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Review

Contents

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Contract

INADEQUATE NOTIFICATION OF WARRANTY CLAIM UNDER SHARE PURCHASE AGREEMENT

Teoco UK Ltd v (1) Aircom Jersey 4 Ltd (2) Aircom Global Operations Ltd [2018] EWCA Civ 23, 18 January 2018

When a claims notification clause in a share purchase agreement states that a party must "set out reasonable details" of a claim in a notice of claims, including "the grounds on which it is based", the party must make explicit reference to the particular warranties alleged to have been breached in order for the notice of claims to be valid.

Schedule 4 of a share purchase agreement (the **SPA**) between the parties contained the following notification clause:

"No Seller shall be liable for any Claim unless the Purchaser has given notice to the Seller of such Claim setting out reasonable details of the Claim (including the grounds on which it is based and the Purchaser's good faith estimate of the amount of the Claim (detailing the Purchaser's calculation of the loss, liability or damage alleged to have been suffered or incurred)."

Teoco UK Ltd (the **Purchaser**) issued proceedings against Aircom Global Operations Ltd (the **Sellers**) in which it claimed, among other things, damages for breach of warranty and an indemnity in relation to tax. The Sellers applied to strike out the Purchaser's claims on the basis that the Purchaser had not given valid notice of the claims under the SPA.

The Purchaser's notices

The Purchaser's lawyers had originally written to the Sellers, referring to the "Tax Covenant, the Tax Warranties and the General Warranties". The letter was stated to constitute "notification in accordance with clause 24 and schedule 4 of the SPA of the existence of Claims, being either Warranty Claims or Tax Claims, as further detailed below". The letter contained a reservation of rights by the Purchaser and enclosed a draft report from Pricewaterhouse Coopers setting out comments on possible tax implications of certain intercompany transactions in which one of the target's subsidiaries had been involved.

A further letter was sent some months later by way of "further notification in accordance with Schedule 4 to the SPA". That letter indicated that two of Aircom's subsidiaries had tax exposures, detailed the amounts of such exposures and appended further evidence.

The Seller argued that neither of these communications constituted sufficient notification under the SPA because both failed to identify the particular warranties and provisions of the Tax Covenant on which the claims were based.

Existing law on claims notification clauses

The Court of Appeal acknowledged that every notification clause turns on its own wording. However, there are cases in which notification clauses have been analysed, and the Court of Appeal held that these decisions[1] can still be of assistance, and noted the following points that were made in them:

- A claims notification clause requiring notice in writing of a claim "setting out such particulars of the grounds on which such claim is based as are then known to the Purchaser promptly" would require that the notice is "sufficiently clear and unambiguous as to leave no room for argument about the particulars of the complaint" (*Senate Electrical*).

- At least in the *Senate Electrical* case, one purpose of the clause was to provide certainty as to the claims being made. In that case, it was said that "certainty is only achieved when the vendor is left in no reasonable doubt not only that a claim may be brought, but of the particulars of the grounds upon which the claim is to be based".
- Similarly, a claims notification clause that stipulated that the vendor of a business would be under no liability in respect of a claim "unless written particulars of such Claim (giving details of the specific matter as are available to the Purchaser in respect of which such Claim is made)" would require the identification of the particular warranty that had been breached; an explanation as to why it had been breached; and a description of the facts giving rise to the breach (*RWE Nukem*).
- Ambiguity in an exclusion clause may have to be resolved by a preference for a narrower construction if linguistic, contextual and purposive analyses do not disclose an answer to the question of what a clause is intended to mean with sufficient clarity. However, the court must "still use all its tools of linguistic, contextual, purposive and common-sense analysis to discern what the clause really means" (*Nobahar-Cookson*).

Notice failed to set out details of the claims and their grounds

Applying these principles, the Court of Appeal agreed with the High Court that the Purchaser's purported notifications had failed to satisfy the requirements of the notice of claims clause in the SPA because they did not identify the particular warranties and provisions of the Tax Covenant on which the claims were based.

The Court of Appeal explained that the reference to "setting out" and the "grounds" of a claim meant that the legal basis of the claim had to be identified, ie explicit reference most likely had to be made to particular warranties or other provisions. The *contra preferentum* rule did not alter the analysis.

COMMENT

Like previous cases that we have commented on, this case emphasises that the requirements of a claims notification clause can be highly sensitive to the precise language used. It is crucial to ensure that a claims notice complies with the particular claims notification clause under which it is given. The courts tend to consider that the purpose of these clauses is to allow sellers to be certain as to the claims that are being made against them. As a result, it can be risky for a buyer (as in this case) to be vague in its claims notice as to the basis for its claims. In particular, where such a clause requires that the details of the claims and their grounds be set out, the legal basis, and at least some factual basis, for that claim will need to be identified. Equally, if a buyer fails to include a particular claim in its claims notice, it may (depending on the terms of the claims notification clause) be precluded from pursuing that claim.
Thus (while bearing in mind that the right approach will turn on the terms of the applicable claims notification clause), as a rule of thumb it is sensible to be both (1) comprehensive, by including all possible claims in the notice of claims, and (2) specific, as to the precise claims being notified.

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[1] *Senate Electrical Wholesalers Ltd v Alcatel Submarine Networks Ltd* [1999] 2 Lloyd's Rep 423; *RWE Nukem v AEA Technology plc* [2005] EWHC 78 (Comm); and *Nobahar-Cookson v The Hut Group Ltd* [2016] EWCA Civ 128.

EARLY REPAYMENT FEES, EXTENSION FEES AND DOUBLE INTEREST PROVISIONS IN LOAN AGREEMENT NOT PENALTIES

(1) Mark Alan Holyoake (2) Hotblack Holdings Ltd v Nicholas Anthony Christopher Candy & 5 ors [2017] EWHC 3397 (Ch), 21 December 2017

Early repayment fees, extension fees and double interest provisions in agreements relating to a loan did not fall foul of the English law rule against penalties. The case shows how the principles set out by the **Supreme Court's ruling in *Makdessi***[1] apply in the context of a loan.

Mark Holyoake (**Mr Holyoake**) wanted to buy a property on the edge of Belgravia. He raised the purchase price from a number of sources, including an unsecured personal loan of GBP12 million from CPC Group Ltd (**CPC**). After CPC alleged that Mr Holyoake was in default, he entered into a series of supplemental agreements with CPC which rescheduled the loan in return for Mr Holyoake paying extension fees (the **extension agreements**).

The property was eventually sold by Mr Holyoake and the loan and extension fees were paid to CPC. Mr Holyoake brought a claim for repayment of the sums paid to CPC on a number of legal grounds. This article focuses on his assertion that certain clauses of the loan agreement and extension agreements were penalties.

Mr Holyoake tried to claim three types of clauses were penal, but did not succeed with any of the claims.

Strike one: early repayment clause

A clause in the loan agreement provided Mr Holyoake with the option to repay the loan early provided that all interest which would have accrued over the term of the loan was also repaid. The judge did not consider this a penalty clause. The clause was not expressed to operate on breach; it governed what sums were due upon early repayment. In *Makdessi* the Supreme Court ruled that the doctrine of penalties applies only to contractual provisions operating on a breach of contract.

The effect of the clause was to ensure that CPC received the interest which would have accrued over the loan term, whether the loan was paid early or not. The clause, therefore, was part of Mr Holyoake's primary obligations and did not fall within the scope of the penalty clause rule.

Although it was not necessary to settle the issue, the judge considered an escrow deed entered into by Mr Holyoake. The deed provided that in the event that Mr Holyoake did not (among other things) complete repayments under the loan, he would be released from all liabilities under the loan agreement, and the full loan amount, including interest, would be payable as a fresh obligation on the following business day. The deed itself did not oblige Mr Holyoake to complete loan repayments. The effect of the deed was that Mr Holyoake agreed to pay the loan and interest not as a penalty for breach of contract but as a consequence of neither refinancing nor completing the loan. The obligation was therefore not within the penalty rule. The judge thought that this "may be an example of clever drafting".

Strike two: loan extension fees

Under the extension agreements, which provided Mr Holyoake more time to pay off the loan, extension fee clauses came in two forms:

(1) extension fees which, if paid in line with an agreed timetable, would reduce the amount of debt payable; and

(2) extension fees which were payable in any event, with no provision to reduce the amount of debt payable.

Again, the judge did not consider either type of extension fees clause to fall within the rule against penalties. The fees were "expressly made payable in return for the extension of time", and where sums are payable under a contract the parties are free to decide what these sums are payable for. Here, the extension fees were, "in a real and substantive" sense, payments in

return for consideration rather than payments due as a result of a breach of obligation.

Strike three: double interest clauses

The extension agreements required payment of further interest on sums which already included previously accrued interest ('double interest' charges). The judge addressed two scenarios where 'double interest' was charged:

- Interest which would have been due "even if Mr Holyoake had kept scrupulously to the timetable for repayment". In this scenario, the rule against penalties could not be engaged as the relevant provision did not operate on breach.
- Interest which would not have been charged had Mr Holyoake adhered to the payment schedule. The judge held that "failure to keep to the repayment schedule" was the trigger for the interest, and this was "undoubtedly a breach of the agreement". The clause therefore engaged the penalty rule.

In the second scenario, the question was whether the clause protected a legitimate business interest, and whether the protection was nevertheless "extravagant or exorbitant or unconscionable". The judge again decided against Mr Holyoake on this point because, clauses providing for the entire balance of debt to become payable on default are standard provisions[2] and charging further interest on top of this sum is also standard practice.

As the judge noted, there is a sound commercial basis for this: "once the debtor is in default, the creditor is not only being kept out of his money but running an enhanced credit risk".

COMMENT

This case demonstrates that carefully framed obligations can make a difference in how the court applies the rule against penalty clauses. It appears that obligations applicable not upon breach of contract but, instead, on a failure of a condition may not be caught by the rule against penalty clauses. This was also reflected in the Court of Appeal decision of *Edgeworth Capital*[3]. In this case the court held that a cross-default provision did not fall foul of the rule against penalties as the fee payable had nothing to do with damages for breach of contract; it was payable on the happening of a specified event. This case, as well as the *Edgeworth Capital* case, also perhaps displays a reluctance by the court to use the penalty rule to frustrate standard loan provisions.

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[1] *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67.

[2] The Angelic Star [1988] 1 Ll Rep 122.

[3] *Edgeworth Capital (Luxembourg) SARL & anr v Ramblas Investments BV* [2016] EWCA Civ 412.

NO CONTRACTUAL DUTY TO PROTECT SPREAD BETTERS AGAINST THEMSELVES

Aryeh Ehrentreu v IG Index Ltd [2018] EWCA (Civ) 79, 31 January 2018

A spread betting company owed no contractual duty to protect a customer from his own gambling addiction or considered choices. "Very clear express words" would be required to give rise to a contractual duty to protect parties from inflicting economic harm on themselves.

The appellant, Ehrentreu, was a customer of the respondent, IG, a spread betting company. The parties' relationship was governed by a Customer Agreement, under which the customer had placed substantial spread bets on market movements over the course of several years.

Under the Customer Agreement, IG was entitled to demand deposits and margins from the customer in certain circumstances. The Agreement included a provision that the customer "acknowledged" that, where he had "failed to pay a deposit or margin call in respect of one or more Bets five business days after such payment becomes due", IG was "obliged to close out such Bets".

In the summer of 2008, the customer placed bets on the movement of the RBS share price. The bets went disastrously wrong and in September 2008 IG began making margin calls on the customer. During this time the customer pleaded with IG to keep his bets open. When IG eventually closed the bets in October 2008, the customer's account was over GBP 1.2 million in debt.

The customer defaulted on a settlement agreement entered into between the parties for repayment of the debt, and IG commenced a claim for the outstanding balance. In his counterclaim – the subject of this appeal-the customer claimed that IG was in breach of the Customer Agreement in not closing out his bets sooner, as well as in breach of its statutory duty, and that this caused him to suffer substantial loss.

The judge at first instance held that IG was not in breach of its statutory duty. That finding was not appealed. As for the breach of contract claim, the judge concluded that IG was obliged under the Agreement to close out the customer's bets and had failed to do so. However, IG's breach of contract was merely the opportunity for the customer's loss, not the cause of it. The cause of the customer's loss was his decision to continue with his bets. The judge also concluded that the customer had wholly failed to mitigate his loss for the same reasons that had led him to his conclusion on causation. The customer appealed the rulings on both causation and mitigation.

No contractual duty

The Court of Appeal referred to the duty of care in tort to protect people from causing harm to themselves. It cited *Calvert v William Hill Credit Ltd* [2008] EWHC 454 (Ch), a case concerning a bookmaker and a gambling addict, in which the court stated that "the recognition of a common law duty to protect a problem-gambler from self-inflicted gambling losses involves a journey to the outermost reaches of the tort of negligence, to the realm of truly exceptional".

Having emphasised the rarity of the duty in tort, the Court of Appeal accepted IG's submission that the position must be even more exceptional in the law of contract. The Court had not been referred to any reported case in which a party had been held to be under a contractual duty to protect a customer against himself.

The Court considered whether the provision requiring IG to close out bets was intended to protect the customer. If it was, then it would follow that its breach caused the loss suffered by the customer.

The Court found that the provision of the Customer Agreement requiring IG to close out bets was not intended to protect the customer. Rather, the use of the words "you acknowledge that" more naturally conveyed that the customer acknowledged that what followed was a provision essentially for the protection of IG. The meaning of "we are obliged" was "we will have to do it", making clear to the customer what would happen if he failed to pay a deposit or margin call, in order to ensure that he had no cause for complaint if IG closed his bets.

The Court held that "very clear express words" would be required before it could conclude that a party had such an exceptional duty to protect others from inflicting harm on themselves. The provision in the Customer Agreement did not contain such express words and was simply not intended to protect the customer against his own gambling addiction or considered choices.

Lack of causation and failure to mitigate loss

In view of the circumstances, the Court of Appeal held that the judge was entitled to conclude that IG's breach of contract was merely the opportunity for the customer's loss and not its cause. The cause was, rather, the customer's decision to remain in the market. In addition, the judge had not erred in concluding that the customer had failed to mitigate his loss for the same reasons as he had concluded that the customer's actions were the cause of his loss. In the court's view, adopting IG's submission, "*causation and mitigation are two sides of the same coin*".

COMMENT

This case confirms that a duty to protect others from inflicting harm on themselves is rare in tort law and even more exceptional in contract law. Very clear express words in the contract spelling out the duty would be required before the court could conclude that such a duty arose. This decision will be welcomed by spread betting companies and indeed other financial institutions with customers who might otherwise attempt to rely on an alleged contractual duty to recover their losses.

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NON-ASSIGNMENT CLAUSES: WHAT THEY DO (AND DON'T) RESTRICT

First *Abu Dhabi Bank PJSC (formerly National Bank of Abu Dhabi PJSC) v BP Oil International Ltd* [2018] EWCA Civ 14, 18 January 2018

A warranty in a receivables financing contract that BP was not prohibited from disposing of the receivable was not breached by a clause in the underlying oil sale contract prohibiting assignment without the other party's consent. The decision usefully interprets common clauses found in commercial agreements and receivables financing contracts – namely non-assignment clauses and warranties concerning ability to dispose of a receivable. Non-assignment clauses are the subject of proposed law reform that would nullify their effect in business contracts. Allen & Overy's Global Intelligence Unit report on the proposed regulations can be read here.

BP contracted to supply oil to the Société Anonyme Marocaine de L'Industrie de Raffinage (**SAMIR**). First Abu Dhabi Bank (**FAB**) guaranteed payment for up to 95% of the sums due from SAMIR to BP, in exchange for a commission fee (the **guarantee**). This was cancelled and replaced a month later by a purchase letter (**purchase letter**), under which FAB agreed to purchase BP's economic interest in the contract with SAMIR (the **Contract**) at 95% of its value. FAB advanced payment to BP, and BP was to pay to FAB all sums it received from SAMIR under the Contract.

Restrictions on assignment

The Contract expressly incorporated BP's general terms and conditions for sales and purchases of crude oil, including a non-assignment provision (s34) which stated that "Neither of the parties to the Agreement shall without the previous consent in writing of the other party (which shall not be unreasonably withheld or delayed) assign the Agreement or any rights or obligations hereunder. […] Any assignment not made in accordance with the terms of this Section shall be void".

However, the purchase letter provided that:

- BP would assign its rights under the Contract to FAB "if legally possible under applicable laws and the Contract";
- in the event that any assignment was not able to take place or was invalid or unenforceable, FAB would be subrogated to BP's rights under the Contract and would be entitled to a funded sub-participation in BP's rights to receive payment from SAMIR;
- any amounts paid by SAMIR to BP would be held on trust for FAB; and
- BP represented and warranted that it was "not prohibited by any security, loan or other agreement, to which it is a party, from disposing of the Receivable evidenced by the Invoice as contemplated herein". The Receivable was defined as the invoice issued by BP to SAMIR under the Contract.

No consent to assignment

BP had neither requested nor obtained SAMIR's consent to the assignment to FAB as at the date of the purchase letter. SAMIR subsequently filed for insolvency in Morocco, and FAB asked BP for an assignment of its rights under the Contract. BP then informed FAB that it needed SAMIR's consent to an assignment. FAB did not request that BP seek SAMIR's consent, but instead commenced proceedings for damages for breach of the representation and warranty in the purchase letter.

At first instance – warranty breached

At first instance, Carr J found for FAB, holding that the inclusion of s34 of BP's general terms in the Contract meant that the representation and warranty in the purchase letter was false.

Court of Appeal – no breach

The Court of Appeal found that there had been no breach of the representation and warranty by BP. Giving the leading judgment, Lady Justice Gloster analysed the question in three stages.

What was BP prohibited from doing under s34 of its general terms and conditions?

Clauses such as s34 of BP's general terms and conditions prohibit parties from legally or equitably assigning their existing or future rights under contracts (without their counterparty's consent). BP was therefore contractually prohibited from effecting a legal or equitable assignment of its rights under the Contract to FAB.

However, BP was not prohibited from taking the other steps contemplated by the purchase letter, including paying sums received from SAMIR to FAB, holding such sums on trust for FAB or granting FAB subrogated rights or a funded sub-participation.

What was the effect of such a restriction on BP's ability to dispose of the Receivable?

Following *Linden Gardens Trusts Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85, it was common ground between the parties that the effect of s34 was that any purported legal or equitable assignment by BP of its rights under the Contract to FAB (without SAMIR's consent) would be ineffective.

Did BP breach the warranty? – No

The representation and warranty had to be interpreted against the commercial context and overall scheme of the purchase letter. Assignment was not the primary method of transferring to FAB sums received by BP under the Contract; that was payment of the amounts received by BP to FAB and the imposition of a trust over those sums. Assignment was a secondary method of FAB receiving the relevant sums. Further, the clause in the purchase letter which required assignment expressly contemplated that assignment may not be possible, and provided FAB with alternative remedies such as subrogated rights or a sub-participation if assignment were impossible for any reason. The payment guarantee agreement which preceded the purchase letter also expressly provided for alternative means of transferring the economic benefit of the Contract if assignment were not possible. That it might not be possible to assign the contract therefore formed part of the factual matrix in which the purchase letter was to be construed.

Against this background and in light of the other terms of the purchase letter, the phrase "from disposing of the Receivable evidenced by the Invoice as contemplated herein" in the representation and warranty did not refer exclusively to an assignment, but envisaged a wider restriction preventing the disposal by BP of its economic interest in the Contract. Section 34 of BP's general terms and conditions did not prohibit BP from disposing of its economic interest in the Contract by all the means contemplated in the purchase letter, it only prohibited legal or equitable assignment, which the relevant terms of the purchase letter expressly contemplated may not be possible in any event. Therefore, on the proper construction of the purchase letter, BP had not breached the representation and warranty.

COMMENT

This case is a useful clarification of the meaning of terms, iterations of which are commonly found in receivables financing contracts. It is also interesting for what was not decided. Gloster LJ's judgment analyses whether clauses prohibiting assignment are capable of rendering ineffective a subsequent equitable (as opposed to legal) assignment, and whether the *Linden Gardens* case can in

fact be distinguished on this point. No finding was made as "with a considerable degree of intellectual disappointment" the question was not before the Court of Appeal. However, the space Gloster LJ devoted in her judgment to this question indicates that it is one considered ripe for review by the Supreme Court should an appropriate case arise.

The commercial rationale of *Linden Gardens* is that it preserves the legitimate commercial purpose of non-assignment clauses by ensuring that contracting parties do not have to deal with third parties that they have not consented to deal with. Gloster LJ's analysis argues that non-assignment clauses only need to render ineffective legal assignments to satisfy this commercial purpose, and to go further and render equitable assignments ineffective is an illegitimate constraint on the freedom of commercial parties to alienate their property.

Similarly, although BP accepted in the Court of Appeal that the effect of s34 of its general terms and conditions was to prohibit it from effecting a legal or equitable assignment (accepting that the Court of Appeal was bound by two of its previous decisions on this point), it reserved its position as to the correctness of those prior decisions should the case proceed to the Supreme Court.

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WIDELY DRAFTED EXCLUSION CLAUSE UPHELD

(1) Interactive E-solutions JLT (2) Interactive E-solutions DMCC v O3B Africa Ltd [2018] EWHC 186 (Ch), 8 February 2018

The Court of Appeal has, yet again, held that a widely drafted exclusion clause represented the allocation of commercial risk between two parties in the satellite telecoms industry. The exclusion clause precluded the claimant from establishing a cause of action within a standard fraud carve-out from the exclusion clause, even where the defendant's subcontractor had made false statements to the relevant regulatory body.

Under a contract between the parties, O3B provided satellite services in Pakistan and Interactive provided satellite-based infrastructure. A dispute arose when Interactive refused to pay service fees to O3B.
The relevant fees fell due when the relevant satellite system had been "successfully placed into commercial operation", which was dependent upon receiving approval from the Pakistan Telecommunication Authority (**PTA**).

As a result of Interactive's non-payment of the service fee, O3B purported to terminate the contract. Interactive brought an action for specific performance of the contract or, in the alternative, counterclaimed damages of USD 55 million for breach of contract.

The contract contained a wide (and verbose) exclusion clause which excluded O3B's liability for anything bar fraud, and also a clause that provided "Nothing… limits the liability of either Party arising from fraud".

At first instance, Mr Richard Salter QC found that Interactive had been unable to establish an arguable cause of action not barred by the exclusion clause, and that only fraud claims fell outside the scope of the exclusion of liability.

What is a claim 'arising from fraud'?

Interactive tried to bring its claims within the fraud exception to the exclusion clause. A key issue for the court was whether the allegations by Interactive were sufficient to make its claims 'arising from fraud'.

Interactive argued that in the course of liaising with the PTA to obtain approval, O3B's subcontractor had written a letter containing statements which Interactive alleged the subcontractor knew to be untrue and that O3B had "*likely*" been aware of. Interactive also claimed that O3B had known (i) that its infrastructure was not compliant; and (ii) that it had not been entitled to apply for approval from the PTA. Interactive therefore claimed that both O3B's application for regulatory approval and its claim for payment from Interactive had been made fraudulently.

The Court of Appeal held that the clause "Nothing… limits the liability of either Party arising from fraud" means "liability in relation to which fraud is a necessary averment, otherwise the 'liability' would not arise from fraud. It would arise from something else". That begged the question: what is fraud? O3B successfully argued that fraud had to mean a cause of action in which dishonesty is a necessary ingredient.

This was a problem for Interactive, as its claim was not based on any allegation that either it or the PTA had been misled by anything said or done by or on behalf of O3B. As such, Interactive did not claim that O3B was liable as a result of any dishonesty, but rather because its demand for payment had been invalid (because O3B had not been entitled to put the system into operation).

Interactive was therefore unable to invoke the 'fraud' carve-out and the Court of Appeal unanimously dismissed its appeal, finding that Interactive's counterclaim did not fall within the words "excluding fraud".

A commercial approach

Lewison LJ noted that although the courts were traditionally hostile to exclusion clauses, since the Unfair Contract Terms Act 1977, they had interpreted them less narrowly recognising (at least in commercial contracts made by parties of equal bargaining power) that exclusion and limitation clauses are "an integral part of pricing and risk allocation". Lewison LJ noted that it had become common drafting practice to include fraud carve-outs to reflect that a contracting party might be willing to assume the risk of negligence by his counterparty, but not the risk of fraud.

COMMENT

As this decision demonstrates, bad behaviour (however serious) on the part of a defendant will not automatically bring a claimant's cause of action within a fraud carve-out unless the claimant can establish a causal link between the fraud and the defendant's purported liability.

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NON-RELIANCE/ADVISORY CLAUSE PROTECTS BANK IN SWAP MISSELLING CLAIM

Marz Limited v Bank of Scotland plc [2017] EWHC 3618 (Ch), 5 December 2017

The terms of an ISDA agreement in which the parties represented that they had relied on their own independent decisions to enter the transaction trumped provisions in an earlier set of terms of business which referred to the bank providing advice and recommendations. A tortious breach of duty to advise claim also failed because the court found on the facts that the client had not relied on the bank to provide advice.

In 2008, as a condition of lending to Marz Limited (**Marz**), Bank of Scotland plc (**BoS**) required the company to hedge against the interest rate risk on a portion of the loan. Marz accordingly entered into an interest rate swap (**Swap**) with BoS. Marz claimed that BoS breached a contractual duty to ensure that the Swap was suitable and breached a common law duty to take care in advising Marz. The court found for BoS in both respects.

Contractual claim fails – ISDA Master Agreement trumps inconsistent terms of business

BoS sent its Terms of Business (**Terms**) for Retail Clients to Marz in February 2008 under cover of a letter that stated BoS would be providing "advisory and execution services". The Terms provided, amongst other things, that where BoS made a recommendation to the client, BoS would take reasonable steps to assess whether it was suitable (clause 5). The Terms also provided that where there was conflict between the Terms and another agreement (and gave the example of an ISDA), the other agreement would prevail (clause 2.2).

The parties later documented the Swap under an ISDA Master Agreement, Part 5(2) of which provided that, absent written agreement expressly imposing affirmative obligations to the contrary, each party represented as at the date of the transaction that it had not relied upon the other party and had made its own independent decisions, was capable of assessing the merits of and understanding the transaction and assuming the risks of the transaction and that the other party did not act as its fiduciary or advisor in respect of the transaction.

The court held that Part 5.2 of the ISDA Master Agreement was in "wholesale conflict" with clause 5 of the Terms and the effect of clause 2.2 of the Terms was that Part 5.2 of the ISDA prevailed as a "comprehensive, subsequent and specifically applicable set of contract terms relating to the Swap". Specifically, the court considered that the Terms did not constitute a written agreement expressly imposing affirmative obligations contrary to Part 5(2) because clause 2.2 of the Terms specifically provided there where there was a conflict between the Terms and another agreement, the other agreement would prevail.

No duty of care owed regarding Swap

Marz claimed that:

- BoS gave it advice on the merits of entering into the Swap and purported to explain the available hedging products in such a way as to enable Marz to take an informed decision; and
- therefore owed common law duties of care in relation to its advice and/or its explanation of the options.

No reliance

The court considered that the question of whether BoS assumed a duty needed to be assessed objectively in the context of the whole relationship between the parties, including the contractual framework and the communications that passed between them. Marz pointed to emails from the bank in which sales staff suggested that a seven-year hedging arrangement was "probably the most suitable for the customer" and that the client could potentially make "quite staggering" and "huge" savings. The salesman also noted that he thought the Swap would be of "great benefit" for the customer. The court considered that this was "obvious sales-talk" and noted that the Product Profile provided in relation to the Swap did not contain a recommendation, but did contain a disclaimer which was inconsistent with the proposition that the bank was advising the customer on the suitability of the product.

The court also found as a matter of fact that Marz had not relied on BoS anyway. It had its own team of advisers and the director with whom BoS negotiated the loan and Swap, Mr Adil, had considerable experience and knowledge of hedging products, including interest rate swaps. The court further found it relevant that M Adil had not wanted Marz to enter into a hedging product and that Marz entered the Swap not because Mr Adil was persuaded by BoS that it would be beneficial, but because it was a condition of the loan that Marz wanted to obtain.

Contract pointed away from concurrent tortious duties

The court also considered that the parties' rights and obligations were largely fixed by their contractual agreements and these "did not leave much if any room for concurrent duties of care on the part of BoS in tort". The court considered the doctrine of contractual estoppel, under which a customer is unable to deny the existence of a particular state of affairs which the parties recorded as the basis on which they had agreed to contract.

While acknowledging that *Springwell Navigation Corp v JPMorgan Chase Bank (formerly Chase Manhattan Bank) & ors* [2010] EWCA Civ 1221 was binding authority, the court regarded the current case "more as a matter of contract than estoppel", in which the parties were bound by their agreement that there was no advisory relationship and the customer had made its own decisions, without reliance on advice from the bank.

COMMENT

This is the latest in a long line of, and is consistent with, unsuccessful misselling cases arising from the 2008 financial crisis. The judgment demonstrates that the English courts continue to approach these cases through an objective assessment of the impact of the contractual and factual context as a whole. The courts will not be easily persuaded that "sales talk" constitutes 'advice'.

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Privilege

LITIGATION PRIVILEGE: APPLYING THE LAW POST-ENRC

Bilta (UK) Ltd (in liquidation) & ors v Royal Bank of Scotland Plc & anr [2017] EWHC 3535 (Ch), 20 December 2017 and *Health and Safety Executive, R. (on the application of) v Jukes* [2018] EWCA Crim 176, 14 February 2018

In two recent decisions, the English courts have grappled with the application of litigation privilege in the wake of Andrews J's decision in *SFO v ENRC*. In *Bilta v RBS*, the court upheld a claim to litigation privilege over documents (including interview transcripts) generated during an internal tax investigation undertaken co-operatively after a threatened adverse tax assessment by HMRC. In *R v Jukes*, on the other hand, the Court of Criminal Appeal followed ENRC in finding that a witness statement generated in an internal investigation into a workplace health and safety incident was not protected by litigation privilege, as matters were still at the investigatory stage where no decision to prosecute had been taken by the Health and Safety Executive.

Litigation privilege after ENRC v SFO

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

In *SFO v ENRC*, Andrews J denied a claim for litigation privilege for documents that were produced by lawyers and forensic accountants during an internal investigation into allegations of bribery and corruption. This was because adversarial litigation was not reasonably in contemplation because a criminal investigation by the SFO was not, in Andrews J's view, adversarial litigation for privilege purposes. In addition, even if prosecution had been reasonably in contemplation, none of the documents had been created with the dominant purpose of being used in such litigation. The appeal against the decision is being heard in July this year.

Bilta seeks RBS's internal tax investigation documents

Bilta sought internal investigation documents generated by RBS and its lawyers after a threatened adverse tax assessment by HMRC. These documents included, as in the *SFO v ENRC* case, transcripts of interviews with employees and ex-employees. The documents were relevant to Bilta's subsequent claim against RBS alleging dishonest assistance in executing some of the trades which were the subject of the internal investigation.

Bilta argued that the documents were not generated with litigation as their sole or dominant purpose. Rather, it said, they were generated as an essential part of the preparation of a report promised to HMRC to assist it in its assessment, and pursuant to RBS's general duties and obligations as a taxpayer and under its own Codes of Practice to provide HMRC with a full and detailed account of the relevant facts concerning its deductions of VAT. Bilta referred to the finding in ENRC that against a background of co-operation and openness, fact-finding aimed at obtaining legal advice on how to avoid an investigation would not be covered by litigation privilege.

A little bit more about the RBS tax investigation

In 2010, HMRC wrote to RBS to confirm it was investigating "missing trader" or carousel intra-community fraud in the UK European Union Allowances (**EUAs**) market. The fraud involved companies trading in EUAs failing to account to HMRC for the value added tax which accrued and, instead, paying their VAT receipts to third parties before going into liquidation. HMRC notified RBS that its investigation might put at risk input tax which had, in accordance with ordinary principles, been claimed by RBS from HMRC. RBS co-operated with HMRC's investigation throughout 2010 and 2011.

In March 2012, HMRC notified RBS by letter (the **HMRC Letter**) of its view that there were sufficient grounds to deny RBS GBP86m of input tax on the basis that it knew or should have known that EUAs' transactions were connected with fraud. At this point, RBS instructed external counsel to provide legal advice in relation to the dispute with HMRC. RBS met with HMRC, and RBS agreed to provide a full written report (the **Report**) on the facts to HMRC before HMRC would decide whether to issue its assessment. To avoid its claim being time barred, HMRC issued an adverse assessment to RBS for GBP86m in late September 2012, but emphasised that it did not intend to "close the door on further discussions" and that it would give "full consideration" to the written report to be provided by RBS.

In January 2014, RBS produced the Report to HMRC. HMRC did not withdraw its assessment, and in October 2014 RBS appealed it to the First Tier Tribunal (Tax Chamber).

Adversarial litigation in contemplation

In terms of the test for litigation privilege, Bilta accepted that adversarial litigation against HMRC was in RBS's contemplation. So the issue before the court was whether the documents were made for the sole or dominant purpose of conducting that litigation.

Wider view adopted – investigation can have dual purpose

The Chancellor held that the documents and interview notes were covered by litigation privilege, having been brought into being by RBS and its litigation solicitors for the sole or at least the dominant purpose of the expected litigation against HMRC following the expected assessment in respect of over-claimed input VAT.

Although the Chancellor was urged by Bilta to follow ENRC, he emphasised that the exercise of determining the sole or dominant purpose in each case is a determination of fact. In a passage likely to be of comfort to corporates facing investigation, he noted that although both the case at hand and *ENRC* "involve internal investigations by corporates in the face of scrutiny by government authorities, one cannot simply apply conclusions that were reached on one company's interactions with the Serious Fraud Office in the very different context of another company's interactions with HMRC.

A continuum forming the road to litigation

The Chancellor emphasised the need to take a realistic and commercial view of the facts: fending off the assessment was part of the continuum forming the road to the litigation. This was supported by:

- evidence that HMRC would proceed to issue an assessment against RBS following the HMRC Letter, and it was unlikely that the promised external solicitor's report would dissuade HMRC from doing so;
- the wider context with HMRC attempting to recover input tax from other participants in the EUA market; and
- RBS's actions in appointing external lawyers within weeks of receipt of the HMRC letter "strongly suggest" RBS anticipated a claim and was gearing up to defend it.

Dissuading HRMC from issuing an assessment could therefore not be said to be the sole or dominant purpose of the investigation – it was the wider purpose of preparing for litigation that was the purpose behind the generation of the documents. The HMRC Letter should be regarded as equivalent to a letter before action in a litigation context.

Co-operation did not affect dominant purpose analysis

Importantly, the Chancellor found that the ostensible collaborative and co-operative nature of RBS's interactions with HMRC did not change the position on litigation privilege. He noted that it was commonplace for HMRC to canvas views of large taxpayers prior to a formal assessment, and it was unsurprising that RBS met with HMRC and updated it on the investigation. He rejected the argument that such co-operation precluded the internal investigation being conducted for the dominant purpose of litigation. Instead, he found that even if one purpose in generating the documents at the time had been to attempt to persuade HMRC to change its mind, this was subsumed under the dominant purpose of preparation for the litigation that RBS expected to be necessary to contest the assessment it expected from HMRC.

Duties as taxpayer subsidiary to dominant purpose

Similarly, the Chancellor was not persuaded that RBS was conducting the investigation solely or dominantly in accordance with its duties as a taxpayer or its Codes of Practice: again, these purposes were effectively subsumed under the purpose of defeating the expected assessment.

R (for and on behalf of the Health and Safety Executive) v Jukes – no adversarial litigation

In this second recent case on privilege, we find the Criminal Court of Appeal following the ENRC v SFO decision.

Mr Jukes had been convicted of failing to discharge the duty to take reasonable care of the health and safety of employees. His defence was broadly that he was not responsible for the health and safety of employees at the relevant time.

In support of its case, the prosecution (on behalf of the Health & Safety Executive) sought to admit into evidence a witness statement Mr Jukes had provided to his company's solicitor, in which he admitted that he was responsible for workplace health and safety. The witness statement had been generated while his employer-company was investigating, in conjunction with external solicitors, the underlying health and safety incident. Mr Jukes argued that his statement was a privileged document, provided to the company's external solicitors at the time when he was an employee of the company. He argued those solicitors acted for both the employees and the company in relation to the investigation of the health and safety incident.

No privilege – just an "investigatory stage"

The Court of Criminal Appeal agreed with the trial judge that the witness statement did not attract litigation privilege. At the time it had been created, no decision to prosecute had been taken by the Health and Safety Executive, and matters were still at the "investigatory stage", which could not be considered adversarial litigation. The Court expressly cited *SFO v ENRC*, agreeing with the analysis that criminal proceedings cannot be reasonably contemplated (for the purpose of litigation privilege) "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".

COMMENT

With two decisions pulling in opposite directions post-*ENRC*, it remains essential for the Court of Appeal to resolve the correct position on litigation privilege: the appeal in *SFO v ENRC* is due to be heard in July 2018.

Until that time, the decision in *Bilta* provides some assistance to corporates seeking to assert litigation privilege in the context of an internal investigation. The Chancellor clearly decided to confine Andrews J's ENRC decision on the purpose of an internal investigation at the instigation of a government authority to the facts of that case, rather than applying it as a precedent for similar factual scenarios. Regardless, the onus of establishing privilege lies with the party asserting it, and being in a position to put forward evidence (such as engagement letters, internal emails and attendance notes) showing the dominant purpose to be litigation will remain determinative.

More importantly, the Chancellor disapproved of the notion that co-operation with a government authority should preclude an internal investigation from ever being found to be conducted for the dominant purpose of litigation. This should assist when seeking to establish litigation privilege in internal investigations conducted after notification of potential litigious action on the part of bodies such as HMRC, the Health and Safety Executive or the FCA.

On the other hand, the Court of Appeal's endorsement of *ENRC* on the non-adversarial nature of a criminal investigation in *Jukes* is troubling for clients asserting litigation privilege in the context of an internal investigation into potential criminal offences.
It highlights again the incongruous result that a company threatened with civil proceedings in relation to allegations of misconduct may conduct an internal investigation protected by litigation privilege (provided the dominant purpose test is met), but a company under criminal investigation for those same allegations cannot, unless it knew enough to be satisfied that a prosecutor could realistically consider themselves to have a good chance of securing a conviction.

That said, the claim for litigation privilege in *Jukes* appears to have been particularly weak: it was clear that Mr Jukes (as a mere employee of the company) was not himself the client of the external solicitor, and the company did not assert privilege or offer any evidence supporting his claim for privilege. It is therefore perhaps of limited application in other cases.

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Tort

NO PARENT COMPANY DUTY OF CARE FOR NIGER DELTA CLAIMS

Okpabi & ors v Royal Dutch Shell Plc & anr [2018] EWCA Civ 191, 14 February 2018

The Court of Appeal has ruled that the English courts do not have jurisdiction over claims by victims of oil leaks from pipelines in the Niger Delta. The judgment comes after the *Lungowe & ors v Vedanta Resources Plc* [2017] EWCA Civ 1528 decision by the Court of Appeal delivered last year, in which it was held that similar environmental tort claims could proceed in the English courts on the basis that it was sufficiently arguable that the UK parent company owed a duty of care to the overseas claimant. The *Okpabi* decision offers insights into what evidence might be necessary to establish parent company liability for acts of a foreign subsidiary.

The claimants sought damages in the English court as a result of serious, and ongoing, pollution and environmental damage caused by leaks of oil from pipelines and associated infrastructure in and around the Niger Delta in part caused by sabotage and illegal bunkering.

The claimants are members of the Bille and Ogale communities where the oil leaks occurred. They contended that the defendants, UK company Royal Dutch Shell Plc (**RDS**), and its Nigerian subsidiary, the Shell Petroleum Development Company of Nigeria Ltd (**SPDC**), were responsible for damage to their lands based on the tort of negligence under the common law of Nigeria (which, the court accepted, was to be regarded as the same as the law of England and Wales).

In particular, they claimed that RDS, the UK parent company, owed a duty of care to the claimants either because RDS controlled the operation of pipelines and infrastructure in Nigeria from which the leaks occurred, or because it had assumed a direct responsibility to protect the claimants from environmental damage caused by the leaks. In establishing whether there was "a real issue to be tried between the claimants and RDS" and a "necessary or proper party" jurisdiction gateway against SPDC, it was necessary for the English courts to rule on its own jurisdiction, the threshold for which is establishing whether the claims against RDS had a "*real prospect of success*". At first instance Fraser J held that there was no arguable case that RDS owed the claimants a duty of care. This decision was upheld on appeal by a majority (Sir Geoffrey Vos and Lord Justice Simon), with Lord Justice Sales dissenting.

The test for parent company liability

The court adopted the same test for establishing parent company liability as was adopted by the Court of Appeal in *Vedanta*:

- The starting point is the three-part test for duty of care of: (a) foreseeability; (b) proximity; and (c) reasonableness, as set out in *Caparo Industries v Dickman* [1990] 2 AC 605.
- A duty of care may arise where the parent company: (a) has taken *direct responsibility* for devising a material health and safety policy (the adequacy of which is the subject of the claim); or (b) *controls* the operations which give rise to the claim.
- Examples of circumstances where the three-part test might be satisfied are found in the decision of *Chandler v Cape Plc* [2012] EWCA Civ 525. These examples include instances where the parent company is well placed, because of its knowledge and expertise, to protect the employees of the subsidiary (or, by analogy, where the parent company affects the operations of the company).

Proximity test fails – insufficient control of subsidiary

Although the foreseeability test was satisfied, there was insufficient proximity. The claimants had tried to show proximity by demonstrating RDS's control of SPDC's operations including:

- the issue of mandatory policies, standards and manuals which applied to SPDC;
- the imposition of mandatory design and engineering practices;
- a system of supervision and oversight in implementing RDS's standards;
- financial control over SPDC; and
- a high level of centralised direction and oversight of SPDC's operations in relation to security.

The majority concluded that none of these factors demonstrated a sufficient degree of control of SPDC's operations in Nigeria by RDS.

Mandatory policies applied to all subsidiaries

Shell's mandatory policies (on which the claimants relied heavily) contained high-level guidance, which is then made available to its subsidiaries to implement. Taking its HSSE & SP Control Framework as an example, this indicated how the effectiveness of HSSE compliance would be reviewed at Group level, but not the existence of any degree of control.

The court found that the imposition of these policies (to all subsidiaries) could not mean that the parent company assumed a duty of care to anyone affected by the policies. Sir Geoffrey Vos commented that the policies applied to all subsidiaries and had not been tailored for SPDC, and that "*there needs to be something more specific for the necessary proximity to exist*".

A dissenting voice

In the view of Lord Justice Sales, however, the claimants had shown that they had a good, arguable case, namely, that RDS owed them a duty of care at the material times, and that RDS had breached that duty of care.

He considered that there was a "*more than merely speculative*" claim based on the evidence produced, including the fact that the existence of global standards was capable of providing a mechanism for the projection of real practical executive control by RDS over the affairs of SPDC.

COMMENT

This decision demonstrates that there is a difference, as far as the law is concerned, between a parent company which takes steps to ensure that there are proper control mechanisms in place over all subsidiaries (for example, by establishing standard global mandatory policies and processes) and a parent company which seeks to exercise control over a subsidiary. It is in the latter case, suggests this decision, that a duty of care may arise.

That said, it is unlikely that this will deter future similar claims against multi-nationals. Mindful of that fact, it is likely that such companies will wish to assess the risk of parent company liability being established. Factors that may point away from parent company liability, as in this case, include standard policies which apply across the board to operating subsidiaries (not tailored to a particular subsidiary's business) and a responsibility for implementing and overseeing any such policies – whether those be environmental and/or human rights focused-being firmly seated at subsidiary level. This, in turn, should help to promote better compliance and awareness of environmental and human rights issues by foreign subsidiaries.

Finally, it is likely that parent company liability for environmental and human rights claims is an area of law that will see further developments in the near future.

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Forthcoming client seminars

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

How not to freeze when a freezing order lands on your desk: key issues and practical tips for non-litigators

Thursday 8 March – 8.300 – 9:30

Mona Vaswani – Litigation- Banking, Finance & Regulatory, Partner-Profile

Juliet de Pencier – Litigation-Banking, Finance & Regulatory, Senior Associate-Profile

Synopsis: Freezing orders impose onerous obligations on parties in relation to their assets and on third parties who have notice of the order. Search orders are similarly burdensome, potentially requiring parties to allow searches to be carried out in their homes and business premises with a view to locating documents or assets. These orders are generally served without any prior warning and require immediate action. In this seminar Mona Vaswani, Partner, and Juliet de Pencier, Senior Associate, in our Litigation practice will discuss the key issues you should consider when a freezing or search order lands on your desk, including:

- How to determine what your client's obligations are in relation to the order.
- Whether those obligations differ if your client (or any relevant assets or property) are based outside the UK.
- What you might be able to do to overturn the order or to limit its effect.
- Additional steps you should anticipate parties with an interest in the order taking in the future.
- Dealing with costs incurred in relation to such orders.

The seminar will be of interest to general counsel, in-house lawyers responsible for providing legal advice to business operations and those in wider management roles who may be required to lead the immediate response to the service of a freezing or search order.

Recent developments in banking and finance law

Friday 16 March –12:30 – 1:30

Richard Hooley – Banking, Consultant-Profile

Synopsis: A review of developments in banking and finance law that have taken place in the last six months.

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

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Key contacts

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

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