ALLEN & OVERY

May 2017

Litigation and Dispute Resolution

Review

EDITORIAL

The capacity of a sovereign state to enter into contracts, and the application of litigation privilege to documents generated during an internal corporate corruption investigation, had not, until now, been ruled on by the English courts. For any party contracting with a sovereign state, particularly in debt financings, Blair J's ruling on capacity provides welcome clarity (see **Contract**). Andrews J's ruling on litigation privilege is, however, undoubtedly less welcome for corporates and, we hope, will be appealed (see **Privilege**). The question of privilege over materials generated during internal investigations is very controversial. The English courts' restrictive view of privilege does not sit easily with corporates being actively encouraged, by investigating authorities, to investigate internally any allegations of wrongdoing that arise in their businesses.

We also cover recent decisions on the POCA consent regime, the recovery of swap break costs when a loan is redeemed early, and a Supreme Court ruling on a refinancing which left a negligent advisor (on the original financing) escaping liability and the lender seriously out of pocket. All are particularly relevant for finance parties or investors.

Allen & Overy LLP acted for the winning bidders (and interested parties) in an unsuccessful attempt by a losing bidder to bring a judicial review claim in relation to the sale by the UK government of Green Investment Bank. This case, and another ruling concerning a challenge by an unsuccessful tenderer in a public procurement project for nuclear decommissioning, provide some useful lessons for those seeking to challenge, or defend, the outcome of a tender process for a contract with a public authority.

Amy Edwards
Senior Professional Support Lawyer
Litigation – London

Contact
Tel +44 20 3088 2243
amy.edwards@allenovery.com

Contents

Contract

CAPACITY OF STATE TO CONTRACT

The Law Debenture Trust Corporation plc v Ukraine [2017] EWHC 655, 29 March 2017

A political battle between Russia and Ukraine has ended up before the English courts, in the context of a dispute over repayment of Eurobonds issued by Ukraine. The decision is the first English law authority on the capacity of a state to contract. Blair J held that once a state is recognised as such, it has unlimited capacity to borrow and cannot be constrained by domestic law restrictions (constitutional or otherwise) on the state. Any lack of compliance with internal restrictions is properly characterised as a question of authority, rather than capacity. The judge also held that terms should not be implied into transferable financial instruments.

Russia sole subscriber to Ukraine Eurobonds

In late 2013, Ukraine was on the verge of signing an Association Agreement with the European Union. It did not ultimately do so: Ukraine contended that Russia applied "massive, unlawful and illegitimate" economic and political pressure to force the Ukraine administration into accepting Russian financial support instead. The transaction was structured as a USD 3 billion Eurobond note issue by the state of Ukraine, with Russia as the sole subscriber.

The documentation was standard for Eurobonds: the documents were governed by English law, with the Law Debenture Trust Corporation appointed as trustee (to represent the interests of the sole noteholder, Russia). In early 2014, Russia invaded Crimea, severely impeding Ukraine's ability to meet its obligations under the notes (due to adverse effects on tax revenues).

Following Ukraine's failure to repay the Eurobond at maturity, the Trustee (acting on the direction of Russia) brought proceedings in the English Commercial Court for summary judgment for non-payment, contending that the debt was a simple English law obligation. Ukraine's defence was threefold:

(1) Capacity and authority: The Eurobond transaction is void because, as a matter of Ukrainian law, Ukraine had no capacity to enter into it due to restrictions in its constitution and budget laws, and the Minister of Finance had no actual authority to sign the various agreements and issue the Eurobonds.

(2) Breach of implied terms: Russia, through its acts in invading Crimea, was in breach of implied terms, including a term not to demand repayment if it unlawfully deprived Ukraine of the benefit of the loan, deliberately interfered with Ukraine's capacity to repay, or breached its obligations towards Ukraine under public international law.

(3) Duress: Wrongful and illegitimate acts by Russia constitute duress under English law, such that the transaction documents were voidable.

Capacity of a sovereign state to contract

No prior case law has considered the question of the capacity of a foreign state to borrow, or indeed to enter into other forms of contract, as a matter of English law. For the purpose of the summary judgment application, it was assumed, as a matter of Ukrainian law, that Ukraine lacked capacity to enter into the Eurobonds due to the breaches of its constitution and budget laws.

The judge found that the question of a state's capacity to contract should be determined as a matter of English law (rather than the law of the relevant state). Lacking prior English authority on how the capacity of a state is determined, Blair J considered how the English court would approach the question in cases involving natural persons, public authorities and foreign corporations but

found those analogies to be inexact, and reasoned instead from principles of public international law. He held that a state's capacity to borrow resides in its sovereignty. So once a state is recognised as such, as a matter of English and international law, it has unlimited capacity to borrow, which cannot be restricted by the state's domestic rules on borrowing. Ukraine did not therefore lack the capacity to borrow notwithstanding any provision to the contrary in its domestic law.

Authority to contract

The court then considered whether the Minister of Finance, as a matter of authority, had bound the state in executing the documents.

Actual authority is determined by local law (in this case, Ukrainian law). The parties agreed that the Minister of Finance had no actual authority under Ukrainian law to sign the various agreements and issue the Eurobonds.

On the other hand, the question of whether there was usual or ostensible authority was governed by English law, as the governing law of the agreements. The term "usual authority" is associated with the type of authority usually held by a person in the position of the person acting, whereas ostensible authority arises where there has been some more direct representation as to the authority of the person acting.

Blair J found that a Finance Minister would not always have usual authority for state borrowing by reason of his/her office: it would depend on the role of the Finance Minister in the particular state, and the particular borrowing.

However, on the facts, there was usual authority, as the Minister had been the signatory of all 31 previous debt issuances (on which the Trustee had also acted) and there was no suggestion that the Trustee was on notice of any lack of authority in this instance.

Blair J also found that the Ukrainian Cabinet had usual authority to hold out the Minister of Finance as Ukraine's authorised representative in the transaction, such that the Minister also had ostensible authority to enter into it. The 'holding out' appears to arise from the existence of a Cabinet Decree, and the issuance of the Prospectus by Ukraine.

No implied terms in transferable financial instruments

Blair J recognised, as a general principle, that a term would be readily implied that one party would not seek to prevent a counterparty's performance of a contract (and that it was powerfully contended that the Crimea invasion had this effect). However, where the subject matter of a contract is a transferable financial instrument, he found there should be no implied terms. There is a need for certainty on the part of transferees who must be able to ascertain the nature of the obligation they are acquiring from the relevant contract.

Duress applied by a foreign state

Ukraine argued that the contractual arrangements were procured by duress, namely unlawful and illegitimate threats and pressure exerted by Russia in the form of threats of trade sanctions and use of force in Crimea. While the English law defence of duress was available to Ukraine, the judge found that it had no real prospects of success because the acts allegedly constituting the duress, being foreign acts of state, were inherently non-justiciable and the court would refrain from adjudicating upon them.

As such, overall, distinguishing the "deeply troubling" political background from the strict legal arguments, Blair J held against Ukraine and granted summary judgment. Ukraine has stated its intention to appeal the judgment.

Implications for dealings with sovereigns

For any party contracting with a sovereign, particularly in debt financings, the judgment provides welcome clarity in this surprisingly underdeveloped area of English law. The ruling establishes that a foreign state recognised in the UK has unlimited capacity to contract as a matter of English law, irrespective of any domestic law provisions to the contrary.

Instead, any domestic law limits are likely to go to the question of whether the actor binding the state had authority, rather than capacity, to contract. And even if there is clearly no actual authority under local law, there may still be usual or ostensible authority established under English law.

Parties contracting with states must therefore continue to carefully consider the state actor's authority in all transactions. The saving grace in this particular case was a long course of prior dealings with the Trustee, a representation from a body (the Ukrainian Cabinet) with usual authority to hold out an authorised representative of the state, and a lack of notice of any deficiencies in the Minister's authority.

It will remain important to consider questions of capacity in the context of assessing the commercial risk of a transaction, particularly in emerging markets. A non-payment or other default by a state counterparty triggered by domestic legal or political imperatives will be commercially problematic even if the agreement proves to be legally enforceable. Litigation against states tends to be particularly hard fought, and the difficulties in enforcing against state assets can often significantly delay or even thwart any remedy.

The separate finding of an absolute prohibition on the implication of terms into transferable financial instruments is a wide-ranging one, going beyond previous case law (and therefore potentially vulnerable to appeal). The ruling provides increased certainty in dealings in, or restructurings of, such instruments.

Finally, this does not change the position on capacity of a foreign public body (rather than the state itself): it is the law of the jurisdiction of the public body which determines capacity. However, if it relates to an English law contract, it remains English law that determines the consequences of any such incapacity.

Stacey McEvoy
Associate
Litigation – Banking, Finance & Regulatory – London

Contact
Tel +44 20 3088 3009
stacey.mcevoy@allenovery.com

RECOVERY OF INTEREST SWAP BREAK COSTS ON EARLY REDEMPTION OF LOAN

Barnett-Waddington Trustees (1980) Ltd v Royal Bank of Scotland Plc [2017] EWHC 834 (Ch), 12 April 2017

Could the bank recover under an indemnity in a loan agreement for the costs of unwinding a related interest rate swap when the loan was redeemed early by the borrower? In earlier proceedings, Warren J had ruled that the bank could not, as the hedge relied upon by the bank was an internal swap. The bank then discovered a related swap with an external counterparty and tried to recover for that in these proceedings. Mann J refused. Although the bank claimed that no one at the bank had been aware of the external swap at the time of the previous proceedings, the court held that the bank had 'corporate knowledge' of the external swap, as it was recorded in the bank's books and a written record of the external swap existed. It would be an abuse of process to allow the bank to rely on the external swap in these later proceedings.

The earlier litigation – an internal hedge

Earlier litigation concerned the interpretation of an indemnity clause in a loan agreement (the **Loan Agreement**) between the defendant (the **Bank**) and a group of borrowers (the **Borrowers**). The Bank agreed to lend more than GBP 9.2 million to the Borrowers at a fixed rate of interest (the **Loan**).

The Loan Agreement permitted early redemption on certain terms, including an indemnity by the Borrowers against any loss incurred by the Bank in unwinding a "*funding transaction*" undertaken in connection with the Loan. The Bank stated that it had hedged its interest rate exposure under the Loan with an internal interest rate swap (the **Internal Swap**). If the Borrowers repaid the Loan early, the Bank would have to unwind this swap. The earlier litigation centred on the Bank's ability to add

the amount required to unwind the Internal Swap to the other redemption charges required to redeem the Loan early. The Bank claimed that the Internal Swap was a "*funding transaction*" and that, accordingly, the Borrowers should bear the cost of unwinding the swap. However, Warren J found in favour of the Borrowers, holding that the Internal Swap was not a "*funding transaction*" under the terms of the Loan Agreement. As the swap was between different divisions of the same lending bank, it did not amount to a "*transaction*" as a transaction required the involvement of two different legal entities. In addition, the Bank would not incur any loss or cost in the event that the internal swap was unwound. In these circumstances, the Borrowers were not liable to pay the Bank any sums in respect of unwinding its Internal Swap.

Bank discovers swap with external counterparty

The Bank subsequently discovered a swap with an external counterparty (the **External Swap**) that was related to the Loan and sought to add the cost of unwinding the External Swap to the redemption charges. In response, the Borrowers sought a declaration that they were not obliged to pay costs relating to the recently discovered External Swap.

The Borrowers argued that the claim was an abuse of process as the Bank ought to have raised the External Swap in the first proceedings, and that it was now too late to bring the claim. The Bank claimed that there was no duty on the Bank, as a defendant to the earlier CPR Part 8 proceedings, to raise issues other than the issues specifically raised by the claimant for determination by the court. It was the Borrowers who had chosen to formulate the issue for the court in a narrow way, focusing on the Internal Swap, and to use Part 8 proceedings which intensified the particular focus that they chose. The Bank asserted that, as a defendant, it was required only to meet the questions raised by the Borrowers in the claim form and not to raise other potential additional questions. Further, the Bank argued that it was not the case that it had failed to disclose the External Swap in the first proceedings; it simply did not know of its existence and should not be penalised for this ignorance.

An abuse of process

Mann J considered whether the first set of proceedings were focused on the Internal Swap as the only point which "*belonged to the litigation*",[1] as a matter of choice on the part of the Borrowers, or whether the point of the proceedings was wider than this.

Mann J rejected the Bank's argument that because the Borrowers had chosen to use Part 8 proceedings, it had chosen to narrow the proceedings to such an extent that the External Swap no longer "*belonged to the litigation*". The choice of Part 8 proceedings did not entitle the Bank to sit back and consider only the Internal Swap without any consideration of whether this was the sole issue between the parties. Moreover, it was the Bank itself that had indicated that the Internal Swap was the relevant transaction in the first proceedings, and it was for this reason, not the Borrowers' choosing, that the Internal Swap had become the focus of the first proceedings. It was the Bank, not the Borrowers, that had chosen to narrow the grounds of the first proceedings by justifying its claims on the basis that it did.

Mann J drew a parallel with a redemption action, where it is the mortgagee that is compelled to articulate the sums that it is claiming. While the Borrowers were not actually seeking to redeem, they were seeking to understand the terms on which they might repay the Loan early, and it was up to the Bank to set out the costs that it would incur if the Borrowers were to do so. Mann J noted that the onus is on the Bank because only it knows the costs that it will incur in the event of early repayment of the Loan.

Corporate knowledge

Mann J also dismissed the Bank's argument that the Bank could not have raised the issue of the External Swap in the first proceedings because it did not know about it at the time. While he accepted that no one individual might have had knowledge, in the strict sense of having it in his or her mind, of the External Swap during the first proceedings, as a matter of corporate knowledge, the Bank did know, or should be taken to have known, of the External Swap as it was in the Bank's books and a written record of the External Swap existed.

Consequently, Mann J held that the Bank should have put forward the External Swap in the first proceedings as it was as naturally the subject of the proceedings as the Internal Swap. The Bank was not entitled to add the cost of unwinding the External Swap to the redemption charges, and the Borrowers were entitled to resist such a claim on the basis that it would represent an abuse of process. The Borrowers were granted summary judgment.

COMMENT

Mann J emphasised that the doctrine of abuse of process was as capable of applying to defendants and defences as to claimants and claims, even if in practice it might be less often invoked against a defendant. His decision is also significant given it comes in the context of a Part 8 claim.

In the course of his decision, Mann J examined the steps that the Bank had taken (or could have taken) in the course of the first proceedings to investigate the existence of the External Swap. Remarking upon the Bank's "corporate knowledge", Mann J noted that if a written record of the information was contained within the Bank's own books, it can be considered part of the organisation's knowledge and the ignorance of particular individuals will be irrelevant. This position reinforces the need for parties to thoroughly investigate matters relating to a claim, and places a particularly heavy burden on large organisations.

Mann J also questioned the level of documentary evidence which the Bank had presented in support of its claim, suggesting that it was not sufficiently detailed to demonstrate a clear link between the External Swap and the Loan. This underscores the importance of financial institutions presenting evidence in a format that is easily digestible for the court.

Nitish Upadhyava
Associate
Litigation – Banking, Finance & Regulatory – London

Contact
Tel +44 20 3088 2159
nitish.upadhyaya@allenovery.com

Laura Milward-Lynch
Litigation – Banking, Finance & Regulatory – London

Contact
Tel +44 20 3088 3731
laura.milward-lynch@allenovery.com

[1] *Henderson v Henderson* (1843) 3 Hare 100 and *Johnson v Gore Wood* [2002] AC 1.

RENEGOTIATION CLAUSE IN LONG-TERM CONTRACT – WHAT IF PARTIES CANNOT AGREE?

Associated British Ports v Tata Steel UK Ltd [2017] EWHC 694 (Ch), 3 April 2017

A long-term licence agreement provided that if the parties could not agree on changes to the contract to reflect a major change in circumstances the matter would be referred to an arbitrator who would decide the new terms. This was enforceable despite there being no guidance in the contract as to the matters that were within the scope of the arbitrator's jurisdiction, nor as to the basis on which he or she should amend the licence. Although the arbitrator would likely be faced with difficult questions, they would not be ones that were impossible to answer, nor would the arbitrator be amending the licence in a vacuum.

Associated British Ports (**ABP**) and Tata Steel UK Limited (**Tata**) concluded a 25-year licence in 1995 for the use by Tata of a harbour in Wales (the **Licence**). Tata agreed to pay a licence fee, comprising a fixed annual sum and a variable sum, in monthly instalments and adjusted by reference to various indices.

Renegotiation clause in long-term agreement

The Licence provided that, halfway through its 25-year term, either party could serve notice on the other to renegotiate the terms of the Licence "*in the event of any major physical or financial change in circumstances*" affecting its operations. If the parties could not reach agreement within six months, "*the matter shall be referred to an Arbitrator*" (clause 22).

In February 2016, Tata gave notice seeking renegotiation of the terms of the Licence, in particular of the licence fee it paid to ABP, as it was facing significant market challenges and urgently needed to reduce its fixed costs. ABP responded that clause 22 had not been validly triggered and that the arbitration clause was, in any event, unenforceable. ABP asked the court to rule on both these issues.

The issues for the court were: (i) if clause 22 is a binding arbitration clause, does the licence fee fall within its scope and (ii) is clause 22 void for uncertainty? It was for Tata to demonstrate that the dispute came within the scope of the arbitration agreement (s9(1) of the Arbitration Act 1996) and for ABP to satisfy the court that the arbitration agreement was null and void, inoperative or incapable of being performed (s9(4)).

Licence fee in scope of the arbitration agreement

Rose J ruled that the issue of the licence fee was plainly within the scope of the arbitration clause: "*it would need very clear words indeed*" before it could be held that something as central to the Licence as the agreed fee could be excluded from the scope of a clause that contemplated extensive revisions of the Licence.

Courts will strive to find certainty]

ABP argued that clause 22 was void, was unenforceable for uncertainty as the trigger event ("*major physical or financial change in circumstances*") was uncertain, and that the arbitrator lacked any guidance by which to set the revised terms of the Licence. Rose J rejected both arguments.

Rose J ruled that it is only in cases where it is legally or practically impossible to give the parties' agreement any practical content that the court will hold it void for uncertainty: "*the courts should strive to give some meaning to contractual clauses agreed by the parties if it is at all possible to do so*". The courts will be even more reluctant to avoid a contractual term as uncertain where the contract has already been performed by the parties for a period of time.

Sufficiently certain – even if difficult

In order to 'trigger' clause 22, the party invoking it must point to a "*major physical or financial change in circumstances affecting*" its operations. Rose J rejected ABP's argument that this phraseology was too uncertain for an arbitrator to come to a sensible view as to whether the clause had been properly triggered. The key difference was between language "*so uncertain that it is incapable of creating a binding obligation and a clause which gives rise to a binding obligation, the precise limits of which are difficult to define in advance*".[1] Clause 22 did not fail on this basis. The scope of the trigger is not entirely open ended and, although it would not always be an easy question, it would clearly be possible to identify some changes as constituting a "*major physical or financial change in circumstances*", and others as not satisfying that test. The question of whether clause 22 was validly triggered may be a difficult one but it is not impossible to answer.

ABP's second argument – that the arbitrator lacked any guidance by which to set the revised terms of the Licence – was also rejected. Before the court will imply a requirement that the arbitrator determine the dispute 'reasonably', it must first be satisfied that there are some means of determining what is 'reasonable'. That hurdle should not, however, easily prevent the court from supplementing an otherwise vague obligation.

Rose J accepted that the Licence was a unique contract but held that the arbitrator would not be adjusting its terms in a vacuum; that task would be constrained by: (i) the existing terms of the Licence, which showed what the parties considered a reasonable bargain previously; and (ii) the nature of the 'major change' that triggered the arbitration and its effect on one party's operations, which the arbitrator's decision would reflect; and the arbitrator will be guided by the parties' submissions. During the six-month negotiation period under clause 22, the parties are free to agree whatever changes they wish to the Licence. If they cannot agree, the arbitrator's task is not to draw up a fresh Licence for them but rather to decide on the reasonableness of the terms of the Licence in the circumstances.

It was plainly intended that, after 12.5 years of performing the Licence on immutable terms, there be a mechanism to adjust and rebalance the terms if circumstances had changed and it was also plain that the parties intended to empower a third party to impose a solution on them, if they could not agree. Clause 22 constituted a binding agreement to arbitrate. Whether it had been validly triggered, and if it had, what consequences followed, were matters for the appointed arbitrator. Accordingly, the court proceedings were stayed under s9 of the Arbitration Act 1996.

COMMENT

This case demonstrates both the reluctance of the English courts to declare parties' agreements void for uncertainty and their willingness to support the arbitral process, where that is the forum chosen by the parties to resolve their disputes. While this is encouraging, parties can undoubtedly save themselves time and cost through more careful drafting. Had the arbitration agreement in the Licence, first, provided some guidance as to the scope of matters that were within its ambit and, secondly, specified how the arbitrator was to carry out his or her task, it is likely that these applications to the court could have been avoided. As to the former, the parties could have sought to define a "*major physical or financial change in circumstances*" as, for example, an event beyond the parties' control and one which is likely to have a significant, enduring effect on either, or both, of the parties' operations. They could have gone on to specify – if that is what they had bargained for – that all terms of the Licence would be considered for amendment in such circumstances. As to the second issue, the arbitrator's task could have been clarified by, for instance, specifying that, in the event the parties could not reach agreement, the matter would be referred to an arbitrator, who would determine what reasonable amendments were required to the terms of the Licence, taking account of its existing terms and the impact on the parties and the Licence of the triggering change in circumstances. In this respect, some lessons might be learned from long-term gas supply agreements, in which price review clauses are commonly found.

Alex Hiendl
Global Practice Manager
Litigation – Arbitration – London

Contact
Tel +44 20 3088 2428
alex.heindl@allenovery.com

[1] *Jet2.com Ltd v. Blackpool Airport Ltd* [2012] EWCA Civ 417, per Moore-Bick LJ at 29.

Crime

COURTS CAN SIDE STEP CONSENT REGIME UNDER POCA – BUT NOT OFTEN

NCA v N & Royal Bank of Scotland plc [2017] EWCA Civ 253, 7 April 2017

The courts can side step the Proceeds of Crime Act 2002 (**POCA**) consent regime (whereby consent from the National Crime Agency provides a defence to money laundering) and order payments to be made without NCA consent, but only in exceptional circumstances. The Court of Appeal allowed the NCA's appeal against (a) court orders to RBS to make payments from 'frozen' accounts, and (b) a declaration that RBS would not be criminally liable if it made the transfers, despite NCA consent not having been provided.

Frozen accounts

N is an authorised payment institution which provides FX and payment services. N held business accounts with Royal Bank of Scotland plc (**RBS**). Suspecting that the credit balance on certain of these accounts was criminal property, RBS froze the accounts and sought the consent of the National Crime Agency (**NCA**), under POCA, to return the funds to N. The NCA gave consent for funds to be returned to N.

While RBS was seeking consent from the NCA, N commenced proceedings for an interim mandatory injunction requiring RBS to operate its accounts and for interim declaratory relief. By the time of the hearing, N had found alternative banking facilities and was not therefore concerned with requiring RBS to operate its accounts going forwards. N did, however, seek to require RBS to carry out past payment instructions. At no time had RBS sought, or the NCA provided, consent for RBS to carry out any of N's payment instructions. RBS argued that in the absence of consent from the NCA, it could not process the payment instructions as to do so could expose the bank to criminal liability.

Court orders payments to be made, despite no NCA consent

At first instance, Burton J ordered RBS to make specific payments, and provided a declaration that RBS would not commit any criminal offence under the money laundering legislation by complying with the orders. Burton J considered that the time limits to give consent, which could reach a maximum of 42 days, would have "*almost certain disastrous consequences*" for N. Burton J indicated that the NCA's consent regarding the return of funds to N demonstrated that the NCA had "no evidence as of now that any of this money is the proceeds of crime or constitutes or represents the benefit from criminal conduct".

NCA appeals – a 'dangerous lacuna in the POCA regime'?

The NCA appealed, arguing, *inter alia*, that such court orders create a dangerous lacuna in the POCA regime and operate to prevent the NCA from carrying out its statutory functions in preventing money laundering.

Court can disapply the POCA regime – but not often

On appeal, Hamblen LJ agreed with the NCA that Parliament has entrusted the NCA with the task of deciding whether consent should be given to carry out certain actions. This meant that "ordinarily" the court should not interfere. Although the POCA regime does not completely oust the jurisdiction of the court to grant interim relief, the statutory regime is highly relevant to the exercise of the court's discretion. The statutory regime "cannot be displaced merely on a consideration of the balance of convenience as between the interests of the private parties involved. The public interest in the prevention of money laundering as reflected in the statutory procedures has to be weighed in the balance

and in most cases is likely to be decisive. Cases justifying such intervention are likely to be exceptional, although the test is not one of exceptionality. One possible example given in argument might be demonstrable bad faith by the bank".

Hamblen LJ also noted that should the balance of convenience be a consideration, this would most likely fall in favour of the bank. Since it will be very difficult for a court to establish whether the funds concerned actually are criminal property, and/or whether the suspicion is relevant or genuine, the balance of convenience would likely favour the bank; the potential risk of criminal liability to the bank is likely to outweigh any prejudice to the customer.

Interim declaration should not have been granted

As stated above, Burton J had declared that RBS would not be committing a criminal offence by making the transfers ordered by the court. However, the Court of Appeal ruled that the case was not sufficiently exceptional to justify the grant of this interim declaration. Whether the bank would commit a criminal offence in making the transactions and whether it was obliged under criminal law to make disclosure were questions of substantive law that only permitted a final, not a temporary, answer. Assuming that an interim answer could be given, the court would need a high degree of confidence in an applicant's entitlement to a declaration before such relief could be granted. The need for a close consideration of the merits is particularly important where, as in this case, the grant of interim declaratory relief is likely to be determinative of the issue. Burton J's findings that there was no evidence that the monies were suspected to be or were criminal property were not borne out by the evidence or the judge's reasoning. The declaration should not have been made.

Nor should the mandatory orders to make the payments have been made

It was clear that the grant of interim declaratory relief was integral to Burton J's decision that the balance of convenience favoured the granting of mandatory interim injunctive relief (to make the relevant transfers); relief should be granted "provided that the defendant can be given protection by reference to the provisions of POCA". If it was inappropriate to grant an interim declaration to provide such protection, it was inappropriate to grant a mandatory interim injunction. Therefore, mandatory injunctive relief should not have been granted either.

COMMENT

Banks are correct to err on the side of caution; the risk of criminal liability is likely to override the damage to commercial interests in most cases. The Court of Appeal's ruling suggests that the balance of convenience is likely to lie in favour of the public interest in the prevention of money laundering in most cases, and only in exceptional circumstances, for example where a bank has acted in bad faith, is the public interest likely to be overridden and a payment order made by the courts without NCA consent. The ruling confirms that the court does have jurisdiction to override the compulsory statutory consent procedure under POCA by granting interim relief, but such occurrences are likely to be rare.

The potential six-fold increase in the length of the moratorium period (up to 186 days) under the Criminal Finances Act 2017, which received Royal Assent in April 2017 and is likely to enter into force later this year, could potentially leave more scope for the balance of convenience to be tipped in favour of the customer. We may also see more cases on these issues before the courts, as firms are increasingly stuck between a rock and a hard place when awaiting NCA consent following a disclosure.

See our article on the Criminal Finances Act 2017 here.

Hayley Humphries
Associate
Litigation – Banking, Finance & Regulatory – London

Contact
Tel +44 20 3088 5126
hayley.humphries@allenovery.com

Equity

REFINANCING PROVIDES NEGLIGENT ADVISORS WITH WINDFALL

Lowick Rose LLP v Swynson Ltd & anr [2017] UKSC 32, 2 May 2017

A loan refinancing transaction led to both the original lender and new lender being unable to recover damages against a negligent advisor who had advised on the original loan, after the borrower defaulted. The Supreme Court's ruling illustrates, even in what Lord Mance describes as a windfall for the negligent advisor, that normal rules relating to recoverability of loss will not easily be avoided. Transactions need to be structured so that loss and right of action reside in the same party.

In 2006, a company (Swynson, the **Lender**) owned and controlled by Mr Hunt, lent GBP 15 million to EMSL (the **Borrower**) to purchase a target company as a subsidiary. Pre-transaction, the Lender and the Borrower jointly instructed a firm of accountants, Hurst Morrison Thomson LLP (**HMT**), to carry out due diligence on the target. HMT was not engaged by, and owed no duty of care to, Mr Hunt. HMT's report was negligent: it failed to draw attention to fundamental problems in the target's finances. Had HMT carried out its task properly, the loan would not have gone ahead.

Post-acquisition, after the target suffered cash-flow difficulties, the Borrower defaulted on interest payments. The Lender provided further debt financing in 2007 and 2008, but the Borrower's financial position did not improve.

In 2008, as a tax management strategy, both the 2006 and 2007 loans were refinanced. Mr Hunt (in his personal capacity) loaned GBP 18 million to the Borrower. In accordance with the terms of that loan, the Borrower used the proceeds to repay the 2006 and 2007 loans to the Lender. The Borrower subsequently became insolvent, leaving the refinanced loans owed to Mr Hunt outstanding.

In 2012, Mr Hunt and the Lender brought a claim against HMT. HMT admitted that it had been negligent but argued that it was not liable in damages to the Lender (because the Lender had not suffered any loss) or Mr Hunt (because it did not owe a duty of care to Mr Hunt).

This was a classic case where the sufferor of the loss (Mr Hunt) was not owed a direct duty by the wrongdoer (HMT). The Lender and Mr Hunt advanced a number of arguments for why either the Lender should be able to recover the loss, on Mr Hunt's behalf, and/or Mr Hunt should recover directly. All arguments failed.

No application of *res inter alios acta* to refinancing

The Lender argued the refinancing was *res inter alios acta* and therefore did not affect the amount of its recoverable loss. This principle is an exception to the general rule that avoided loss is not recoverable. It means that "collateral benefits", whose receipt arose independently of the circumstances giving rise to the loss, do not make good a recoverable loss. As Lord Neuberger made clear, 'collateral' payments to a claimant which should not be taken into account when assessing loss are normally those payments that are effectively paid out of a claimant's own pocket (such as from insurance which the claimant has taken out) or which are the result of benevolence (eg from a government, family and friends).

The Lender argued that the refinancing was a collateral benefit such that the amounts it received from the Borrower did not make good its loss arising from HMT's negligence.

The court ruled that the refinancing was not a collateral benefit. The Lender's loss from the wrongdoing was made good when the loan was repaid. The fact that the money used to repay the loan was

borrowed from Mr Hunt (as the beneficial owner and controller of the Lender) was irrelevant, as it would have been if borrowed by the Borrower from a bank or other third party.

No extension of the principle of transferred loss

The principle of transferred loss is a limited exception to the general rule that a claimant (such as the Lender) can only recover loss which he has himself suffered.

Its purpose is to avoid a legal black hole preventing recovery when the third party (eg Mr Hunt) who suffers the loss is not the party with a contractual relationship (eg the Lender) with the wrongdoer (eg HMT). Where the known purpose of a contract is to benefit a third party, and the anticipated effect of a breach will be to cause loss only to that third party, then the third party's loss may be recovered by the contracting party (even though the contracting party has not itself suffered any loss). The contracting party will account to the third party for damages recovered from the wrongdoer. A narrow version of this principle has been widely recognised by the courts where the third party suffers loss as the intended transferee of property. Some previous cases have extended the principle more broadly to all contracts, not just those that involve a transfer of property.

The court ruled that neither the narrow nor the broader application of the principle could help the Lender or Mr Hunt. The narrow approach did not apply because Mr Hunt did not suffer loss in his capacity as the owner of an asset or property: while he suffered loss, it arose from the refinancing, rather than the original loan and therefore was different to the Lender's original loss. The broader approach also did not assist Mr Hunt because, although he had suffered loss, the original contracts (HMT's engagement and the 2006 loan agreement) had not been entered into with the known object to benefit Mr Hunt, as a third party effecting a refinancing.

Equitable subrogation unavailable as no finding of unjust enrichment

The Lender argued that HMT had been unjustly enriched by Mr Hunt's provision of funds to the Borrower to repay the loans, such that Mr Hunt was subrogated in equity to the Lender's claim against HMT.

The four basic questions in a claim of unjust enrichment are:

(1) Has the defendant benefited or been enriched?

(2) Was the enrichment at the expense of the claimant?

(3) Was the enrichment unjust? and

(4) Are there any defences?

Although expressing some doubt about the position, the court was prepared to assume that HMT was enriched (as its liability for damages was reduced to nil), at Mr Hunt's expense (tracing through the advance made by Mr Hunt to the Borrower).

The court rejected the argument that the enrichment was unjust. The court accepted that Mr Hunt was labouring under a form of mistake when he arranged the repayment of the loans: he had no intention to relieve HMT of any liability, and did not understand the significance of the repayment of the loans on such liability.

However, this was not a mistake in respect of which equity would grant relief: there was no defect (such as a defeated expectation) whatsoever in the refinancing transaction. It worked exactly as intended and provided Mr Hunt with the tax structuring benefit sought through repayment of the loans. While the indirect consequential effect of his arrangement was to extinguish the Lender's claim against HMT in respect of the earlier loan, Mr Hunt did not seek or envisage that he might obtain any direct interest in such a claim through the refinancing (unlike in cases such as *Menelaou* involving defeated expectations of mortgages by way of security for funds). As there was no defeated expectation in respect of the refinancing transaction, there was no injustice recognised at law that could be corrected by the law of equitable subrogation, and Mr Hunt's claim failed.

COMMENT

The negligent accountants escaped liability. As Lord Mance observed "*I can understand it being said that it is an injustice….and a pure windfall for HMT*".

A clear line is being drawn around the law of unjust enrichment by the Supreme Court, with Lord Sumption keen to emphasise that the law of unjust enrichment does not "create a judicial licence to meet the perceived requirements of fairness on a case-by-case basis". Rather, there are discrete factual situations where enrichment is treated as unjust: where some legal norm or legally recognised expectation has been disrupted, leading to a windfall benefit conferred on the recipient. In such circumstances, a unilateral mistake can be undone to restore participants to their pre-transfer position, with a defeated expectation specifically enforced. But the law of unjust enrichment will not provide a party who has made a unilateral mistake, or a party whose expectation is 'disappointed', with recourse against any who may have indirectly benefited from the mistake or disappointment: the claimant must show some specific defect or defeated expectation in the transaction at hand for the doctrine of unjust enrichment to attach. It is therefore necessary to ensure any contract (such as the refinancing between Mr Hunt and the Lender) reflects the parties' expected allocation of benefits or security (such as a claim against a negligent advisor, or a charge over an asset), rather than relying on a judicial protection against unfairness to remake their bargain. Mr Hunt was unable to show that there was such a defeated expectation in this case – the refinancing had been largely carried our for tax purposes, had worked entirely as intended and was thus not a defective transaction.

In some transactions, parties provide a contractual payment mechanism to ensure that any potentially 'unjust' enrichment is pre-emptively contractually addressed. An example is the inclusion of termination payments by the public authority, in PPP-type concession contracts on early termination, for default by the private sector party. It might seem odd for a defaulting party to be receiving termination payments. However, this is a way of alleviating the public authority's potential 'unjust' enrichment on account of it getting the main project asset (eg a hospital, bridge or prison), on termination, before it is paid for. Instead of the authority being 'enriched', the termination payments payable to the private sector concessionaire allow, in turn, the lenders to be paid. This reduces the risk associated with litigating an unjust enrichment claim and helps make the project more bankable. By the same token, in this case, Mr Hunt could easily have anticipated the lack of an ability to claim against HMT and asked for reliance on the due diligence of HMT as a condition of the loan that was being made in his personal capacity, as regularly occurs in a commercial context.

For those with potential claims against negligent advisors, all three aspects of the judgment are important. There are clear limits imposed on the use of legal exceptions to general principles of loss: despite general considerations of fairness, the existence of the corporate veil means that the structure of the underlying transaction and correct identification of the party benefiting from the cause of action should not be discounted as technicalities. The obvious point, however, is to ensure issues of reliance are addressed before committing to transactions if at all possible.

However, the refinancing in this case was somewhat peculiar, in that it was effected by a transaction between the beneficial owner of the Lender and the Borrower, rather than as between the Lender and the Borrower. However, for those whose claims fall into this category, while the judgment does not directly overrule or conflict with last year's Court of Appeal decision in *Tiuta International Ltd v De Villiers Surveyors*, which extended liability for negligent advice to the entirety of any refinanced liability, the Supreme Court has now granted leave to appeal that decision.

Stacey McEvoy
Associate
Litigation – Banking, Finance & Regulatory – London

Contact
Tel +44 20 3088 3009
stacey.mcevoy@allenovery.com

Judicial Review

REFUSAL OF JUDICIAL REVIEW OF SALE OF GREEN INVESTMENT BANK

R (SDC LLP) v Secretary of State for Business, Energy and Industrial Strategy [2017] EWHC 771 (Admin), 7 April 2017

The UK Government's decision to sell the Green Investment Bank Plc (the **GIB**) to a consortium led by Macquarie should not be subject to judicial review, the High Court has ruled. While there was a sufficient public element for the Government's decision to be amenable to judicial review, the challenge brought by an unsuccessful bidder was dismissed as it was both too late, and did not contain allegations which constituted breaches of public law. The ruling reinforces that there are limits to when a commercial decision taken by a public body is judicially reviewable. Allen & Overy acted for the Macquarie consortium.

The GIB is a public limited company, which currently has the Secretary of State for Business, Energy and Industrial Strategy (the **Secretary of State**) as sole shareholder. It was formed to promote and accelerate investment into the UK's "green economy" and to act in accordance with certain statutory "green purposes".

In June 2015, the Secretary of State announced his intention to privatise the GIB, and the sale was formally launched in March 2016. By the final stage of the sale process, two rival bidders remained: a consortium led by Sustainable Development Capital LLP (the **claimant**) and a consortium led by Macquarie (the **Macquarie Consortium**).

The Secretary of State set out certain minimum requirements that bids should meet, but retained a wide discretion to conduct the sale.

Following various rounds of submissions and bids, on 27 September 2016 the Secretary of State decided to appoint the Macquarie Consortium as preferred bidder and to offer it a period of exclusivity to finalise negotiations. This decision was communicated to the claimant on 30 September 2016 or, by the latest, 10 October 2016. The claimant challenged the decision. The timing of the challenge became an issue in dispute as the claimant:

- raised its initial complaints with the Secretary of State on 11 October 2016;
- entered into pre-action correspondence with the government's lawyers on 2 November 2016; and
- applied for permission to bring a judicial review claim on 19 December 2016.

The challenge

The claimant's main argument was that only it should have been awarded preferred bidder status as its bid was 'compliant' with the sale process, whereas the Macquarie Consortium's bid was not. The claimant argued in the alternative that if neither bid was 'compliant', then both the claimant and the Macquarie Consortium should have been offered exclusivity and the Secretary of State had acted unlawfully or unfairly in not doing so.

The court decided that the decision was, in theory, amenable to judicial review because the GIB is a publicly-owned asset, that it was to be sold as a matter of government policy, and that its sale had to be reported to Parliament. However, the court went on to make clear that there are high procedural and substantive hurdles to success in such a challenge.

Claim must be made promptly

The court held that the claimant should be refused permission as the judicial review claim had not been brought promptly. It had unduly delayed in issuing its claim, particularly where the claimant appreciated the urgency in concluding the sale process and the potential impact of the proceedings on the Secretary of State and the Macquarie Consortium. A judicial review claim form must be filed "***promptly****...and in any event* ***not later than 3 months after*** *the grounds to make the claim first arose*" (emphasis added).[1] Given the circumstances, following the pre-action protocol was no excuse for the weeks of delay in commencing proceedings. Accordingly, even though the claim was issued within three months of the alleged grounds to make the claim arising, it had not been filed "promptly".

No breaches of public law

Lewis J noted that the courts have previously indicated that complaints about tendering exercises are themselves unlikely to involve allegations of breach of any applicable principle of public law. Simply attaching public law labels (such as "irrationality" or a breach of a "duty to act fairly") is unlikely to give rise to public law challenges if the claim actually does nothing more than challenge the *commercial judgment* of a public body to prefer one bidder over another. The Secretary of State retained a wide discretion to refuse to accept any or all offers, and to determine the process by which the sale was conducted. Furthermore, the claimant had not demonstrated any arguable public law error on the part of the Secretary of State.

Finally it was held that, even if permission had been granted and any public law error identified, the court would still have refused to grant any remedy as a matter of discretion under ss31(6) and (7) of the Senior Courts Act 1981, because of the claimant's delay in applying for judicial review.

COMMENT

This case reiterates the importance of a potential claimant in judicial review proceedings acting promptly and the stark consequences of getting this wrong. A claimant cannot simply work to the three-month period in CPR 54.5 as a long-stop that will always be accepted by the court – real consideration must be given to what 'prompt' means in the particular circumstances. The decision also underlines the need to identify allegations of public law illegality at an early stage in a dispute; it is not sufficient simply to allege that the public body's decision was wrong.

From the public body's perspective, the decision follows a line of authority where the courts have been willing to entertain public law review of sales of publicly-owned assets. While these may at first sight appear wholly commercial decisions, the courts are prepared to act as a check on the public body's powers where there is a sufficient public law element for the decision to be amenable to judicial review. Nevertheless, subsequently demonstrating a public law breach can be a high hurdle, particularly where the public body retains a wide discretion to manage the relevant process.

Maeve Hanna
Senior Associate
Litigation – Banking, Finance & Regulatory – London

Contact
Tel +44 20 3088 1844
maeve.hanna@allenovery.com

[1] CPR 54.5.

Privilege

SFO V ENRC PRIVILEGE RULING RESTRICTS PRIVILEGE IN INTERNAL CORRUPTION INVESTIGATION

Serious Fraud Office v Eurasian Natural Resources Corporation Ltd [2017] EWHC 1017 (QB), 8 May 2017

Enforcement authorities (both criminal and regulatory) have been taking an increasingly combative approach to claims to legal professional privilege in recent years. In this case the UK Serious Fraud Office (**SFO**) successfully challenged claims to privilege by a company over various documents that were produced by lawyers and forensic accountants during an internal investigation into allegations of bribery and corruption. It is the first case in which the English court has had to consider a claim for litigation privilege in which the adversarial litigation said to have been reasonably in contemplation was criminal, rather than civil. The ruling suggests that litigation privilege is going to be very difficult to claim in relation to many internal investigation materials. The company is seeking permission to appeal the decision.

In any assessment of whether a claim to privilege can be made out, or of whether a judgment on privilege applies in other contexts, an understanding of the facts is critical. The facts here were relatively straightforward. In December 2010, ENRC received an email from an apparent whistleblower containing allegations of bribery and financial wrongdoing in relation to its Kazakh subsidiary. This led ENRC to instruct lawyers to carry out an internal fact-finding investigation into the allegations. In 2011, the SFO became involved. It contacted ENRC, drew its attention to the SFO's self-reporting guidelines and suggested a meeting. There followed a lengthy period of dialogue between ENRC and the SFO, including a series of meetings in which ENRC updated the SFO on the progress of its internal investigation. The SFO announced that it was commencing a criminal investigation in April 2013.

As part of its investigation, the SFO sought to compel ENRC to produce a range of documents. The SFO's powers of compulsion do not extend to documents which ENRC would be entitled to refuse to disclose on grounds of legal privilege in proceedings in the English High Court. ENRC refused to disclose four categories of documents on the basis that they were subject to legal advice privilege, litigation privilege or both. According to the judgment, "*ENRC* [had] *repeatedly promised that it would give full and frank disclosure of the results of its internal investigations to the SFO, but then changed its mind*".

As a result, the SFO commenced these proceedings, seeking production of the documents on the basis that they were not privileged.

The disputed documents

The documents that the SFO wanted to see fell into four categories:

(1) Notes taken by lawyers of the evidence given to them by ENRC's employees, former employees, subsidiaries, suppliers and other third parties (**Interview Notes**).

(2) Materials generated by forensic accountants, as part of a "books and records" review, with a focus on identifying controls and systems weaknesses and potential improvements (**Accountants' Reports**).

(3) Documents, including slides, indicating or containing factual evidence, used by lawyers to present to a committee within ENRC and/or ENRC's board (**Factual Updates**).

(4) Emails between a senior executive and the head of mergers and acquisitions at ENRC, who was a Swiss qualified lawyer (**Communications with a Legally Qualified Businessman**).

Litigation privilege

Litigation privilege protects communications between clients or their lawyers and third parties for the purpose of obtaining information or advice in connection with existing or contemplated litigation when, at the time of the communication in question:

- litigation is in progress or reasonably in contemplation;
- the communications are made with the sole or dominant purpose of conducting that anticipated litigation; and
- the litigation is adversarial, not investigative or inquisitorial.

ENRC argued that the Interview Notes, Accountants' Reports and Factual Updates were subject to litigation privilege on the basis that their dominant purpose was to enable ENRC to obtain advice or evidence in connection with anticipated adversarial criminal litigation.

The judgment – no litigation privilege

Litigation not in reasonable contemplation [

ENRC's claim for litigation privilege failed at the first hurdle. ENRC failed to establish on the facts that it was "*aware of circumstances which rendered litigation between itself and the SFO a real likelihood rather than a mere possibility*".

The court ruled that a criminal investigation by the SFO is not adversarial litigation for privilege purposes. An SFO investigation is a preliminary step taken, and generally completed, before any decision to prosecute is taken. In practice this means that a claim to privilege can only be made out where a prosecution is in reasonable contemplation. The judge took the view that ENRC did not contemplate a prosecution when the documents in question were produced, so those documents were not protected by litigation privilege. In particular, the judge observed that:

- while not co-operating could lead to criminal proceedings and criminal sanctions, ENRC, on its own case, had planned to co-operate;
- "*prosecution only becomes a real prospect once it is discovered that there is some truth in the accusations, or at the very least that there is some material to support the allegations of corrupt practices*". In this case, there was no evidence that there was anything beyond the unverified allegations themselves: "*The difficulty for ENRC in the present case is that there is no evidence that it was ever aware that it had any such problem, or of anything more tangible than a fear that one might emerge*"; and
- one "*critical difference*" between the starting of civil and criminal proceedings is that there is no real inhibition against bringing unfounded civil proceedings, save the cost consequences. However, a prosecution cannot be started unless and until the prosecutor is satisfied that there is a sufficient evidential basis for prosecution and the public interest test is also met. "*Criminal proceedings cannot be reasonably contemplated unless the prospective defendant knows enough about what the investigation is likely to unearth, or has unearthed, to appreciate that it is realistic to expect a prosecutor to be satisfied that it has enough material to stand a good chance of securing a conviction*."

Dominant purpose not met

The court also ruled that, even if a prosecution had been reasonably in contemplation, none of the documents in question were created with the dominant purpose of being used in the conduct of such litigation. There was no evidence to show that the purpose of the internal investigation had anything to do with the conduct of future criminal proceedings in the event that evidence of criminal conduct emerged, and attempts to persuade the SFO to engage in a civil settlement failed.

In the judge's view, the main purpose of the internal investigation was to establish if there was any truth to the whistleblower allegations, and to prepare for any future SFO investigation. Against a background of

co-operation and openness, fact-finding aimed at obtaining legal advice on how to avoid an investigation is not covered by litigation privilege. Even if the fact-finding could have had a dual purpose (ie avoidance of litigation plus, if prosecuted, mounting a defence), there was no evidence of a dual purpose for ENRC.

The fact that ENRC intended to show the vast majority of the fruits of its internal investigations to the SFO was also fatal to its claim for litigation privilege. The judge held that litigation privilege does not apply to documents which are specifically created to be shown to a litigation adversary. The evidence clearly showed that ENRC intended to be fully co-operative and transparent.

Avoiding litigation not sufficient

While accepting that litigation privilege can protect third party documents created with a view to settling litigation once it is in train, the judge rejected the idea that litigation privilege also extended to third party documents created in order to obtain legal advice as to how best to avoid contemplated litigation.

Legal advice privilege

Legal advice privilege attaches to confidential communications between a client and its lawyers, acting in their professional capacity, in connection with the provision of legal advice. There is no need for litigation to be contemplated. Privilege attaches to all material forming part of the continuum of the lawyer-client communications, even if those documents do not expressly seek or convey legal advice.

ENRC argued that the Interview Notes and Factual Updates were subject to legal advice privilege (in relation to the Interview Notes, characterising them as lawyers' work product). The Communications with a Legally Qualified Businessman, ENRC asserted, were subject to legal advice privilege as they recorded requests for and the giving of legal advice by a qualified lawyer acting in the role of a lawyer.

The judgment – a claim to legal advice privilege could only be made out in relation to some documents

The judge endorsed the approach taken recently by the English High Court in *The RBS Rights Issue Litigation*.

- Legal advice privilege attaches only to communications between a lawyer and those individuals within a client entity who are authorised to obtain legal advice on that entity's behalf (the **true client**).
- The protection afforded to lawyers' working papers, as a sub-category of legal advice privilege, is justified if, and only if, they would betray the trend of the legal advice. A note of what a solicitor is told by a prospective witness is not, without more, a privileged document, even if the solicitor has interviewed the witness with a view to using the information that the witness provides as a basis for advising his client.

On this basis, the judge rejected ENRC's claim to legal advice privilege in relation to the Interview Notes.

The judge also agreed with Snowden J in *Property Alliance Ltd v Royal Bank of Scotland Plc*, that factual information communicated by a lawyer to his client, either in conjunction with the provision of legal advice, or so as to enable the client to take a fully informed decision as to what to do and what further advice to obtain, should be privileged. As a result, she concluded that the Factual Updates were protected by legal advice privilege.

The judge found that the Communications with a Legally Qualified Businessman were not protected since the person in question was acting as a 'man of business' rather than wearing his legal spectacles.

Category of document	Privilege claimed	Result
Interview Notes	Litigation privilege (**LP**) and legal advice privilege (**LAP**)	**NOT LP**: litigation not reasonably in prospect and not dominant purpose **NOT LAP**: not with client
Accountants' Reports	LP	**NOT LP**: litigation not dominant purpose
Factual Updates	LP and LAP	**NOT LP**: litigation not reasonably in prospect and not dominant purpose **LAP**: part of continuum of communications
Communications with a Legally Qualified Businessman	LAP	**NOT LAP**: acting as a man of business not a lawyer

Impact of ENRC privilege ruling

This decision does not mean that parties can no longer obtain legal advice in the context of an internal investigation. Communications between a lawyer and a client for the purposes of legal advice continue to be protected. However, the combination of the judge's confirmation that fact-finding communications between a lawyer and anyone other than the true client are not privileged together with her findings on when litigation can be said to be in contemplation in a criminal context, make it difficult for parties or their lawyers to claim privilege over factual enquiries necessary to allow that advice to be given. Those facts will often be known only to individuals within a client organisation who are not authorised to seek or obtain advice and are therefore not the true client.

The judge's decision means that particular care must be taken over communications involving so-called "third parties", including individuals within a client organisation who are not authorised to seek or obtain legal advice, in circumstances where an investigation is carried out to establish whether allegations can be substantiated.

And, even where litigation can be said to be in contemplation, in order for a claim to privilege to succeed, the documents in question must be produced for the dominant purpose of the conduct (including settlement) of the litigation, rather than avoiding litigation or with a view to being shown to an adversary (although the distinction between settling and avoiding litigation in this context is at best difficult to discern).

The judge's observation about the difference between criminal proceedings and civil litigation suggests that this decision should not change the current understanding of when litigation can be said to be in contemplation in ordinary civil proceedings (although it may have an impact on the analysis in relation to any attempt to avoid litigation). But it does imply that litigation privilege is going to be more difficult to claim in other criminal contexts. The judge's reasoning also appears to produce the rather incongruous result that a company threatened with civil proceedings in relation to allegations of misconduct can investigate them protected by litigation privilege (provided the dominant purpose test is met), but a company under criminal investigation for those same allegations cannot.

The procedures and decision-making processes in regulatory investigations (eg Financial Conduct Authority (FCA) or Competition and Markets Authority investigations) are not the same as those in SFO investigations. The judge's rationale for refusing a claim to privilege in this case does not therefore necessarily apply in the context of a regulatory investigation. In an FCA context, for example, the lower burden of proof and broad nature of the FCA Principles for Businesses may be distinguishing factors. Ultimately, each case will need to be considered on its facts to determine whether a claim to privilege might succeed, including (a) when the regulatory process in question can be said to become adversarial and (b) when that adversarial process can be said to have been in contemplation in that particular case.

ENRC sought permission to appeal from the judge but was refused. We understand that ENRC is now seeking permission to appeal from the Court of Appeal. For now, however, parties considering whether and how to conduct any internal investigation will need to think very carefully about their strategy and approach. If you would like to discuss the strategies that may be available, please contact Calum Burnett, Mahmood Lone, Michelle de Kluyver or your usual A&O contact.

Calum Burnett
Partner
Litigation – Banking, Finance & Regulatory – London

Contact
Tel +44 20 3088 3736
calum.burnett@allenovery.com

Mahmood Lone
Partner
Litigation – Banking, Finance & Regulatory – London

Contact
Tel +44 20 3088 4974
mahmood.lone@allenovery.com

Michelle de Kluyver
Counsel
Litigation – Banking, Finance & Regulatory – London

Contact
Tel +44 20 3088 3686
maeve.hanna@allenovery.com

Public Procurement

BREACH OF PUBLIC PROCUREMENT RULES – DAMAGES AND TIMING OF CHALLENGE

Nuclear Decommissioning Authority v EnergySolutions EU Ltd [2017] UKSC 34, 11 April 2017

The Supreme Court has ruled that a public authority's breach must be sufficiently serious under both UK and EU public procurement laws for a disappointed tenderer in a public procurement process to be able to sue the public authority for damages. In the context of a public tender for decommissioning nuclear power plants, the court ruled that there was no obligation on the respondent company to have made a challenge in the standstill period between the notice of the outcome of the tender process and the contract being awarded (to a third party) if it was only seeking damages. The decision thus slightly takes the time pressure off a disappointed tenderer who suspects that there has been a breach of public procurement laws but does not seek to prevent the contract being signed.

The appellant (the **Contracting Authority**) is a public body tasked with making the sites of former nuclear power plants in the UK suitable for other uses. For the purpose of this appeal it was to be assumed that it had breached the Public Contracts Regulations 2006[1] (the **Public Contracts Regulations**), which give effect to the Public Procurement Directive[2] (the **Public Procurement Directive**). It was alleged to have misapplied its own criteria to conclude erroneously that a consortium of which the respondent (the **Economic**

Operator) was a member should not be awarded a tender for decommissioning nuclear power plants. The Economic Operator brought a claim against the Contracting Authority for damages for breach of the Public Contracts Regulations and the Public Procurement Directive.

Three preliminary issues came before the Supreme Court.

Breach must be 'sufficiently serious' under the Public Procurement Directive

The first issue was whether the Public Procurement Directive, as amended by the Remedies Directive[3] (the **Remedies Directive**), requires an award of damages only where the applicable breach by the contracting authority is '*sufficiently serious*'. In other words, whether liability arises only if the so-called *Francovich* conditions, which determine (and limit) state liability under EU law, are met.

Following the ECJ decision in *Spijker*,[4] which concerned the scope of application of the *Francovich* conditions, the Supreme Court decided that there was clear authority that the liability of a contracting authority under the Public Procurement Directive is assimilated to that of the state; and that such state liability exists only where the *Francovich* conditions are satisfied. The second of the *Francovitch* conditions is that any breach must be '*sufficiently serious*', so that was therefore a requirement to claim damages for breach of the Public Procurement Directive.

Breach must also be 'sufficiently serious' under the Public Contracts Regulations

The second, closely-related issue was whether the Public Contracts Regulations confer on a contracting authority the liability to compensate *any* breach of the Public Contracts Regulations (not merely one which is '*sufficiently serious*'). Since the answer to the first issue was 'yes', this was in effect a question as to whether domestic law is less restrictive than EU law for an economic operator who seeks to claim damages.

The Court of Appeal had decided this issue in favour of the Economic Operator by finding that there is a right to damages for *any* breach of the Public Contracts Regulations. This was based on its analysis that any claim was a private law action for breach of statutory duty and accordingly subject to ordinary English rules as to the availability of damages.

The Supreme Court held that this was wrong. The claim could not be treated as a private law claim for breach of a domestic statutory duty; the correct analysis was that the duty arises under EU law.

The *Francovich* conditions represent the ECJ's determination as to the minimum protection that an economic operator can expect under the Remedies Directive. While a domestic legislature was entitled to provide wider protection, it could be assumed that the legislator would have made this clear had it intended to do so. With respect to the Public Contracts Regulations, Parliament had not done so.

The explanatory material relating to the Public Contracts Regulations referred to the '*need*' to '*implement*' and to '*transpose*' the directives and to doing so with a '*minimalist approach*'. It therefore demonstrated that the legislative intention was to implement the directives without '*gold plating*'. That interpretation was consistent with the use of the word '*may*' in the Public Contracts Regulations ('*the Court may… awarded damages*'), which seemed to the Supreme Court to otherwise have no significance or persuasive explanation.

Accordingly, the Public Contracts Regulations could not be construed as less restrictive than EU law. An economic operator bringing a claim under the Public Contracts Regulations must establish that the *Francovich* conditions are met and therefore that the contracting authority's breach is '*sufficiently serious*'.

Failure to mitigate because claim not brought before entry into contract

The final issue was whether, despite the Economic Operator having issued a claim within the time limit prescribed under the Public Contracts Regulations, it should nonetheless be denied an award of damages on the basis that it was open to it to bring a claim earlier, before the Contracting Authority had wrongfully awarded the contract to a third party. This would automatically have had the effect of preventing the Contracting Authority from entering into the contract. In

essence this was an argument that the alleged harm suffered by the Economic Operator could have been mitigated by it issuing the claim earlier (as this would have preserved its ability to overturn the decision and be awarded the contract itself in a re-run of the process); that it had been unreasonable in not doing so; and that accordingly it was not entitled to recover its loss.

Under the Public Contracts Regulations, after giving notice of the outcome of the tender process, a contracting authority is subject to a 10-day standstill during which it must not enter into the contract. If an economic operator issues proceedings before the contract is signed the prohibition on entering into the contract will automatically continue. Meanwhile an economic operator has 30 days from the date of notice to commence a claim, which may potentially be after the contract has been entered into. Had the Economic Operator brought a claim before the contract had been agreed it was recognised that the likely sequence of events (reflecting procedures under the Public Contracts Regulations) would have led to a cross-undertaking and/or security being required of the Economic Operator as a condition of preventing the Contracting Authority obtaining a court order lifting the continuing prohibition on it entering into the contract.

The Supreme Court recognised that in practice therefore the Economic Operator had two probable options:

- bring a claim within 10 days and subsequently provide a cross-undertaking and/or security to prevent the contract being entered into; or
- bring a claim after the contract has been entered into and claim only damages.

The former option involved a risk that the Economic Operator's challenge would fail and that it would then have to pay the Contracting Authority for loss or damage suffered as a result of the delay in entering the contract.

These options were for the Economic Operator to choose between on the basis of its own best interests. The Economic Operator could not be said to have acted unreasonably in failing to take the steps that would have prevented entry into the contract but have adverse consequences for it were its challenge unsuccessful (ie the first option). No authority had been cited suggesting that a party acts unreasonably by not taking steps to prevent a perpetrator from giving effect to its own breach. It was for the Contracting Authority to take the risk of entering into the contract before the end of the period during which a claim could be started.

COMMENT

The decision whether to bring a challenge to a public procurement award is often vexed. Not only must the decision be made quickly, but when it relates to a costly and time-critical project it might also carry substantial risk (for the disappointed economic operator as well as the contracting authority).

In that context this decision is welcome for businesses that tender for UK public contracts, foremost for offering practical assistance by establishing that an economic operator is under no obligation to rush to take steps to prevent a contracting authority from entering into the contract (with potentially severe financial repercussions if its challenge fails) if it is content to limit its relief to a claim for damages. Instead the economic operator is entitled to simply allow the contracting authority to proceed to give effect to its own breach and then sue it for damages. In those circumstances the only financial downside would be the possible liability for costs of the litigation.

However the decision also offers comfort for contracting authorities by confirming that a successful damages claim will require an economic operator to establish that the authority's breach was '*sufficiently serious*' within the meaning of the *Francovich* conditions.

Nicholas Gomes
Litigation – Banking, Finance & Regulatory – London

Contact
Tel +44 20 3088 2669
nicholas.gomes@allenovery.com

[1] (SI 2006/5).

[2] (Parliament and Council Directive 2004/18/EC).

[3] (Council Directive 89/665/EEC, itself amended by Council Directive 2007/66/EC).

[4] *Jozef Maria Antonius Spijkers v Gebroeders Benedik Abattoir CV and Alfred Benedik en Zonen BV*: ECLI:EU:C:1986:127.

Tort

GIVING PROFESSIONAL ADVICE FOR FREE – WHAT IS MY LIABILITY?

Basia Lejonvarn v (1) Peter Burgess (2) Lynn Burgess [2017] EWCA Civ 254, 7 April 2017

An architect who provided professional services to her friends, free of charge and without a contract, nevertheless owed a duty of care to exercise reasonable care and skill and was therefore legally responsible for her negligence. Although it is an extreme example, this case nevertheless serves as an important reminder that professionals should think carefully before they offer gratuitous services to friends.

Mr and Mrs Burgess (the **Claimants**) and Mrs Lejonvarn (the **Defendant**) were former neighbours and had also been good friends for some years. Mr and Mrs Burgess decided to carry out an extensive landscaping project in their garden (the **Garden Project**).

The Burgesses instead asked for Mrs Lejonvarn's help because she was an American qualified architect (although not a registered architect in the UK), and had just set up her own practice. Mrs Lejonvarn had also been involved in work for Mr Burgess' company during her two previous jobs in architecture firms.

Mrs Lejonvarn agreed to help and secured a contractor to carry out the earthworks and hard landscaping. She intended to subsequently provide design services in respect of the "soft" elements of the Garden Project (for example, planting and lighting) for which she would charge a fee. However, the Garden Project never got that far. Mrs Lejonvarn had no prior experience of managing major landscaping projects and was unable to implement the Burgesses' dream design. The Burgesses became increasingly unhappy about the quality and progress of the work, costs overran significantly and the parties' relationship eventually became so acrimonious that Mrs Lejonvarn was replaced by a different landscaper.

The Burgesses claimed that most of the work done while Mrs Lejonvarn was involved in the Garden Project was defective and that she was legally responsible for it. They claimed damages of approximately GBP 260,000 in both contract and tort on the basis that Mrs Lejonvarn had assumed responsibility for the provision of professional services while she was acting as an architect and a project manager.

Following a trial of the preliminary issues, the court found that there was no contract but Mrs Lejonvarn did owe the Burgesses a duty of care in tort. Mrs Lejonvan appealed.

Duty of care for pure economic loss

This is a case in which the losses claimed were pure economic losses.

The first instance court applied the "*assumption of responsibility*" test. Under this test,[1] a duty of care arises where a party with a special skill applies it for the assistance of another and, in doing so, assumes or undertakes a responsibility to that party.

The first instance court held that a duty of care had arisen under this test because Mrs Lejonvarn had voluntarily tendered professional services in circumstances where she knew the Burgesses would rely on the proper performance of those services. She had also expressed confidence in her own ability to manage the Garden Project and the Burgesses had no reason to disbelieve that she had such expertise and experience. Although the services were being provided gratuitously, they were still professional services which were being provided "*in a professional context and on a professional footing*". They were also being provided in the expectation that Mrs Lejonvarn would be paid for the second phase of the work.

Defendant tries to argue for a three-fold test

On appeal, Mrs Lejonvarn contended that the first instance judge had erred in applying the test of assumption of responsibility. Her argument was that, in order for there to be an assumption of responsibility, there must be a contractual framework around it which defines the services being provided. As the first instance court had found that there was no contract between Mrs Lejonvarn and the Burgesses, the assumption of responsibility test was therefore inappropriate. Instead, Mrs Lejonvarn said that the court should have applied the three-fold test set out in *Caparo Industries Plc v Dickman* [1990] 2 WLR 358 in order to determine whether she owed a duty of care to the Burgesses. The three-fold test asks whether:

- the loss was reasonably foreseeable;
- there was a sufficient relationship of proximity between the parties; and
- in all the circumstances, is it fair, just and reasonable to impose a duty of care?

Mrs Lejonvarn's motivation for arguing that the court should apply the three-fold test was that the court would then have to consider each question separately. Mrs Lejonvarn submitted that the test would fail on the third question because it was not fair, just and reasonable in all the circumstances to impose a duty of care.

Assumption of responsibility test is correct

The Court of Appeal held that the first instance court had applied the correct test. In doing so, it cited the House of Lords' decision in *Commissioners of Customs and Excise v Barclays Bank plc* [2006] UKHL 28 which makes it clear that the assumption of responsibility test is appropriate in cases involving a relationship akin to a contractual relationship. While the first instance court had agreed with Mrs Lejonvarn that no contract existed, it had nevertheless found that the parties' relationship was akin to a contractual one. The services were being provided in a professional context, Mrs Lejonvarn had described the Burgesses as being her clients and the Garden Project was important to the growth of her new business.

The Court of Appeal also emphasised that, as noted by the House of Lords in *Barclays Bank*, the assumption of responsibility test effectively subsumes all aspects of the three-fold approach because "*such considerations will have been taken into account in determining whether there has been an assumption of responsibility*". Any separate enquiry into whether it was fair, just and reasonable to impose liability was therefore unnecessary.

Scope of the duty

The Court of Appeal also clarified three important points about the scope of duty.

The distinction between duties in contract and in tort

On appeal, Mrs Lejonvarn contended that the duty found by the first instance court involved a positive obligation to act in a specific manner in the future and that this was the law of contract, not of tort. The Court of Appeal recognised the importance of the distinction between undertaking positive obligations (which it agreed was "*the realm of contract*") and the imposition of a negative duty, for example to avoid doing something or avoid doing it badly ("*the realm of the tort of negligence*"). However, it emphasised that, unlike a contractual duty, the tortious duty was not a duty to provide the services; the duty related to how those services were carried out. Therefore, Mrs Lejonvarn did not have to provide any services to the Burgesses, but to the extent that she did so, she owed a duty to exercise reasonable skill and care in the provision of those services.

Fact-specific circumstances

The Court of Appeal also acknowledged that the first instance decision had been a trial of preliminary issues, and not a full trial of all the issues in dispute. On this basis, it emphasised that the precise nature and extent of the duty of care owed could only be defined following a full consideration of the specific facts.

The distinction between professional consultants and builders

Mrs Lejonvarn also argued on appeal that it was anomalous for her to owe a duty of care for the Garden Project when the builders who actually carried out the work did not (on the basis of the generally accepted position that while builders may be liable for defective

work under a contract, they are generally not liable to third parties for pure economic loss in tort).

The Court of Appeal accepted that this was a relevant consideration, as was the fact that the Burgesses would have a contractual claim against the builders for defects in the work carried out. However, the Court of Appeal emphasised that there was a distinction between a builder and a professional, which Mrs Lejonvarn held herself out to be. It cited the judgment given by Lord Justice Jackson in *Robinson v PE Jones (Contractors) Ltd* [2012] QB 44: "*it is perhaps understandable that professional persons are taken to assume responsibility for economic loss to their clients … They expect their clients and possible others to act in reliance upon their work product, often with financial or other economic consequences*". The Court of Appeal found in this case that both parties had recognised that, in order for the Garden Project to be successful, Mrs Lejonvarn's professional services would be required. These were not services that could be provided by the builders.

COMMENT

While this case is a salutary reminder of the potential pitfalls of gratuitous advice, the Court of Appeal's judgment should not cause professionals to hang up the phone every time their friends ring and ask for advice.

As the first instance court was careful to emphasise, this was an unusual case. It was a significant project and the services were being provided over a relatively lengthy period of time. This was not a piece of brief ad hoc advice given in a social context.

Sophie Orwell
Litigation – Corporate – London

Contact
Tel +44 20 3088 2471
sophie.orwell@allenovery.com

[1] *Hedley Byrne and Co Ltd v Heller and Partners* [1964] AC 465, and subsequently developed in *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145.

Forthcoming client seminar

All events mentioned below are held at A&O's office at Bishops Square unless otherwise stated).

A guide to 'reasonable' and 'best ' endeavours

Friday 16 June 2017 – 12:30 – 1:30

Presented by: Richard Hooley, Consultant – Profile

Contractual obligations may require standards of diligence that fall short of an absolute warranty of outcome. Common examples are where a party agrees to exercise 'reasonable endeavours', 'all reasonable endeavours' or 'best endeavours' to bring about a specified outcome or event. What is meant by these terms? Do they operate on a sliding scale of performance? To what extent can the obligor take account of its own financial interests? When does the obligation end? This seminar will examine these questions in the light of the most recent case law, including Leggatt J's judgment in *Astor Management AG v Atalaya Mining plc* [2017] EWHC 425 (Comm).

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 where 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 Karen Birch on +44 20 3088 3737 or karen.birch@allenovery.com

Litigation Review consolidated index 2017

Grappling with severe exchange rate fluctuations in assessing the costs of litigation: *Elkamet Kunststofftechnik GmbH v Saint-Gobain Glass France S.A.* (Mar)

Crime

Courts can side step consent regime under POCA – but not often: *NCA v N & Royal Bank of Scotland plc* (May/June)

Unsuccessful challenge to SFO's Letter of Request: *The Queen on the application of Unaenergy Group Holding Pte Ltd & ors v The Director of the Serious Fraud Office* (Apr)

The future of Deferred Prosecution Agreements: recent SFO speech (Mar)

Reform of corporate criminal liability for economic crime (Jan/Feb)

Damages

Professional advisors not liable for client's poor commercial judgment: *BPE Solicitors & anr v Hughes-Holland (in substitution for Gabriel)* (Apr)

Theft of confidential information results in only nominal damages for employer: *Marathon Asset Management LLP & anr v Seddon& anr* (Mar)

Disclosure

Using documents previously disclosed in earlier litigation: *(1) Robert Tchenguiz (2) Rawlinson & Hunter Trustees SA v (1) Grant Thornton UK LLP (2) Stephen John Akers (3) Hossein Hamedani (4) Johannes Runar Johannsson* (Mar)

Equity

Refinancing provides negligent advisors with windfall: *Lowick Rose LLP v Swynson Ltd & anr* (May/June)

Insolvency

Foreign bank resolution: effect on loan enforcement in England and Wales: *Guardians of New Zealand Superannuation Fund & 11 ors v Novo Banco, S.A.* (Jan/Feb)

Insurance

Judicial review of financial ombudsman decisions – Wednesbury unreasonableness:

R (on the application of Aviva Life & Pensions (UK) Ltd) v Financial Ombudsman Service & ors (Apr)

Is the payment of a sum into an escrow account sufficient to ascertain an insured loss? *(1) WR Berkley Insurance (Europe) Ltd (2) Aspen Insurance UK Ltd v Teal Assurance Co Ltd* (Mar)

Judicial review

Refusal of judicial review of sale of Green Investment Bank: *R (SDC LLP) v Secretary of State for Business, Energy and Industrial Strategy* (May/June)

Privilege

SFO v ENRC privilege ruling restricts privilege in internal corruption investigation: *Serious Fraud Office v Eurasian Natural Resources Corporation Ltd* (May/June)

Investigations: notes of employee interviews not privileged: *The RBS Rights Issue Litigation* (Jan/Feb)

Public procurement

Breach of public procurement rules – damages and timing of challenge: *Nuclear Decommissioning Authority v EnergySolutions EU Ltd* (May/June)

Tort

Giving professional advice for free – what is my liability?: *Basia Lejonvarn v (1) Peter Burgess (2) Lynn Burgess* (May/June)

THIS REVIEW IS AVAILABLE BY EMAIL

Receive it today by emailing your request to:
litigationpublications@allenovery.com

Key contacts

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

Allen & Overy LLP

One Bishops Square, London E1 6AD, United Kingdom

Tel +44 20 3088 0000

Fax +44 20 3088 0088

www.allenovery.com