a contractual obligation to use 'all reasonable endeavours' (page 7). We cover the Court of Appeal's decision in *Global Motors Inc v TRW Lucas Varity Electric Steering Limited* where Beatson LJ analyses the effect of a "no variation" clause in a contract. We discuss two Court of Appeal decisions which reiterate that the *contra proferentem* rule should only apply to clauses whose meaning is ambiguous. The decisions underline that the return to literalism (post the Supreme Court's ruling in *Arnold v Britton*) applies to exclusion clauses (page 13). We report on the Commercial Court's decision in *Vinergy International (OVT) Ltd v Richmond Mercantile Ltd FZC* on whether a party terminating for common law repudiatory breach had to follow contractual termination provisions (page 15) and finally we consider a decision of Burton J on whether or not clause headings matter when construing a provision (page 17).

Also of interest in this edition are reports on whether the English courts will enforce a contract procured by bribery (page 5) and how best to go about correcting a drafting error (page 9).

We have produced a series of specialist papers on the potential legal implications of Brexit on various business areas. These can be found at: www.allenovery.com/Brexit.

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Contract

"NO VARIATION" CLAUSES WEAKENED BY COURT OF APPEAL

Globe Motors Inc v TRW Lucasvarity Electric Steering Ltd [2016] EWCA Civ 396, 20 April 2016

When is a change not a change? One answer to that paradox is: when it is an attempted contractual variation. Such variations can fail for a number of reasons: lack of consideration, lack of clarity in what is agreed and an absence of sufficient intention. The Court of Appeal considered a further potential issue that arises frequently in practice but has only infrequently been considered by the courts: the effect of so called "no variation" clauses.

TRW made power assisted steering units for various car makers. Globe supplied TRW with components used in the production of those units, in particular with certain types of motor (referred to as **Gen 1 motors**). The supply agreement (the **Agreement**) was exclusive and long term. Globe Motors Portugal, the second claimant, was not a named party to the Agreement but in practice was the entity that supplied the Gen 1 motors to TRW. TRW had started purchasing Gen 2 motors from DEAS Emerson (a company that TRW acquired after the supply arrangement with DEAS Emerson commenced).

Six issues were raised on appeal, of which two are significant:

- As a matter of contractual interpretation, did the Agreement extend to catch Gen 2 motors, such that TRW was in breach by purchasing them from DEAS Emerson rather than Globe?
- Had the parties varied the Agreement by conduct to make Globe Motors Portugal a party in circumstances where the Agreement expressly required any variation to be in writing and signed by the parties?

The interpretation issue

The Court of Appeal decided that the Gen 2 motors did not fall within the scope of the Agreement, such that TRW's purchase of them from DEAS Emerson was not a breach of contract. This, obviously, disposed of the parties' dispute (and was the reason that the Court of Appeal did not consider in any detail the majority of the six issues before it). From a precedent perspective, however, the ultimate destination reached by the Court of Appeal is less interesting than the route it took. In an eloquent and well reasoned judgment, Beatson LJ, with whom Underhill and Moore-Bick LJJ agreed, drew together a number of threads and possible areas of future tension coming out of recent Supreme Court judgments on the interpretation of contracts and the implication of terms. He highlighted the following:

- There is no special approach to the interpretation of long term contracts – it is a question of ascertaining the presumed intention of the parties in the usual way. However, in doing so the court may take into account that a flexible approach may best match the reasonable expectations of the parties in the context of a long term agreement. If the wording is wide enough, it may catch a concept or entity that did not exist when the contract was made.
- That flexibility of approach may also manifest itself in an increased willingness on the part of the court to imply into the contract a duty to co-operate or act in good faith, as contemplated in *Yam Seng*.
- At the same time, the two processes – interpretation and implication – are different and should not be confused. In particular, where (as here) implication of an obligation to co-operate was not possible, it was illegitimate to stretch the interpretation of the express terms to fill some perceived gap.

- Implication of a term will only be possible where the language of the contract, viewed against its context, permits it.

This reflects the two-stage approach to contractual analysis emphasised by Lord Neuberger in *Marks & Spencer Plc v BNP Paribas* last year. The starting point is to ascertain what the express terms mean; only then does one look to see if anything should be added. It highlights the distinct nature of those two steps and the peril for a party in not addressing issues clearly up-front: even in long term contracts where there is greater flexibility in the approach to interpretation, it will not go as far as to add terms by the back door.

The variation issue

Having decided that there was no breach, the question of whether Globe Portugal was a party to the Agreement became irrelevant; even if it had been, it could have no claim. However, it was recognised that this was an issue of broader importance and was addressed by all three judges, with the leading judgment again being given by Beatson LJ.

The Agreement contained the following clause:

> "6.3 Entire Agreement; Amendment: This Agreement, which includes the Appendices hereto, is the only agreement between the parties relating to the subject matter hereof. <u>It can only be amended by a written document which (i) specifically refers to the provision of this Agreement to be amended and (ii) is signed by both Parties.</u>"

It was common ground that no such written document existed adding Globe Portugal as a party. However, HHJ Mackie QC had found that the parties' conduct over a prolonged period demonstrated all the factual elements necessary for a variation to that effect. Did clause 6.3 nevertheless preclude Globe Portugal from being a party?

The question is one of conflicting agreements between the parties. On the one hand the parties have agreed that any changes have to be in a certain form. On the other hand, they have agreed that the contract should be altered without following that form. Which agreement prevails? The position is further complicated because the Court of Appeal has considered this issue on two previous occasions. On the first, in *United Bank v Asif* (unreported, 11 February 2000), it concluded that the earlier agreement prevailed; on the second, in *World Online Telecom Ltd v I-Way Ltd* [2002] EWCA Civ 413, it concluded that it was the latter that did so.

The Court of Appeal in *Globe Motors* preferred the reasoning in *World Online*: informal variation was possible, despite the express wording of clause 6.3 to the contrary. Beatson LJ reasoned that it was always open to parties to make and unmake their agreements and to waive compliance with particular provisions of them. If any other clause in a contract could be waived or amended, why not this one? However, the fact that an informal variation was legally possible did not mean that it was probable: "the court would be likely to require 'strong evidence' before finding there has been an oral variation of such a clause".

Whilst the result is a logical one and has considerable appeal as a matter of legal principle, the Court of Appeal recognised that it could create issues in practice: there is the risk of uncertainty or of false or frivolous claims of oral variation that cannot be dealt with summarily. Moreover, whilst the decision is technically *obiter* – a point noted by each of the judges – it is clear and well reasoned, and will obviously be highly persuasive. Following on from *C&S Associates UK Ltd v Enterprise Insurance Co plc* [2015] EWHC 3757 (Comm) it therefore represents a further weakening of no variation provisions.

How, then, can a party control variations to its contracts? As the Court of Appeal noted, no variation provisions remain of some value because they raise the bar in terms of showing that the oral discussion was intended to constitute a variation. Moreover, whilst this was not addressed by the Court of Appeal, other routes remain open to the parties. To take a straightforward example, corporate parties could limit the identity of those individuals who have the power to agree a variation. In such a case, anyone not identified in the clause would

not have actual authority to negotiate a variation on the company's behalf. Provided the company does nothing to grant them apparent authority, its contract will remain unaltered. That, in itself, requires on-going vigilance, but it gives the company some shelter against the winds of change.

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ENFORCEABILITY OF CONTRACT PROCURED BY CORRUPTION

National Iranian Oil Company v Crescent Petroleum Company International Ltd & Crescent Gas Corporation Ltd [2016] EWHC 510 (Comm), 4 March 2016

The English High Court ruled that there is no English public policy that would preclude enforcement of a contract procured by corruption (as opposed to a contract illegal in itself). Under English law, a contract procured by bribery is voidable at the instance of the innocent party.

National Iranian Oil Company (**NIOC**) and Crescent Petroleum Company International (**Crescent Petroleum**, a UAE entity) entered into a long-term gas supply and purchase contract. The contract was governed by Iranian law and referred all disputes, including disputes in relation to the validity of the contract, to arbitration. In 2003, Crescent Petroleum purported to assign the contract to its subsidiary Crescent Gas Corporation Ltd (**Crescent Gas**). In 2009, Crescent Petroleum and Crescent Gas (**Crescent entities**) commenced LCIA arbitration proceedings against NIOC claiming that it had breached its obligation to deliver gas under the contract.

In the arbitration, NIOC argued that the contract was not enforceable because it was procured by a bribe. The LCIA tribunal considered evidence of corruption in the arbitration, including at a 30-day evidentiary hearing. The tribunal rendered an award in favour of the Crescent entities ruling that the contract was valid and binding and that NIOC had been in breach since 2005. On the issue of corruption, the tribunal found that, although there was an attempt to bribe, there was no evidence that the contract was tainted by it and there was no evidence of imbalance in the parties' agreement.

NIOC challenged the award in the English High Court under s67 (lack of substantive jurisdiction) and s68 (award procured by fraud or contrary to public policy) of the English Arbitration Act 1996 (the **EAA**). NIOC contended that the award was not valid under English law because it resulted from a contract procured by Crescent's corruption, such that enforcement should be denied on public policy grounds (s68(2)(g) of the EAA). NIOC did not rely on any fresh evidence of corruption and argued that, although the arbitral tribunal dismissed the allegations of corruption, the court considering English public policy may take a different view. It also argued, albeit creatively, that even if the attempt to bribe failed, the contract was tainted by Crescent's misconduct, and that the taint was sufficient to deny enforcement.

Burton J ruled that NIOC's challenge was unarguable and had "no reasonable prospect of success".

No English public policy requiring court to refuse to enforce a contract procured by bribery

The principal issues before the High Court on the public policy argument were, in essence:

- Is an award contrary to public policy if the underlying contract was procured by corruption (as opposed to the subject matter of the contract itself being illegal)?

- Can the court reopen public policy issues if they have already been considered and decided by the arbitral tribunal?

On the first issue, Burton J agreed with *Honeywell International Middle East Ltd v Meydan Group LLC* [2014] EWHC 1344 (TCC), drawing a distinction between the enforcement of: (i) contracts to commit an illegality; and (ii) contracts procured by an illegality. While the former are void, the latter are only voidable at the election of the innocent party with counter-restitution and can accordingly be enforced. The judge noted that there is certainly no English public policy requiring the court to refuse enforcement of a contract which has been preceded, and is unaffected, by an unsuccessful attempt to bribe, on the basis that such contract is allegedly tainted. Introducing a concept of tainting of a contract which is otherwise legal and enforceable would create uncertainty and undermine party autonomy.

On the second issue, the judge agreed with previous decisions of the English courts which generally refuse to reopen the findings of an arbitral tribunal, absent "fresh evidence" or save in "very exceptional circumstances" (see, eg, *Westacre Investments Inc v Jugoimport-SDRP Holding Company Ltd* [1999] QB 740). Critically, the allegations of bribery were considered and rejected by the arbitral tribunal "after full consideration and evidence" in the arbitration. Burton J ruled that there was no basis to reopen the tribunal's decision on this point because there was no fresh evidence of corruption and no exceptional circumstances that would justify doing so.

COMMENT

The case confirms previous case law, including *Honeywell and Westacre*, that there is no English public policy requiring an English court to refuse enforcement of a contract procured by an illegality (to be contrasted with contracts that are illegal per se – for example, a contract to pay a bribe). Where a contract is procured by an illegality, it is merely voidable at the instance of the party innocent of the illegality (in this case, NIOC) as opposed to being automatically void and therefore unenforceable for being contrary to public policy. Here, the contract could have been avoided by NIOC if it had correctly argued that the contract was voidable (but it does not appear to have done so). By contrast, if the tables were reversed and it was NIOC who sought to enforce its rights under the contract against Crescent entities, the latter could not have resisted enforcement because they were not the "innocent" party.

While Burton J held that the court would not interfere with a contract even if one or more of the parties had committed criminal acts for which they could be prosecuted, he considered the claimant's counsel's arguments based on recent international conventions to outlaw bribery and the increase of legislation to criminalise it. However, these arguments were not sufficient to persuade the court to change English public policy on the enforcement of a contract procured by bribery.

It is worth remembering however that under the English Bribery Act 2010, it is a criminal offence to offer a bribe (even if the bribe is not accepted). Moreover, any proceeds from a contract procured by bribery may constitute criminal property and be covered by money laundering rules. UK companies and foreign companies carrying on business or a part of their business in the UK are caught by the English Bribery Act 2010.

Parties who are considering making corruption allegations before the English courts in order to resist enforcement of a contract should bear in mind that the evidentiary threshold for proving corruption is high; direct evidence is often unavailable and circumstantial evidence may be insufficient. Moreover, once corruption allegations are made, and regardless of the outcome of these assertions, the commercial relationship between the parties will likely be irreparably compromised.

This case is also a useful reminder that, where issues of corruption had been considered by an arbitral tribunal, fresh evidence is required in order to reopen the arbitrators' decision before the English courts. The threshold for challenging an award on public policy grounds under s68 of the EAA is very high and the English court will not conduct a review on the merits of an arbitral award.

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"ALL REASONABLE ENDEAVOURS" CONSIDERED BY COURT OF APPEAL

Bristol Rovers (1883) Ltd v Sainsbury's Supermarkets Ltd [2016] EWCA Civ 160, 17 March 2016

In a property dispute, an "all reasonable endeavours" obligation extended to making a new planning application or appealing a planning decision. Once Sainsbury's had done so, its general endeavours obligation did not cease unless, as per the contract, a planning counsel's advice was that further application or appeal would be less than 60% likely to succeed. The case shows how obligations to use "all reasonable endeavours" can be limited in scope by a specific obligation.

Bristol Rovers football club entered into a conditional contract to sell its football stadium to Sainsbury's. The contract contemplated the demolition of the Memorial Stadium and the building of a Sainsbury's superstore. One of the conditions was that there should be no restrictions on delivery and despatch of goods to and from the store between the hours of 5am to midnight on any day. Over time the economics of the deal changed and Sainsbury's wanted to terminate the contract lawfully.

The contract required Sainsbury's to "use all reasonable endeavours to procure the grant of [acceptable planning permission] as soon as reasonably possible…". There was a further provision which obliged Sainsbury's to pursue an appeal against a planning refusal if planning counsel advised that such an appeal had a 60% chance or greater of achieving acceptable planning permission.

Bristol City resolved to grant, but did not grant, planning permission subject to restrictions on the times when deliveries could be made. These restrictions were unacceptable to Sainsbury's and ultimately agreed by the parties to be contrary to one of the conditions in the contract. Accordingly, Sainsbury's pursued an application under the Planning Act to obtain planning permission without the restrictions on deliveries.

This application was refused. There was a disagreement between the parties as to whether this Planning Act application was an appeal within the meaning of the contract. Ultimately, and simplifying matters since both parties acted as if this application was an appeal, they were held to this, by way of an estoppel by convention, at first instance and on appeal.

Having obtained planning counsel's advice that an appeal of the refusal of the Planning Act application was less than 60% likely to succeed, Sainsbury's sought to terminate the contract on the grounds that one of the conditions had not been met. Bristol Rovers claimed that the contract had been terminated in breach of contract. Bristol Rovers lost at first instance and appealed to the Court of Appeal where it also lost.

Context

As Lewison LJ puts it in his book *The Interpretation of Contracts: "An obligation to use reasonable endeavours to achieve the aim probably only requires a party to take one reasonable course, not all of them; whereas an obligation to use best endeavours probably requires a party to take all the reasonable courses he can. In that context, it may well be that an obligation to use all reasonable endeavours (or to do all things reasonably necessary) equates with using best*

endeavours." The Court of Appeal in this case did not grapple with these distinctions. Instead it focused on whether the obligation persisted at the relevant time and if so whether it had been breached.

"All reasonable endeavours" obligation did not end after first appeal

The Court of Appeal rejected Sainsbury's argument that its "all reasonable endeavours" obligation ended with an initial planning application which is refused (and an appeal would have less than 60% chance of success) or an unsuccessful appeal. It was clearly envisaged elsewhere in the contract that Sainsbury's might withdraw a planning application and submit another one where it was reasonable to do so or where to do so would enhance the prospects of obtaining planning permission. The Court of Appeal acknowledged that Sainsbury's obligation to appeal was qualified by the provisions about the 60% test but that did not mean the process came to an automatic halt after an unsuccessful appeal. Rather "it will do so when there are no more reasonable steps which Sainsbury's can take to secure the grant of [planning permission]".

If so, what did "all reasonable endeavours" entail?

Sainsbury's was not in breach of its "all reasonable endeavours" obligation by its failure to lodge a further Planning Act application. It was not obliged to do so unless planning counsel advised that it had passed the 60% test, and this had not occurred.

The Court of Appeal was not prepared to accept that the "all reasonable endeavours" obligation required Sainsbury's, as Bristol Rovers claimed, to give consent to Bristol Rovers to file its own Planning Act application in circumstances where Sainsbury's would not themselves be obliged to file such an application.

COMMENT

This case is a useful illustration of how the court approaches endeavours clauses in the planning context. All reasonable endeavours extended to appealing a planning a decision, or in this case, making a new planning application. Once Sainsbury's had done so, its endeavours obligation did not cease unless counsel's advice was that further appeal or application would be less than 60% likely to succeed.

The case shows that the scope of a general "all reasonable endeavours obligation" will be limited by any express provisions in the contract which regulate a party's obligation to take a particular course of action. If acting for the obligor, consider other express terms that can be used to limit the scope of such an obligation including, for example, time limits and limits on expenditure. In return, the obligee may want to specify the nature or frequency of update reports, or state that such an obligation "includes but is not limited to" certain steps (thus avoiding any later argument that an activity that is not covered by the express wording in a clause is therefore not part of the endeavours obligation).

Careful consideration should be given before using a best endeavours or all reasonable endeavours obligation. In *Jet2.com v Blackpool Airport Ltd* [2012] EWCA Civ 417, the Court of Appeal concluded that a party may be required to take action which is contrary to its own commercial interests.

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CORRECTING DRAFTING ERRORS – WHAT IS THE BEST APPROACH AND WHAT EVIDENCE IS ADMISSIBLE?

LSREF III Wight Ltd v Millvalley Ltd [2016] EWHC 466 (Comm), 8 March 2016

The High Court held that a mistaken reference in an interest rate swap confirmation to the 1992 ISDA Master Agreement instead of the 2002 ISDA Master Agreement (and the agreed form of Schedule thereto) could not be corrected by interpretation. However on the facts the mistaken reference could be corrected by rectification. The decision highlights that interpretation is unlikely to cure a drafting error unless there is some ambiguity or linguistic mistake which makes the drafting commercially absurd. Rectification may however work where interpretation does not, and has the added benefit of allowing evidence of the subjective intentions of the parties and their negotiations to be admitted.

The dispute arose out of loans and related hedging arrangements between a bank lender and three affiliated special purpose vehicle (**SPV**) borrowers. Over the course of six years, the loans and hedges were restructured. An issue arose in relation to one restructured hedge with one SPV as to whether it was governed by the printed form of the 1992 ISDA Master Agreement (without a Schedule), which had been incorporated into the Confirmation of the restructured hedge, or whether it was governed by the 2002 ISDA Master Agreement that was then in place between the bank and that SPV at the time of entry into the restructured hedge. This mattered because the 2002 ISDA Master Agreement included an Additional Termination Event that was subsequently triggered by repayment of the loan made to another SPV. No such Additional Termination Event applied under the printed form of the 1992 ISDA Master Agreement. The judge accepted that it was a clear administrative error that the Confirmation documenting the restructured hedge mistakenly omitted reference to the existing 2002 Master Agreement and instead used standard language incorporating the printed form of the 1992 ISDA Master Agreement (without a Schedule). The error could not be cured as a matter of construction, but rectification was available in these circumstances.

Facts

Millvalley Limited (**Millvalley**), a SPV of the property developer William McCabe, acquired an interest in a Glasgow department store. In 2006 Millvalley entered into an interest rate swap with Anglo Irish Bank Corporation (the **Anglo Irish**) to hedge its interest rate exposure on the loan that funded that acquisition (the **Original Swap**). The Original Swap was confirmed in a long-form swap Confirmation that included market standard language requiring the parties to negotiate in good faith the execution of a 1992 ISDA Master Agreement "with such modifications as you and we shall in good faith agree" and, pending such execution, incorporating the printed form of the 1992 ISDA Master Agreement (without a Schedule). No Master Agreement was in fact executed at that time.

Anglo Irish was nationalised in 2009 and in 2011 merged with another troubled Irish entity to form the Irish Bank Resolution Corporation (the **IBRC**).

In mid-2011 an extension of loans by the IBRC to two of Mr McCabe's other SPVs (the **Loans**) was agreed, on the basis that Millvalley sold the store and repaid its loan. However the Original Swap remained in place and was used as a hedge for the Loans. As part of this process Millvalley and the IBRC entered into a 2002 ISDA Master Agreement dated 13 December 2011 (the **Millvalley 2002 Master Agreement**) to document the existing hedging arrangements. In the Schedule to the Millvalley 2002 Master Agreement, the parties agreed various Additional Termination Events triggered by the repayment, prepayment or cancellation, in whole or in part, of the Loans.

In late 2012 the Loans were further restructured, and the Original Swap restructured so that its term and notional amount matched that of the restructured Loans (the **Restructured Swap**). On 19 December 2012 Millvalley and the IBRC executed a long-form Confirmation of the Restructured Swap, that did not refer to the Millvalley 2002 Master Agreement but instead included the same market standard language that had been in the Confirmation of the Original Swap requiring the parties to negotiate in good faith to execute a 1992 ISDA Master Agreement and pending such execution incorporating the printed form of the 1992 ISDA Master Agreement (without a Schedule).

In June 2014 one of the Loans was repaid, triggering an Additional Termination Event under the 2002 ISDA Master Agreement. The IBRC issued a notice designating an Early Termination Date under Section 6(b) and sought payment of an Early Termination Amount of GBP 4,282,518.90 plus interest.

Millvalley refused to pay the Early Termination Amount, arguing that the Restructured Swap was governed by the 1992 ISDA Master Agreement, which did not contain the relevant Additional Termination Event. The 2002 ISDA Master Agreement was not referred to in the Confirmation of the Restructured Swap and therefore did not apply.

The IBRC assigned its claim for the Early Termination Amount to LSREF III Wight Limited (**Wight**).

Correcting the mistake by interpretation?

It was common ground between the parties that there had been no contemporaneous discussions in late 2012 as to which ISDA Master Agreement applied to the Restructured Swap, and Cooke J accepted evidence from Wight that the reason the Restructured Swap referred to the 1992 ISDA Master Agreement was simply because the 2002 ISDA Master Agreement between the parties had not been correctly entered into the IBRC's operating systems, and so the system that automatically generated the swap Confirmation for the Restructured Swap did not generate the correct form of Confirmation.

Wight argued that, as a matter of construction of its terms in the relevant commercial context, the Restructured Swap was governed by the Millvalley 2002 Master Agreement, on the basis that something had plainly gone wrong with the language of the swap Confirmation, and a reasonable person having all the relevant background would have understood the parties to be referring to the Millvalley 2002 Master Agreement.

Cooke J rejected this argument. Applying Lord Hodge's summary of the case law on remedying mistakes by construction in *Arnold v Britton* [2015] AC 1619, he held that the reference could not be corrected by construction as there was no ambiguity in the language and a linguistic mistake could only be corrected by construction where, without the correction, the linguistic mistake would be such a "commercial nonsense as to make it absurd for the parties to refer to it". Cooke J held that, while it was clear on the evidence that the reference to the 1992 ISDA Master Agreement was a mistake, the Confirmation itself did not drive the court to the conclusion that that reference was a commercial nonsense or absurd. The terms of the Restructured Swap could operate perfectly sensibly by reference to the 1992 ISDA Master Agreement.

Correcting the mistake by rectification?

Wight also argued that, if the proper construction of the Restructured Swap is that it is governed by the 1992 ISDA Master Agreement, then it should be rectified so as to refer to the Millvalley 2002 Master Agreement.

Cooke J found that as a matter of construction the Millvalley 2002 Master Agreement governed the Original Swap from 13 December 2011. In other words, it was the ISDA Master Agreement contemplated by the language requiring the parties to negotiate in good faith to put in place an ISDA Master Agreement. The fact that it was based on the standard form 2002 ISDA Master Agreement rather than the standard form 1992 ISDA Master Agreement did not affect this conclusion, the choice of form falling within the scope of the words "with such modifications as you and we shall in good

faith agree". Cooke J further held, on the evidence of the exchanges between the parties during the 2011 and 2012 restructurings, that there was a common understanding that was objectively communicated between the IBRC and Millvalley that the Millvalley 2002 Master Agreement would also apply to the Restructured Swap. Therefore the mistaken reference tothe 1992 ISDA Master Agreement in the Confirmation of the Restructured Swap was capable of rectification as, on the facts, the four requirements for rectification set out in *Daventry District Council v Daventry & District Housing* [2012] 1 WLR 1333 were met. There was an objective common continuing intention that the Restructured Swap should be governed by the Millvalley 2002 ISDA Master Agreement, that continued at the time of the execution of the Restructured Swap, there was an outward expression of accord as to that intention, and it was only by mistake that the Confirmation of the Restructured Swap did not reflect that intention.

COMMENT

This case is a good lesson on the importance of seeking the right remedy. In particular it demonstrates that, although the four *Daventry* requirements for rectification are often not easy to satisfy, where a linguistic mistake falls shy of commercial absurdity a rectification argument may succeed where a construction argument would otherwise fail, especially in light of the reversion to a more literal approach to the construction of contracts in *Arnold v Brittan*.

In particular a rectification argument can be a useful toolto put before the court contemporary evidence as to the parties' negotiations and subjective intentions, which would otherwise be inadmissible in a pure contractual interpretation case. Often, as in this case, such evidence makes plain the parties' real understanding of their agreement, and exposes the artifice of one side's legal position. In this case Cooke J posed himself the same essential question on construction and rectification – what would the reasonable objective observer, possessed of all the relevant background, conclude as to the intention of the parties – but, because of the additional background information available to that observer for the rectification question, arrived at a different conclusion.

While he did not need to decide the point, Cooke J noted that a number of recent High Court decisions have doubted whether an outward expression of accord should be a strict legal requirement for a rectification claim (rather than simply an evidential factor), reflecting academic criticism of *Daventry*. *Daventry* remains good authority that it is a strict legal requirement, but the issue is ripe for further judicial consideration.

Finally the court also emphasised that standard form contracts, such as the ISDA Master Agreement, are less susceptible to purposive linguistic interpretations by reference to background circumstances and factual matrix, due to the heightened importance of consistency and predictability of the meaning of terms in such contracts, given their widespread use and therefore the potential impact of a judicial interpretation of any provision of the standard form on other transactions governed by the same standard terms.

Two minor points worth noting in passing. First, the Millvalley 2002 Master Agreement included a form of "sweep-in" clause in Part 5(a) of the Schedule, although as a matter of interpretation the clause did not encompass the Restructured Swap for reasons explained by Cooke J in his judgment. Secondly, Cooke J specifically considered Section 11 in awarding costs on an indemnity basis in favour of Wight and rejecting an argument by Millvalley that the Section 11 indemnity somehow fell outside the limited permission to transfer an Early Termination Amount under Section 7 of the ISDA Master Agreement.

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COURT OF APPEAL CONFIRMS CROSS-DEFAULT PROVISION DOES NOT FALL FOUL OF PENALTY RULE

Edgeworth Capital (Luxembourg) SARL & anr v Ramblas Investments BV [2016] EWCA Civ 412, 28 April 2016

The Court confirms, in this short judgment, what most people thought, namely that a cross-default provision is not susceptible to the penalty rule.

Ramblas argued that a fee payable under a so-called "upside fee agreement" was unenforceable as being a penalty, because it far exceeded any loss that Edgeworth, as assignee of the original lender RBS, could suffer as a result of the breach of contract in failing to make repayment under a junior loan agreement. The Court of Appeal held that the recitals and the upside fee agreement itself made it clear that the fee was the remuneration payable to Edgeworth for providing part of the finance necessary to complete the purchase of the *Ciudad Financiera*, a development in Madrid. The fee became payable on a specified date when the repayment of the junior loan fell due. The event which constituted an "Event of Default" under the junior loan agreement and caused the loan to fall due for repayment was not a breach of the junior loan agreement, but a breach of a personal loan agreement, a separate further loan agreement, by the borrowers. As the judge said, the fee had nothing to do with damages for breach of contract; it was payable on the happening of a specified event. Accordingly, it did not fall foul of the rule against penalties as formulated in *Cavendish v Makdessi*.

This Court of Appeal judgment has the following rather brilliant line from Lord Justice Moore-Bick, "The appeal raises no point of law of general importance and no one other than the parties to the proceedings are likely to be interested in its outcome".

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DEFAULT INTEREST PROVISION BREACHES PENALTY RULE (OBITER)

Hayfin Opal Luxco 3 SARL & anr v Windermere VII Cmbs Plc & ors [2016] EWHC 782 (Ch), 8 April 2016

Following the Supreme Court's new test for penalties in *Cavendish v Makdessi*, Snowden J found (obiter) that a default interest provision (which provided for interest to be paid on unpaid interest) in a commercial mortgage-backed securitisation structure was extortionate and fell foul of the penalty doctrine. The fact that the issuer's liability was on a limited recourse basis was not relevant as the penalty doctrine does not depend upon whether it is subjectively intended to, or does, provide a deterrent to the particular contract-breaker.

This case relates to the rights attaching to a certain class of notes in a commercial mortgage-backed securitisation structure called "Windermere VII", which had been arranged by Lehman Brothers International (Europe) in 2006. A subsidiary issue was whether certain interest provisions were void as a penalty.

Snowden J deliberately chose not to express any view on whether the provision in question was a conditional primary obligation (so that the penalty rule did not apply) or a secondary obligation (so that it did) as discussed in *Cavendish*.

However, assuming the penalty rule applied, and acknowledging that he did not have to decide the point, Snowden J observed that if, contrary to his primary position, the provision under scrutiny meant that in the event of non-payment of interest on a payment date, further interest would accrue and be payable on that amount, "the almost inevitable result that could be anticipated at the time of contract would be a multiplication of the unpaid amount by a very sizeable factor to arrive at a sum many times the amount that would adequately compensate the innocent party for being kept out of its money. In any conventional terms, the imposition of such interest rates for breach in failing to make payment of a sum due would be regarded as exorbitant (if not extortionate)".

Snowden J went on to say that he did not think that the fact that the obligations of the issuer of the notes were imposed on a limited recourse basis provided any exception or defence to the application of the penalty doctrine, "As Lords Neuberger and Sumption indicated in *Cavendish*, the penalty doctrine does not depend upon whether it is subjectively intended to, or does, provide a deterrent to the particular contract-breaker, but must be founded upon objective reference to some norm". Accordingly, as Snowden J put it, "the penalty doctrine focuses on the lack of proportionality between the amount of the secondary liability imposed and the innocent party's legitimate interest in performance of the primary obligation". As a result, whether a clause is a penalty could not therefore depend upon the ability of the particular contract-breaker to pay the specified amount, or the source from which he is to pay: "An innocent party cannot save a clause from being a penalty by claiming that even though it provides for payment of a wholly disproportionate amount to the interest which he (the innocent party) has in performance, the contract-breaker is so rich that he will not notice the difference. Nor can he do so by promising to limit his claim to specified funds in the hands of the contract-breaker, if the available amount of those funds would still be capable of paying a wholly disproportionate amount, and payment might deprive the contract-breaker of the ability to pay debts due to other creditors with lower priority".

Interestingly in *Credit Suisse Asset Management LLC v Titan Europe 2006-1 Plc and others* [2016] EWHC 969 (Ch) the Chancellor of the High Court noted that the parties had referred to Snowden J's various obiter comments made in *Hayfin* and sought to rely on them or to distinguish them. The Chancellor, accordingly declined to follow this example, fearing that any obiter views, like those of Snowden J, might be deployed in an argument in future cases where, almost inevitably, the wording of the relevant instruments and the surrounding matrix of fact will not be identical. If that happened, he thought, it would be likely to create more rather than fewer difficulties for a judge in such a case.

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INTERPRETATION OF EXCLUSION CLAUSES

Nobahar-Cookson & ors v The Hut Group Ltd [2016] EWCA Civ 128, 22 March 2016 and *Transocean Drilling UK Ltd v Providence Resources Plc* [2016] EWCA Civ 372, 13 April 2016

The Court of Appeal has twice in two months handed down judgments on how the return to literalism (post the Supreme Court's ruling in *Arnold v Britton*) applies to exclusion clauses. This is an important development for all commercial parties who seek to limit their contractual liabilities towards their counterparties, whether by shortening limitation periods, narrowing or qualifying definitions of loss or any of the myriad other devices found under the umbrella "exclusion clause".

Interpretation of exclusion clauses and *contra proferentem*

An exclusion clause is one which excludes or restricts a party's contractual liability, whether by imposing time limits for instituting claims, narrowing or qualifying definitions of loss, restricting parties' recourse to rights or remedies, or curtailing the application of the rules of evidence or procedure. Two recent Court of Appeal judgments have considered the construction of exclusion clauses and, in particular, how the principle of *contra proferentem* should apply to such clauses.

Contra proferentem only applies where there is ambiguity, ie the conventional methods of interpretation – chiefly seeking the natural meaning of the words – produce differing and plausible interpretations of the same wording. The essence of the principle of *contra proferentem* is that it allows the wording of a clause to be interpreted strictly against the party who "proffers" that wording. Generally, *contra proferentem* operates against the party that drafted the wording and now seeks to rely on it. An exclusion clause, however, can be construed *contra proferentem* against any party which seeks to rely on it. This is because the party which seeks to rely on an exclusion clause bears the burden of proving it. The principle is most often associated with contracts between parties of unequal bargaining power. There has been longstanding uncertainty as to whether or not *contra proferentum* can apply to a negotiated agreement.

A similar but distinct approach, no longer regarded as a presumption, operates specifically in relation to exclusion clauses: the principle in *Gilbert-Ash*. In *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689, 717H Lord Diplock held that there is a presumption that neither party to the contract intends to abandon any remedies for breach which clear words are required to rebut. This is now seen as a principle of commonsense: parties do not normally give up valuable rights without making it clear that they intend to do so.

***Contra proferentum* applied to negotiated exclusion clause**

In *Nobahar-Cookson & ors v The Hut Group Ltd* [2016] EWCA Civ 128 the appellant, Mr Nobahar-Cookson (originally the defendant) sought to overturn a High Court ruling in favour of The Hut Group (**THG**), which had brought a claim for a breach of warranty in the Share Purchase Agreement (**SPA**) by which THG had purchased a sports nutrition business from Mr Nobahar-Cookson. Mr Nobahar-Cookson had argued at first instance that the claim fell foul of the 20-day time limit for notification of such claims under the SPA. Considering the meaning of the term "aware of the matter" in the relevant limitation clause, Blair J had rejected Nobahar-Cookson's argument on the basis that the point at which THG as buyer had become "aware" of the fact that it had grounds for a claim was on receiving advice to that effect from its forensic accountants (the narrow interpretation), rather than when THG uncovered the facts it referred to those accountants (the wider interpretation). As such, the clock had not begun to run for the 20-day limit early enough to make THG's claim time-barred.

Briggs LJ, delivering judgment in the Court of Appeal, arrived at the same conclusion as the lower court but did so on very different grounds.

Where the two courts differed in their approaches was whether or not the principle of *contra proferentem* should apply to resolve the ambiguity between the narrow and wider interpretations of the limitation clause. Blair J was of the view that it should not, his rationale being that the SPA imposed similar time limits on both parties (a similar time-bar elsewhere in the contract operated solely against Mr Nobahar-Cookson as Seller) and this ruled out *contra proferentem*. Brigg LJ was of the opinion that the High Court had erred in this approach, and held that where a court applied the "natural meaning" test from *Arnold v Britton* to an exclusion clause and arrived at two differing interpretations, neither of which was commercially absurd, *contra proferentem* should apply and the narrower interpretation favoured.

It should be noted that while both other judges agreed with Briggs LJ on the outcome of the appeal, they both also qualified their agreement by making it plain that they would have put more emphasis on the "commerciality" of the preferred interpretation.

Contra proferentum should not be applied automatically to exclusion clauses

In *Transocean Drilling UK Ltd v Providence Resources Plc* [2016] EWCA Civ 372 (*Transocean*) an oil exploration company, Providence, hired a rig from *Transocean* to drill an exploratory well. During drilling a fault developed in the rig resulting in a four-week suspension of operations. Under the hire agreement, liability was apportioned between the parties by a complex and wide-ranging set of indemnities and exclusion clauses. One such exclusion clause operated to exclude recoverability of "consequential loss". This was a bilateral clause making each party subject to the same exclusions. The High Court had found that the breakdown was caused by *Transocean's* breach of the agreement. The breach was a failure to provide the rig in serviceable condition. *Transocean* appealed on a point of contractual interpretation ie whether or not certain losses were "consequential" and thus excluded.

The losses in question were referred to as "spread costs" and included the costs wasted on other contractors to provide ancillary services such as diving, weather and engineering services. Popplewell J took *contra proferentem* as his starting point for construing the exclusion clause on the basis that, in his view, the principle in *Gilbert-Ash* necessitated the application of *contra proferentem* without further enquiry.

Moore-Bick LJ, delivering judgment in the Court of Appeal, overruled this approach for three reasons. First, there was no ambiguity in the language of the contract. *Contra proferentem* is a method of interpretation of last resort and should only be invoked where there is ambiguity, not where an enquiry into the natural meaning of the words, as per *Arnold v Britton*, produces a single, commercially reasonable interpretation. Secondly, he held that *contra proferentem* is not synonymous with the principle in *Gilbert-Ash* and it should not be assumed that where one is applicable, so is the other. Finally, the Court of Appeal held that *contra proferentem* has no part to play in interpreting a clause which acts against both parties equally, especially where they are of equal bargaining power.

In this case, where the clause in question was a mutual exclusion clause that two parties of equal bargaining power had negotiated and agreed to, the Court of Appeal placed great emphasis on the obligation of the courts to give effect to contractual language agreed between commercial parties, particularly in light of *Arnold v Britton*. The court confirmed that even where parties have bound themselves to onerous obligations, an interpretation that reflects what the parties actually agreed to is to be preferred. Interference from the bench should be curtailed in favour of party autonomy. Moore-Bick LJ went so far as to suggest that parties might successfully, and without fear of interference, mutually exclude liability for any breach of a given contract. As long as the language of the contract clearly states the parties' intention to give up rights and remedies, the principle of freedom of contract dictates that it should be interpreted plainly.

COMMENT

The reiteration by the Court of Appeal in both cases that *contra proferentem* should only apply to clauses whose construction is ambiguous is a helpful clarification.

The relevant wording in each of these cases was markedly different from the other. In *Nobahar-Cookson* the clause was ambiguous. In *Transocean* the clause was clear, unambiguous and mutually operative against both parties to the agreement.

The overriding impression from both cases is that the Court of Appeal was keen to favour an approach to contractual interpretation that respects agreements reached by commercial parties, and will not leap to apply *contra proferentem* when faced with an exclusion clause, an approach that will be welcomed.

It seems that the court will be willing to uphold a clear and unambiguously drafted mutual exclusion clause between two equal contractual parties and thus drafting clauses to meet these conditions should – while there are no guarantees – improve the likelihood that an exclusion clause will be upheld.

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TERMINATION FOR REPUDIATORY BREACH: DO CONTRACTUAL NOTIFICATION PROVISIONS APPLY?

Vinergy International (PVT) Ltd v Richmond Mercantile Ltd FZC [2016] EWHC 525 (Comm), 15 March 2016

A party who terminated a contract for common law repudiatory breach was not obliged to follow contractual termination provisions. Vinergy International (PVT) Ltd claimed that the termination was not valid because the terminating party had not provided notice or an opportunity to remedy the breach, as required by the termination provisions in the contract. The Commercial Court noted that there was no generally applicable rule and refused to imply a term in circumstances where the contractual termination provisions did not expressly cover common law repudiation.

Vinergy entered into a master supply agreement in August 2008 (the **Agreement**) with Richmond to receive a supply of bitumen for an extendable term of ten years. Disputes developed between the parties and Richmond terminated the agreement in July 2012. Vinergy denied liability and claimed that Richmond had unlawfully terminated the agreement.

An arbitral tribunal found that there had been three repudiatory breaches by Vinergy: (i) a breach of the exclusivity provisions of the Agreement by which Vinergy had undertaken to buy bitumen exclusively from Richmond; (ii) a failure by Vinergy to pay an invoice from July 2011 for almost a year; and (iii) failure by Vinergy to pay demurrage for certain shipments.

The tribunal held that Richmond had lawfully terminated the Agreement and awarded Richmond sums which had fallen due for payment and damages.

Vinergy appealed, claiming that the tribunal's finding was wrong in law.

Termination provisions in contract

Amongst other termination rights contained in Clause 17, Clause 17.1.1 allowed either party to terminate the Agreement immediately upon "*failure of the other party to observe any of the terms [of the Agreement] and to remedy the same where it is capable of being remedied within the period specified in the notice given by the aggrieved party…*". When Richmond terminated the Agreement, it did not give notice requiring remedy in accordance with Clause 17.1.1.

Clause 18 confirmed that termination in accordance with Clause 17 did "*not prejudice the rights of action or remedy* [of either party] *in respect of any antecedent breach by the other party of any such party's obligation under* [the] *Agreement*".

Repudiatory breach not covered by termination provisions

Vinergy argued that any common law right to terminate for repudiatory breach had to be exercised in the manner prescribed by Clause 17. It relied on *Lockland Builders Ltd v Richwood* (1995) 46 Con LR 92 (CA) in which the court had found that a party who sought to terminate for repudiatory breach should have followed a specific contractual termination provision because the alleged breaches fell within the scope of the termination clause.

Teare J recognised that the arbitral tribunal had already made a finding of fact that *Vinergy's* actions amounted to repudiatory breach. So he approached the matter as one of construction (relying on guidance from the Court of Appeal in *Stocznia Gydinia SA v Gearbulk Holdings Ltd* [2009] EWCA Civ 75 that *Lockland Builders Ltd* had not laid down any general principles for such situations). Teare J considered the following question: was the notice provision in Clause 17.1.1 intended to apply when a party sought to exercise its common law right to accept a repudiatory breach as terminating the Agreement?

There was nothing in Clause 17.1.1 which *expressly* referred to the right of a party to accept a repudiatory breach as terminating the Agreement and Teare J found that he could not imply such a provision for three reasons: (i) Clause 17.1.1 did not deal with common law repudiation and instead termination under the Clause was predicated upon "*failure…to observe any of the terms*" of the Agreement (which could be major or minor in terms of seriousness); (ii) the requirement to give notice to remedy in Clause 17.1.1 did not apply to other termination rights contained in the remainder of Clause 17 (with the judge therefore inferring that the notice requirements were intended only to apply to the specific termination right contained in Clause 17.1.1); and (iii) nothing in Clause 18 touched on either party's rights at common law to accept a repudiatory breach as terminating the contract.

Exclusivity breach incapable of remedy anyway

Teare J went on to consider the position if his approach was wrong and if *Lockland Builders Ltd* had laid down a more general principle. He considered whether "a clause requiring notice to remedy applies to breaches within the scope of the clause". First, he noted that it was clear that only breaches which were remediable would fall within the scope of Clause 17.1.1. Teare J considered that the second and third breaches by Vinergy (failure to pay an invoice, and failure to pay demurrage) were remediable and Vinergy was bound by the finding of the tribunal that the first breach (failure to adhere to an exclusivity arrangement) was "incapable of remedy" (despite being attracted by Vinergy's arguments to the contrary).

As such, even if Clause 17.1.1 applied to repudiatory breaches which were capable of remedy, it could not apply to the breach of the exclusivity provisions because that breach was not capable of remedy. Given the seriousness of the breach, Richmond was entitled to accept Vinergy's repudiatory breach of the exclusivity provisions as terminating the contract without the need to require remedy of the breach.

COMMENT

In all but a handful of circumstances, the court will approach an agreement on the natural reading of the words. In this case, if the parties had wished to apply notice provisions to common law termination for repudiatory breach, they should have done so expressly. The message is very clear: if you wish to include cure

periods and specific notice periods for repudiatory breaches, do so explicitly. The court will not, as a matter of construction or implication, allow a party to require its counterparty to comply with such provisions at a later date.

This case follows a number of recent decisions in which the court has considered the interplay between express contractual rights to terminate an agreement and the rights to terminate that arise under common law. For example, the court's decision in *C&S Associates UK Ltd v Enterprise Insurance Co Plc* [2015] EWHC 3757 (Comm), highlights that exclusion of any common law remedy must be done explicitly, and the more valuable the right in question (for example, the right to terminate for repudiatory breach), the more express this wording must be. The decision in Vinergy takes this approach to its natural conclusion: where the parties intended to amend common law rights (for example, to add a cure period for repudiatory breaches), they must be explicit and clear in their drafting.

A cautious party may, despite this decision, wish to observe contractual notice provisions in case the specific facts of the case lead a judge to construe that such provisions apply to a common law termination for repudiatory breach. In such circumstances, the party exercising the provisions should ensure that it makes it abundantly clear that, despite following contractual notice provisions, it is exercising its common law right to terminate for repudiatory breach. Following the decision of Leggatt J in *Newland Shipping and Forwarding Ltd v Toba Trading FZC* [2014] EWHC 661 (Comm), it is clear that a terminating party must explicitly communicate which right is being exercised (or that both rights are being exercised in circumstances where there is no inconsistency in doing so), otherwise the communication may not be sufficiently certain for there to have been an effective termination.

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CLAUSE HEADINGS: WHEN DO THEY MATTER (AND WHEN DO THEY NOT?)

Citicorp International Ltd v Castex Technologies Ltd, 24 February 2016

Despite a provision that "headings shall be ignored", Burton J stated that he would find it "… impossible not to be assisted" by a clause heading in construing a clause. This decision draws together the authorities on the use of headings as an aid to interpretation of clauses, and examines the effectiveness of "headings shall be ignored" type provisions, which commonly appear in commercial contracts.

Castex Technologies Limited (**Castex**), a company listed in India, had issued convertible bonds due to convert to equity shares of Castex in 2017. Citicorp International Limited (**Citicorp**) was the bond trustee. The bond conditions permitted Castex, in certain circumstances, to force the conversion of the bonds into shares before 2017 following the giving of a "Mandatory Conversion Notice". It purported to give that notice on 31 July 2015 (**Notice**). Citicorp, on the instruction of certain of the bondholders, commenced proceedings alleging the Notice did not comply with the formalities requirements of the bond conditions.

The bond issue was governed by a trust deed, including as a schedule a "form of certificate for definitive bonds". The bond conditions (which were referred to in the form of certificate and in the trust deed definitions) appeared in a separate document. The trust deed provided in Clause 1.3 that "Headings shall be ignored in construing this Trust Deed."

In the bond conditions, condition 8 dealt with redemption and conversion notices. Condition 8.2 expressly provided for the giving of conversion notices, and Castex purported to give the Notice under that provision. Condition 8.11, which Citicorp contended was applicable to the Notice, had the following noteworthy features:

- it was headed "Redemption notices"; and
- it provided that all notices given under "*this Condition*" would specify six matters that did not all appear in the Notice.

Citicorp accepted that the matters relating to redemption in Condition 8.11 were not required to be included in the Notice (because this was not a redemption scenario). Argument centred on whether the other matters specified in the condition, which were omitted from the Notice, would invalidate it.

Condition 8.11 not applicable and, if it was, the heading could not be ignored

Without reference to the heading, Burton J found that Condition 8.11 did not apply to the Notice (principally because the absent matters related to redemption and not conversion notices). Further, as the Conditions "… are simply referred to in, and stand alongside" the trust deed, rather than being incorporated in them, Burton J found that the "headings shall be ignored" clause (clause 1.3) of the deed would not apply to the Conditions.

Use of headings in agreements

Burton J also commented that he would "… find it impossible not to be assisted" by the heading to Condition 8.11 even were clause 1.3 of the trust deed to apply. The judge referred to two lines of authority. First, in *SBJ Stephenson Ltd v Mandy* [2000] FSR 286 and *Doughty Hanson & Co. Ltd v Roe* [2007] EWHC 222 (Ch) the court was faced with a clause to the effect "clause headings are inserted for convenience only and shall not affect the construction of the agreement". In *SBJ Stephenson*, Bell J determined the court could look to the heading where it could "tell the reader at a glance what the clause was about." Similarly, in *Doughty Hanson*, Mann J determined the relevant clause was admissible "as descriptive of what the provision is about".

Secondly, in *Gregory Products (Halifax) Ltd v Tenpin (Halifax) Ltd* [2012] 2 AER (Comm) 645, where Lewison J indicated "… respect for party autonomy means that the headings cannot be allowed to alter what would otherwise have been the interpretation of the clause in question" – albeit in the context of a clause where the heading and content of the clause were materially inconsistent.

In following the *SBJ Stephenson* and *Doughty Hanson* line of authority, Burton J found the heading and content of condition 8.11 were consistent. The judge further indicated that it would astonish the parties to the agreement if the heading of Condition 8.11 had to be ignored.

COMMENT

The decision provides limited support for the proposition that a clause heading may be used as an interpretive aid, despite a provision precluding reliance on clause headings to aid interpretation. However, that proposition is only true so long as the heading and substantive content of the clause are consistent.

The admissibility of a heading as an interpretive aid is less clear where the heading is inconsistent with the content of the following clause. For example, in the *Gregory Products* case, the relevant clause heading was "Conditionality", while the clause was unconditional. Lewison J conceded the clause dealt generally with conditionality, but Burton J's decision (that the heading cannot alter the clause's interpretation), when considered against the *SBJ* and *Doughty Hanson* decisions, means it is difficult to derive a general proposition as to when headings may impact interpretation.

What is clear is that all four decisions (this decision and the three relied on by the judge) proceed on the basis that a heading may assist where it is consistent with the clause that follows it, and that a clause must be read

in its entirety to determine its overall meaning. As such, it seems to be that where the content of a clause is inconsistent with the heading, the heading (in a document with a provision for headings to be ignored in interpreting the document) must be ignored in determining the parties' rights and obligations.

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Damages

HOW MUCH WOULD YOU CHARGE TO LET YOUR COUNTERPARTY BREACH THE CONTRACT? – *WROTHAM PARK* DAMAGES

Karen Morris-Garner & Andrea Morris-Garner v OneStep (Support) Ltd [2016] EWCA Civ 180, 22 March 2016

The Court of Appeal's decision in this case suggests *Wrotham Park* damages may become more common as a remedy for breach of contract. These damages reflect how much the innocent party would have asked for to release the defaulting party, had it been asked, and is a useful remedy where it is difficult to show financial loss. The difficulty has been that it has not been clear when they should become available. The Court of Appeal has now clarified the issue: *Wrotham Park* damages will be awarded where the claimant would have very real problems in establishing financial loss and it is a "just" response to a breach of contract. The Court of Appeal rejected the notion that such damages should be restricted to exceptional circumstances.

OneStep (Support) Limited (**OneStep**) is a social care business. In 2002, its shares were divided equally between Karen Morris-Garner and Charmaine Costelloe and both were also directors. They had also entered into a shareholders agreement, which included certain non-compete clauses. Both Charmaine's husband, Martin Costelloe, and Karen's civil partner, Andrea, were also heavily involved in the business.

In 2004, the working relationship between the Morris-Garners and the Costelloes began to break down. In 2006, Charmaine served a "Deadlock Notice" under the shareholders agreement that required Karen to either buy Charmaine's shares or sell her own for a certain price. Karen opted to sell her shares, stepped down as a director of the company, and entered into a settlement deed which contained further non-compete clauses. Andrea entered into a similar settlement deed to terminate her employment with OneStep.

However, the month before the "Deadlock Notice" had been served, and unbeknownst to anyone at OneStep, Karen had incorporated a new company called Positive Living Limited (**Positive Living**). In 2007, Positive Living started marketing its business. The services it offered included those also offered by OneStep. In 2012, OneStep launched proceedings against both Karen and Andrea Morris-Garner for breach of the restrictive covenants in the shareholders agreement and the settlement deed.

At first instance, Philips J found that the Morris-Garners had breached their non-compete obligations and held that OneStep were in principle entitled to "*Wrotham Park damages*" to reflect the amount that might have

been reasonably demanded by OneStep in 2007 for releasing the Morris-Garners from those obligations.

The Morris-Garners appealed, both in respect of the question of breach and as regards the availability of *Wrotham Park* damages as the remedy. This note focuses on the latter issue.

What are *Wrotham Park* damages?

The primary remedy for breach of contract is damages reflecting the loss suffered by the innocent party. The aim is to compensate the innocent party by putting them in the position they would have been in had the contract been fulfilled.

However, in *Wrotham Park Estate Co Ltd v Parkside Homes Ltd* [1974] 1 WLR 798, Brightman J awarded damages for breach of a restrictive covenant attaching to land, assessed by reference to the contract-breaker's gain from the breach, at 5% of the anticipated profit from the wrongful development. The judge considered this to be the sum that the claimant, acting reasonably, could have demanded for relaxing the restrictive covenant. *Wrotham Park* damages were thus born.

Wrotham Park damages have been the subject of considerable academic and judicial scrutiny. There is continuing debate as to whether the damages are an unusual form of compensatory damages (compensating for loss of an opportunity to bargain) or in fact gain-based (restitutionary) damages. On either view, however, it is accepted that such damages are unusual. The cases in which they have been given tend to fall into one of these three categories:

- breach of restrictive covenant cases (sometimes in lieu of an injunction);
- breach of confidence (in relation to both contractual and equitable duties of confidence); or
- proprietary torts (eg trespass, conversion).

However, just because there has been a breach of a restrictive covenant, or the commission of a trespass, does not mean that there is automatically a right to *Wrotham Park* damages. The question that therefore arises – and which was put to the Court of Appeal in this case – is when they should be available as a matter of principle.

When are *Wrotham Park* damages available?

The Court of Appeal approved a two-limb test:

(1) The claimant would have very real problems in establishing financial loss

In the leading judgment, Christopher Clarke LJ noted that *Wrotham Park* damages were a "flexible" response to the need to compensate a claimant. Denying *Wrotham Park* damages on the basis that, while practically difficult, it might technically be possible to prove financial loss (as the Morris-Garners had submitted) would inhibit that flexibility.

In his concurring judgment, Longmore LJ agreed, noting that Gibson LJ had held in *Experience Hendrix LLC v PPX Enterprises* [2003] EWCA Civ 323 that all that was required was that "the claimant would have difficulty in establishing financial loss".

On the facts, though the trial judge had not found that OneStep was incapable of establishing identifiable loss, OneStep nonetheless met this first limb of the test. Its losses related to its goodwill and slowdown in business, and it would have "very real problems" in proving such losses.

(2) *Wrotham Park* damages are the just response

In identifying this as the second limb of the test, Christopher Clarke LJ rejected the Morris-Garners' submission that *Wrotham Park* damages should only be available where otherwise a "manifest injustice" would arise. The dicta referring to "manifest injustice" on which the Morris-Garners relied were simply "expressions of the position in relation to the facts of the particular cases" and not the formulation of some abstract test.

Christopher Clarke LJ added that "What is the just response is, quintessentially, a matter for the judge to decide" and saw no basis for disturbing his decision on the justice of the remedy that he had given. Similarly, Longmore LJ emphasised in his concurring judgment that "it is appropriate to consider the justice of the case on a broad brush basis".

The factors in this case that made an award of *Wrotham Park* damages "just" included that the non-compete clauses were the crucial part of the settlement agreement that had led to the Morris-Garners being paid a large sum of money to sell their shares, and the fact that their breaches of those covenants were deliberate, intended from the very start, and conducted with subterfuge and furtiveness. This last factor was particularly important to Longmore LJ because it meant that OneStep had been unable to seek an injunction to resolve the dispute at an early stage.

The availability of *Wrotham Park* damages is not limited to "exceptional circumstances"

The Morris-Garners submitted this additional check was necessary to stop *Wrotham Park* damages swallowing up the primary remedy for breach of contract, ie straightforward compensatory damages. The language of this limb suggests that they may have had in mind Lord Nicholls' remark in *Attorney General v Blake* [2001] 1 AC 268 that compensatory damages should be awarded save in "exceptional circumstances", which has been often cited by the courts to refuse gain-based relief.

OneStep argued that this should not form part of the test for the availability of *Wrotham Park* damages and Christopher Clarke LJ again agreed. The Morris-Garners were eliding the tests for the availability of account of profits for breach of contract and *Wrotham Park* damages.

Quantifying *Wrotham Park* damages

For completeness, it should be noted that this appeal was solely concerned with the availability of *Wrotham Park* damages. No guidance was given as to the process for quantifying such damages. However, there have been other cases where such guidance has been given. The assessment must consider what sum would have been arrived at by the parties themselves, making reasonable use of their bargaining positions, at the date that the wrong was committed. For these purposes it is irrelevant that the parties would not in reality have agreed to a deal.

A recent example of a detailed quantum assessment can be found in *CF Partners v Barclays Bank* [2014] EWHC 3049 (Ch) (a breach of confidence case). There, the judge weighed up the weak negotiating position of the innocent party against the fact that the other party had deliberately breached its duties of confidence and therefore must have placed some value on the information that it used for its own purposes. As a cross check, the judge considered the overall gain made from the breach of confidence and was satisfied that the sum he had arrived at constituted a reasonable fee for unlocking that gain.

COMMENT

The consequence of this decision is that *Wrotham Park* damages may be more widely pursued as a remedy for breach of contract. However, it still remains difficult to predict exactly when they will be available. In particular, the second limb of the test set out above (ie are *Wrotham Park* damages the just response) is vague and uncertain.

Certainty is a prized feature of English contract law. Commercial parties often have to decide whether a breach of contract might be economically efficient, ie whether the recoverable loss suffered by the counterparty would be less than the gain received by the contract-breaker, such that, after damages have been paid, both parties would in fact end up in the same or better position than they would have been had the contract not been breached (see eg R Posner, *An Economic Analysis of the Law*). Not knowing the extent of their liability on breach makes such decision making much more difficult. It is to be hoped that future cases will provide more guidance.

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Sanctions

UK ENFORCEMENT OF FINANCIAL SANCTIONS LIKELY TO RISE

The new UK Office of Financial Sanctions Implementation (**OFSI**)[1], part of HM Treasury (**HMT**) opened on 31 March 2016. This may signal a shift towards more aggressive enforcement of the financial sanctions regime in the UK.

OFSI is responsible for the implementation and administration of international financial sanctions in effect in the UK, for domestic designations under the Terrorist Asset-Freezing Act 2010, licensing exemptions to financial sanctions, and directions given under Schedule 7 to the Counter-Terrorism Act 2008,[2] and under Council Regulation (EU) No 833/2014,[3] concerning Russia's actions in Ukraine. OFSI will "work closely with law enforcement to help ensure that financial sanctions are properly understood, implemented and enforced".[4]

Also, in February 2016, the UK's Home Secretary presented the Policing and Crime Bill to Parliament. The Bill includes proposals to increase criminal penalties for financial sanctions breaches, enhance the ability of HMT to enforce the new regime, and provides for the swifter implementation of UN financial sanctions. As an alternative to a criminal prosecution for breach of financial sanctions, the Bill provides for HMT to impose monetary penalties for financial sanctions non-compliance. HMT will have powers to impose monetary penalties of up to GBP 1 million or 50% of the estimated value of the funds assessed to be in violation of the relevant financial sanctions. The new Bill will also allow HMT to pursue criminal prosecutions and enter into deferred prosecution agreements.

These developments bring the UK closer to the approach in the U.S. The U.S. sanctions enforcement regime, implemented by the Office of Foreign Assets Control (**OFAC**), has a significant enforcement record and has levied some large fines in recent years. Historically there has been little enforcement in the UK, although the Financial Conduct Agency (**FCA**) has fined banks for having inadequate systems and controls.

For UK businesses, the creation of OFSI with significant enforcement powers will increase the risk of falling foul of financial sanctions. It is important for businesses to keep up to date with UK sanctions. The new OFSI website contains a consolidated list of targets and an email updating service.[5]

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1 https://www.gov.uk/government/organisations/office-of-financial-sanctions-implementation.

2 http://www.legislation.gov.uk/ukpga/2008/28/schedule/7.

3 http://eur-lex.europa.eu/legal-content/EN/TXT/;ELX_SESSIONID=Dj2cTbFhLGxyP62DYN0W9JlS1hyLtqPbHdnzXYLGzTcxCkGJsz1s!2004986111?uri=OJ:JOL_2014_229_R_0001.

4 https://www.gov.uk/government/news/new-body-to-support-financial-sanctions-implementation-launched.

5 https://www.gov.uk/government/organisations/office-of-financial-sanctions-implementation.

Settlement

WIDE INTERPRETATION OF RELEASE CLAUSE IN SETTLEMENT AGREEMENT

Khanty-Mansiysk Recoveries Ltd v Forsters LLP [2016] EWHC 522 (Comm), 29 March 2016

A settlement agreement relating to a dispute over legal fees of GBP 130,000 also covered a subsequent GBP 70 million claim for breach of contract and negligence. The existence of a potential claim for breach of contract and negligence was not suspected at the time the settlement agreement was entered into. Properly construed, the widely-drafted release clause and definition of claims captured claims beyond the initial dispute. The context did not act to limit the scope of the settlement agreement. A claim for breach of contract and negligence was within the realms of possibility rather than an "unknown unknown". The case serves as a good reminder of how important it is to consider the scope of release wording. Often parties will be pulling in opposite directions when negotiating this wording, but it is vital to understand what is, and what is not, being "released".

The defendant law firm advised an oil exploration company on the acquisition of oil exploration licences through a transfer of shares in a Russian company. A dispute arose regarding an unpaid GBP 130,000 invoice for legal advice and a related guarantee provided by a company director. The dispute culminated in a tripartite settlement agreement between the defendant, the company and the director. The company subsequently discovered that the transfer of shares in the Russian company had not been effective and it was ultimately put into liquidation. The claimant acquired the company's claim from the liquidators and sought to bring a claim for breach of contract and negligence against the defendant relating to the legal advice provided in connection with the share acquisition. The court was asked to determine whether the settlement agreement relating to the unpaid invoice should be construed as having settled the present claim.

Settlement Agreement

The release clause in the settlement agreement provided for the full and final settlement of all or any claims which the parties had, or could have had, against each other. It was expressed to include claims currently in existence or coming into existence in the future, regardless of whether or not such claims were in the contemplation of the parties at the time of entry into the settlement agreement. Under the terms of the settlement agreement the parties also covenanted not to sue each other, directly or indirectly, in connection with or in relation to the claims.

"Claims" was defined to encompass any potential claim, counterclaim, potential counterclaim, whether known or unknown, suspected or unsuspected, however and whenever arising, whether or not such claims were within the contemplation of the parties at that time. Both the release clause and "Claims" definition, Eder J noted, were very wide.

The "Claims" definition was qualified by the wording "arising out of or in connection with" the action commenced to recover the amounts due under the invoice and the invoice itself. The present claim did not "arise out of" that action or the invoice. However, the court held that, using the natural meaning of the words, the present claim was connected to the action and to the invoice as they all related to the provision of the same legal services.

Approach to construction

The parties acknowledged that the starting point regarding the construction of a settlement agreement was, as per the House of Lords' confirmation in *Bank of Credit and Commerce International SA v Ali* [2002]

1 AC 251, that general release clauses should be construed in the same manner as the terms of any other contract, and that no special rules applied to their interpretation.

The claimant relied on the decision in *BCCI v Ali* to argue that the scope of the release clause in the settlement agreement should be limited by the surrounding circumstances. The claimant referred in particular to Lord Bingham's "cautionary principle"; 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 he was unaware and could not have been aware.

Eder J rejected the claimant's argument that the broad ambit of the release clause as drafted in the settlement agreement was limited by the context. It was accepted that the original dispute related only to the quantum of the unpaid invoice and the present claim for breach of contract and negligence was entirely unsuspected at that time, but such a claim was not wholly inconceivable. An objective observer would not have thought it impossible. It therefore differed from the claim in *BCCI v Ali* where the basis of the subsequent claim was only recognised by the House of Lords as a matter of law after the settlement agreement was formed, making it an "unknown unknown".

The court found that properly construed, the tripartite settlement agreement draft was sufficiently wide to settle all "Claims", not just those relating to the initial dispute, and that "Claims" did capture the present claim.

COMMENT

The narrow and limited nature of the original dispute relating to legal fees, as well as the disparity in value between the original dispute and subsequent claim for breach of contract and negligence, might lead the unwary to assume that an agreement settling the former would not encompass the latter. The decision underscores the need to consider carefully the drafting of the release clause and claims definition when entering into a settlement. Parties should be conscious that a widely-drafted agreement may compromise their ability to bring unknown claims in the future. The desire to achieve a final resolution to a dispute must be balanced against the risk of unintentionally settling potential future claims.

The broad drafting was held to evidence the parties' intention that the ambit of a settlement agreement should extend beyond their initial dispute and encompass claims such as the present one. Lord Bingham's "cautionary principle" did not assist the claimant when the wide wording of the settlement agreement was taken into account.

Moreover the court's reasoning suggests that against such a backdrop, few claimants will be able to rely on the "cautionary principle" where their settlement is widely drawn. The claimant in *BCCI v Ali* succeeded as the substance of its claim had not been recognised as a matter of law at the time that the settlement agreement in question was entered into, rendering it an "unknown unknown". This decision makes clear that unsuspected but conceivable claims will not be similarly excluded from the scope of a widely-drafted release clause.

Also significant is the expansive meaning attributed to the wording "in connection with" in the analysis resulting in the finding that the present claim was connected to the original dispute relating to the unpaid invoice as they both related to the same legal services.

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INTERNAL INVESTIGATIONS: MANAGING INCREASED EXPECTATIONS AND CHALLENGES

Thursday 19 May 2016 – 8:30am – 9:30am

Presented by: Arnondo Chakrabarti, Partner, Litigation; Jonathan Hitchin, Partner, Litigation; Blair Keown, Senior Associate, Litigation; Brandon O'Neil, Senior Associate, Litigation and Sarah Hitchins, Associate, Litigation.

Over the past couple of years, expectations for internal investigations undertaken by corporates and financial institutions have increased considerably. These increased expectations have been reinforced by what we are seeing in practice from various regulators and law enforcement agencies, as well as by statements and speeches made by the FCA and the SFO in the UK, as well as regulators and enforcement agencies based in other jurisdictions.

In this seminar, our White Collar Crime, Contentious Regulatory and Employment lawyers will focus on the key challenges that corporates and financial institutions face when carrying out internal investigations – for example, interview techniques and recordings, the concept of 'co-operation' and what it means in practice, the production and format of investigation reports, maintaining privilege and liaising with regulators and authorities. We will also provide practical suggested solutions to these challenges, which reflect how firms should manage the expectations of regulators and law enforcement agencies regarding internal investigations.

This seminar will be of particular interest to Legal, Compliance and Employment/HR personnel who are involved in the conduct of internal investigations. An update on developments in banking and finance law and practice in the last six months.

Registration and breakfast will take place from 8am; the seminar commences at 8:30am.

STANDBY LETTERS OF CREDIT

Wednesday 15 June 2016 – 12:30pm – 1:30pm

Presented by: Richard Hooley, Consultant

Standby LCs are used to support private placements, commercial paper programmes, leveraged leases, export credit-related finance and other structured deals. This seminar will explain how standby LCs operate and compare them with commercial letters of credit, demand guarantees and suretyship guarantees. The seminar will also consider what can be done to prevent fraudulent demands for payment being made under a standby LC, as well as the main features of ISP98 (comparing it to URDG 758), which is a set of uniform rules commonly incorporated into standby LCs.

Registration and a buffet lunch will take place from 12pm; the seminar commences at 12:30pm.

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When mitigation leads to a profit, who should benefit?: *Fulton Shipping Inc of Panama v Globalia Business Travel S.A.U. (formerly Travelplan S.A.U.) of Spain ("The New Flamenco")* (Mar)

"Many thanks Myles, much appreciated" – lessons in audit rights, repudiatory breach and informal variation: *C&S Associates UK Ltd v Enterprise Insurance Co plc* (Mar)

Costs

Court cannot divide an offer to settle: *Sugar Hut Group Ltd & ors v A J Insurance Service* (April)

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