ALLEN & OVERY

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# Litigation and Dispute Resolution

## *Review*

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# Arbitration

## ARBITRATOR APPOINTED MULTIPLE TIMES IN RELATED ARBITRATIONS

*Halliburton v Chubb* [2018] EWCA Civ 817, 19 April 2018

The fact that an arbitrator has accepted appointments from the same party in multiple references concerning the same or overlapping subject matter does not, without more, give rise to an appearance of bias. However, as a matter of law and good practice in international arbitration, an arbitrator should disclose such appointments on an on-going basis – ie both before or after any new appointments by the same party.

In the aftermath of the 2010 explosion on the Deepwater Horizon oil rig, Halliburton (who had been providing services to the lessee of the rig) claimed under its liability insurance. Chubb, its insurer, refused to pay and Halliburton commenced arbitration. Halliburton and Chubb each appointed arbitrators (**N** and **P**, respectively) but couldn't agree on the identity of the third arbitrator. Chubb's preferred candidate, **M**, disclosed that he was currently appointed as arbitrator in two pending references involving Chubb and that he had previously acted as arbitrator in a number of arbitrations to which Chubb was a party, including appointments on behalf of Chubb.

Following a contested application to the English High Court, M was appointed as the third arbitrator. M then went on to accept two further appointments (one by Chubb) in references concerning the Deepwater Horizon incident. Neither appointment was disclosed to Halliburton, who sought an order, under s24(1)(a) Arbitration Act 1996 (**Act**), that M be removed as an arbitrator, arguing that there were justifiable doubts as to his impartiality.

Halliburton's application was dismissed by Popplewell J. On appeal, Halliburton argued that Popplewell J had failed to properly consider the procedural unfairness which could arise where an arbitrator accepts appointments in overlapping references with only one common party. That common party could, Halliburton argued, acquire information and knowledge which would enable it to make submissions and adduce evidence which may influence the common arbitrator. The common party may also have the opportunity to assess the views of the common arbitrator in one arbitration and to tailor its submissions and evidence accordingly in the other. Given the confidential nature of arbitration, the fact that the common party possessed any such "inside information" would likely be unknown to the other party.

**Duty of impartiality**

The Court of Appeal stated that the starting point is that an arbitrator should be trusted to decide the case solely on the evidence and argument before him or her in the relevant reference. The fact that an arbitrator has previously decided the same or similar issues, or has been appointed in overlapping references (including those with only one common party) cannot – in isolation – justify a conclusion of apparent bias.

Although a lack of independence could give rise to justifiable doubts of impartiality, the court pointed out that this had not been included as a separate ground for removal under the Act as "there may well be situations in which parties desire their arbitrators to have familiarity with a specific field, rather than being entirely independent".

**Test for disclosure**

Noting that the Act contains no disclosure requirements, the court concluded that an arbitrator should disclose facts or circumstances known to him or her which "would or might" give rise to justifiable doubts as to his

or her impartiality, ie those which would or might lead a fair-minded and informed observer to conclude there was a real possibility of bias.

The court noted that many arbitration institutional rules, including the IBA Guidelines, the ICC Rules and the LCIA Rules, impose a stricter (subjective) test of disclosure "which may reflect good practice in international commercial arbitration". However, the court found the authorities were clear that disclosure under English law required a "detached" approach, which should not be confused with the approach of the complainant party, based on the "more certain standards of an objective observer".

The crucial point is that the arbitrator should consider what he or she should disclose based on prevailing circumstances at the relevant time. Although M had been at pains to point out that he had not learned any factual information that would not have been known to his co-arbitrators in the Halliburton reference, and it did in fact transpire that there was little overlap between the cases, the court agreed with Halliburton that disclosure should not be decided with the benefit of hindsight: "[T]he question at the time that disclosure ought to have been contemplated is not whether the fact would have provided the basis for a reasonable apprehension of lack of impartiality, but whether it might have provided such a basis".

**What circumstances might give rise to justifiable doubts?**

The court cautioned that an arbitrator should take care not to pre-emptively give disclosure where none is warranted. The court considered the House of Lords decision of *Davidson v Scottish Ministers (No 2)* [2005] 1 SC 7 in which their Lordships noted that disclosure of 'apparent bias' could cause difficulties as judges will generally disclose previous activities or associations irrespective of whether they could in fact form the basis of any reasonable apprehension of lack of impartiality. The court went on to examine *Taylor v Lawrence* [2003] QB 528, in which Lord Woolf similarly observed that unnecessary disclosure can undermine the litigant's confidence in the judge, and *Locabail (UK) Ltd v Bayfield Properties Ltd* [2000] QB 451, in which Lord Bingham said that a judge would be "as wrong to yield to a tenuous or frivolous objection as he would to ignore an objection of substance".

**Consequences of non-disclosure**

Hamblen LJ, who gave the leading judgment, noted that if an arbitrator has failed to make disclosure in circumstances where he or she ought to have done, this will inevitably "colour the thinking of the observer" (citing the dicta of Lord Bingham in *Davidson*), and is therefore relevant when considering apparent bias.

However if, on examination, the fact or circumstance which ought to have been disclosed does not give rise to justifiable doubts as to the arbitrator's impartiality then that non-disclosure cannot, in and of itself, justify an inference of apparent bias. Although disclosure would have been desirable (and would no doubt have alleviated Halliburton's concerns over M's acceptance of a closely related appointment also involving Chubb), there was no apparent bias in the absence of a substantive contributing factor.

**Should have disclosed, but no bias**

Although M ought (as a matter of law, and of good practice in international arbitration) to have disclosed his appointments in the later overlapping references, Sir Geoffrey Vos (Chancellor of the High Court), Lord Justice Simon and Lord Justice Hamblen held him blameless for his "innocent" oversight and unanimously dismissed Halliburton's appeal, upholding Popplewell J's finding that an informed and fair-minded observer would not conclude that there was a real possibility that M was biased.

## COMMENT

The *Halliburton* decision will no doubt come as something of a relief to arbitrators and those who appoint them alike. As noted by the court, the pool of suitably qualified and experienced arbitrators from which a party may select its nominated arbitrator is often small, and if arbitrators are unnecessarily precluded from accepting overlapping appointments this could have the unintended consequence of preventing a party from nominating its desired arbitrator if multiple arbitrations had arisen out of an event, or overlapping circumstances. In the absence of "something more", arbitrators (and

judges) should be presumed to be independent and capable of determining each reference on the facts and evidence before them.

It is worth noting that the court's decision was influenced by the fact that Halliburton's concerns had been fully ventilated before any substantive arbitration commenced. Contrary to Halliburton's suggestion that he might have been unconsciously influenced by his later appointments, the judges felt it likely that M would have been actively conscious to take steps to ensure nothing in those references influenced his approach in the arbitration brought by Halliburton against Chubb.

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## ACT OF STATE DOCTRINE APPLIES IN ARBITRATION

*Reliance Industries Ltd and BG Exploration & Production India Ltd v Union of India* [2018] EWHC 822 (Comm), 16 April 2018

The foreign Act of State doctrine applies to arbitration just as it applies to litigation before the English courts, according to Popplewell J, in the first English law authority on the point. The dispute arose under two oil and gas Production Sharing Contracts, in which the Indian Government had refused to pay for oil and gas. The ruling will be of interest to all commercial parties who contract with foreign states.

**Amounts owing under Production Sharing Contracts**

The dispute arose under two Production Sharing Contracts (the **PSCs**) between, inter alia, the claimants and the Government of the Union of India (the **Government**). In practice, the oil and gas produced from the fields covered by the PSCs was sold to Government-controlled nominees. The Government instructed the nominee purchasers to withhold payment of the amount that was due to the claimants for the oil and gas on two occasions.

Various disputes were eventually submitted to arbitration under the PSCs by the claimants, including a claim for the sums withheld by the nominees. The claimants argued that they were entitled to payment by the Government of the amounts withheld by the nominees as, under the PSCs, the Government was the principal debtor for the amounts owing for the oil and gas supplied to the nominees. The PSCs were governed by the law of India, except for the arbitration agreement, which was governed by English law.

**Government tries to rely on its sovereign powers to excuse non-payment**

In the arbitration, the Government submitted that the nominees were entitled to withhold the payments because they had been directed by the Government to do so, pursuant to a legislative act. It relied on two notices issued pursuant to a so-called Office Memorandum (the **OM**) issued by the Ministry of Petroleum and Natural Gas. While the first notice referred to the OM, the second did not. The Government maintained that the OM was an executive order passed by the Government as a legislative act, and its sovereign powers were not curtailed by the PSCs.

The OM provided that "it has been decided by the Government that in case of statutory or contractual amounts due to the Government as calculated by contractors […] are not deposited in a timely manner […] the Government of India or its nominee shall withhold payments until such time as the default is remedied by contracts". The claimants contended that, on a true construction of its terms, the OM did not

deprive them of their substantive right to payment under the PSCs or afford the Government with the power to direct the nominees to withhold payment because there were no "amounts due to the Government as calculated by contractors". At this stage the Government did not specifically raise the Act of State doctrine.

**Tribunal finds that it lacked jurisdiction**

Although the Tribunal concluded that the Government was the principal debtor under the PSCs and was prima facie liable to pay the amounts owing, the majority found that the Tribunal did not have jurisdiction to determine the question of whether the Government was entitled to direct its nominees to withhold any part of the payment that was otherwise due to the claimants. The majority's view was that the Tribunal's jurisdiction extended only to determining the rights and obligations of the parties under the PSCs, not to the issue of whether the OM permitted the Government to expropriate substantive rights under the PSCs. The claimants appealed to the English court.

**A reminder of the Act of State doctrine**

The English court will recognise, and will not question, the validity or effect of a foreign state's legislative acts (or the effect of a foreign state's executive acts in relation to property situate within its territory) and will not adjudicate upon whether such acts are lawful.

The Government argued before the English court that the issues before the Tribunal were non-arbitrable because of this doctrine. The claimants argued that the Tribunal had jurisdiction, because: (1) the foreign Act of State principles of non-justiciability do not apply to arbitration; (2) to the extent that the Government might have had an Act of State objection, it had waived any such objection by submitting to the arbitration and in any event by failing to object promptly; and (3) the issue before the Tribunal was arbitrable (and would have been justiciable before a court) because it concerned the construction and/or applicability of the OM, rather than its validity.

**Foreign Act of State doctrine applies in arbitration too**

On appeal, Popplewell J held that the issues in question did in fact engage the foreign Act of State doctrine, and that therefore they were non-justiciable before the court and not arbitrable before the Tribunal. Popplewell J considered that the rationale of the Act of State doctrine derives from the concept of sovereignty, which recognises the power and right of a state to determine the property rights of those whose property is situate within its territory. He did not see any good reason why the doctrine should be any less applicable in arbitration than in litigation before an English court.

Popplewell J disagreed with the claimants that there had been a waiver or submission to the jurisdiction of the Tribunal by the Government. A state's agreement to have contractual disputes determined by arbitration is not sufficient for it to have waived its right to object to the tribunal determining Act of State issues which might be raised in the course of any dispute under the contract.

## COMMENT

This judgment raises issues concerning the interplay between English private international law rules and arbitration law. Up until now the Act of State doctrine was not thought to be relevant in an arbitration context. This decision means that now a state party seeking to avoid performance under a contract, by issuing legislation or executive orders conflicting with its obligations under the contract, may be able to invoke the Act of State doctrine in an English seated arbitration. When contracting with a state, a private party may therefore wish to provide in the contract that the state will not invoke a foreign Act of State defence to meet a claim that otherwise falls within the scope of the arbitration agreement.

Separately, a private party may also wish to include an appropriate stabilisation clause in the contract. This type of clause, which can take various forms, aims to protect a private party from any economic loss suffered as a result of legislative changes introduced subsequent to the contract. In circumstances where a state party seeks to

circumvent its contractual obligations through a legislative or executive act, the private party should then be able to trigger the stabilisation clause. This would avoid the need to invoke any contractual provision that conflicts with the legislation in question, and thus avoid any potential Act of State issues as the validity of the legislation would not be challenged.

It should also be possible to limit the effect of this ruling to contracts governed by foreign substantive law. This is because, where the contract is governed by English substantive law and the obligation in question is to be performed outside of the state concerned, it would be possible to argue that any supervening illegality brought about by sovereign actions of a state party to the contract do not excuse the state's performance of its English-law-governed contractual obligations as long as those obligations are to be performed outside of the territory of the state concerned.

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# Conflict of laws

## ENGLISH COURT REFUSES TO RESPECT FOREIGN EXCLUSIVE JURISDICTION CLAUSE

*Republic of Angola & anr v Perfectbit Ltd & ors* [2018] EWHC 965 (Comm), 26 April 2018

Despite an exclusive jurisdiction clause in favour of the Angolan courts, the High Court was satisfied that England was the appropriate forum to hear a claim by the Republic of Angola and Angola's central bank against several English and non-EU defendants. The decision highlights the English court's ability to take jurisdiction in a dispute where there are multiple co-defendants, some of whom are English, notwithstanding the existence of an exclusive jurisdiction clause in favour of a non-EU court. It is also a good reminder of the impact of the ECJ's ruling in *Owusu*.

**An alleged fraud on Angola**

The Republic of Angola (**Angola**) and Banco Nacional de Angola (**BNA**) brought a claim in the English High Court alleging that they were the victims of a large fraud by the defendants. The defendants were entities and individuals domiciled in England, Angola, Brazil and the Netherlands.

In 2017, Angola and the BNA paid over USD500 million to an English defendant company, in relation to a purported investment fund being established by the defendants for the benefit of Angola. The payments were made under two contracts between the BNA and an Angolan defendant company, signed in July and August 2017. One contract was subject to Angolan law and exclusive jurisdiction, and the other provided for English governing law and London arbitration.

The Angolan Government and the BNA commenced English proceedings against the defendants in November 2017. The non-EU defendants challenged inter alia the jurisdiction of the English court to hear the dispute. They relied on the Angolan exclusive jurisdiction clause in one of the contracts, submitting that both BNA and

Angola were bound by it. They argued that Angola was bound by the clause despite it not being party to that contract as they alleged that Angola had given authority to the BNA to enter into the contract. Finally, the non-EU defendants also argued that the nature of the claim, being "Angolan to its core", meant it should be heard in Angola. An application in respect of the arbitration clause was not pursued.

**Exclusive jurisdiction clause more likely to be overridden if proceedings against related defendants in England on foot**

Bryan J rejected the jurisdiction challenge. The judge drew a distinction between a case where proceedings are commenced in England, in breach of an exclusive foreign jurisdiction clause, against a single defendant, and a case where (as here) there are multiple defendants. In the former, the presence of an exclusive jurisdiction clause is likely to be determinative of the appropriate forum. However, in the latter, there may be other overriding factors in play; in particular whether there would be concurrent related claims in England too.

**Continuing claims in England a determinative factor**

Bryan J was satisfied that England was clearly the most appropriate forum. In the judge's view, the determinative factor was that the claims against the England domiciled defendants would proceed in England anyway. This is because under the Brussels Regulation, where proceedings in a commercial matter are brought in the English court against a defendant who is domiciled in England, the English court has no power to stay those proceedings on the ground of *forum non conveniens* (following the ECJ decision in *Owusu v Jackson*). So if one or more of multiple co-defendants in a case are domiciled in England, it will be more difficult for a non-EU co-defendant to challenge jurisdiction since obtaining such a stay in favour of a foreign court (even one which has been chosen by an exclusive jurisdiction clause) will inevitably fragment the proceedings. There would be a real risk of inconsistent judgments if proceedings also had to be brought in Angola.

**Real connecting factors to England**

Furthermore, the judge found there were real connecting factors to England. Two of the defendant companies were domiciled in England, the foreign defendants were directors of one of the English companies, and the transfer of funds was to an English bank account of one of the English-defendant companies.

**Timing of appropriate forum test**

One issue, on which the judge ruled *obiter*, was whether the appropriate forum test was to apply to the circumstances as of the date of the application for service out of the claim form or on the return date hearing. It did not affect the outcome in this case, but if it had been of impact, it was held that the requirements for permission to serve out, including the appropriate forum test, should be considered as at the date permission was sought.

## COMMENT

This ruling illustrates how it will be more difficult for a non-EU co-defendant to challenge the jurisdiction of an EU Member State court of domicile of another co-defendant in circumstances where there is a third state exclusive jurisdiction agreement that does not apply to the Member State domiciled party. This is particularly the case where there are substantial connecting factors between the dispute and the Member State. This is because the Member State court is not allowed, under the Brussels Regulation, to stay proceedings against a defendant domiciled in that Member State. In order to reduce multiple related proceedings with the attendant risk of inconsistent judgments and increased costs, the Member State is more likely to retain its jurisdiction over the non-EU co-defendants if it can do so.

In short, the English court is more likely to respect a third state jurisdiction clause where the claim is against one non-English defendant, and less likely where there are multiple co-defendants, one of whom is domiciled in England, and where the claims are all inextricably linked

and have connecting factors to England. Here the English court did so on the basis of the many links between the dispute and England. Bryan J has also given a neat reminder of the impact of the principle established by the ECJ in *Owusu*.

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# Contract

## DO "NO ORAL VARIATION CLAUSES" WORK?

*Rock Advertising v MWB Business Exchange Centres* [2018] UKSC 24, 16 May 2018

The Supreme Court has ruled that clauses limiting the parties' ability to vary their contract, often referred to as "no oral variation clauses", are binding on the parties. A purported oral variation to a contract that failed to comply with the clause was therefore ineffective.

**Rent arrears – and an alleged oral variation**

MWB had rented out serviced offices to Rock under a licence agreement. Over time, Rock built up significant arrears of rent. It contended that it had reached an oral agreement with MWB as to the terms on which those arrears would be repaid. MWB denied that any agreement had been reached but also relied on a clause in the licence, which provided that "All variations to this Licence must be agreed, set out in writing and signed on behalf of both parties before they take effect." It was uncontroversial that no such written agreement existed. That, said MWB, was the end of the matter.

**"No oral variation" clauses are valid and enforceable**

The judge at first instance agreed with MWB: the variation was of no effect. The Court of Appeal did not: it said that such clauses were unenforceable – just as a party can make a contract, it can unmake it; a clause prohibiting change can be changed like any other.

The Supreme Court has restored the judge's decision. The alleged oral variation of the licence could not succeed because it did not comply with the "no oral variation" clause.

**A commercial justification for "no oral variation" clauses**

The reasoning underlying the Supreme Court's decision was pragmatic: (1) these clauses prevent attempts to undermine written agreements by informal means, which may be open to abuse; (2) oral agreements can give rise to misunderstandings and crossed purposes both as to whether a variation was intended and as to its terms, something that these clauses avoid; and (3) formality in recording variations makes it easier for corporations to police internal rules restricting the authority to agree them. The Supreme Court considered these to be legitimate commercial reasons for agreeing a "no oral variation" clause like the one in this case, and said it was not the role of the law of contract to obstruct the legitimate intentions of businessmen.

What of the argument that had proved attractive to the Court of Appeal, that of party autonomy to make, unmake and remake their contract as they wished? The Supreme Court had two answers. First, the concept of party autonomy only truly exists up to the point of contracting. Thereafter, the contract restricts what the parties can do in all kinds of ways. That is the very point

of the contract. Conceptually, "no oral variation" clauses are no more of a fetter on party autonomy than any other provision. Second, it does remain open to parties to vary their contracts; they simply need to follow the relevant provisions if they wish to do so. Most parties who fail to observe the "no oral variation" clause do not intend to dispense with it; they have simply forgotten about it. Those who had it in mind and chose to ignore its requirements "were courting invalidity with their eyes open". The law of contract did not need to step in to help either of those groups.

**Estoppel – an exception, not the rule**

The Supreme Court accepted that a purported oral variation might, on certain facts, give rise to an estoppel against the party seeking to rely on the "no oral variation" clause but those facts would be the exception, not the rule. At the very least there would have to be a clear representation that the variation was valid notwithstanding its informality and some evidence of reliance beyond the informal promise itself. The estoppel path is legally open, therefore, but practically narrow.

## COMMENT

The decision will be a relief for many commercial parties seeking certainty in their contractual arrangements. It allows them to protect against inadvertent or informal change and limits the scope for factual disputes about who said what to whom. It falls some way short of resolving all issues in this area, however. In addition to estoppel, where the Supreme Court's guidance will have to be worked out on the facts of particular cases, two are potentially of particular importance.

First, there are the rules on consideration. All contracts must be supported by consideration. Essentially, each side must bring something to the table for the bargain to become an enforceable agreement; the law will not enforce purely gratuitous promises. That is normally reasonably straightforward when the contract is first entered into but becomes harder to establish when a contract is varied. In particular, there is a question as to what happens when one party provides some additional benefit but the other party simply agrees to render the same or some lesser performance to that which was already required under the original contract. That was MWB's argument here. Under the alleged agreement, MWB was said to have granted more time to pay (clearly an additional benefit) but Rock was simply paying the amount already due under the contract at a later time.

The cases in this area are split. The older cases, which include decisions of the House of Lords, supported MWB's position: legally, Rock was providing no additional benefit and so the purported variation failed for want of consideration. The more recent cases, which are at Court of Appeal level, have largely gone the other way. Although Rock was simply doing that which it was already legally obliged to do, in practical terms there was some benefit: MWB had a better chance of recovering the amount it was due – and it was better to have a unit occupied than unoccupied. That had been the decision of the Court of Appeal in this case.

While acknowledging that this was a "truly fundamental issue in the law of contract" and an area of law that is "probably ripe for re-examination", the Supreme Court considered that any decision would strictly be *obiter* and so declined to express a view. That might suggest that their Lordships were therefore inclined to support Rock's position; after all, even *obiter* support for pre-existing House of Lords-authority would largely settle the question, whereas *obiter* opposition would open it up for debate. But that is simple speculation. The question remains an open one and may prove to be a potential battleground in the many contracts where there is no clause restricting the mechanism for variation.

Second, there are the rules on unjust enrichment and restitution. There is a line of cases dealing with contracts that are required by statute to be in writing but which the parties have made orally. Those agreements failed as contracts for lack of formality but the courts have at times allowed recovery for what is known as *quantum meruit*, the value of services provided in accordance with the agreement. In some cases, the amount recovered was assessed by reference to the contractually specified value of those services, essentially amounting to enforcement of the agreement by another route. Might that route be open in the case of a variation that failed to

comply with a no oral variation clause? Such an argument would not have helped Rock – it was not providing anything additional – so the Supreme Court did not need to consider it. On the right facts, however, it may be arguable.

*Rock Advertising v MWB* seeks to take a practical approach: if parties agree to operate their contractual relationship in a particular way, they will be held to that agreement. The price of that apparent simplicity is that the decision does not resolve some of the key issues in this area. It will remain open to parties to argue that their facts are critically different from those in *Rock Advertising* or that different legal principles apply. Some things, it seems, never change.

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## BANK'S BASIS CLAUSES UPHELD IN UNFAIR RELATIONSHIP CLAIM

*Carney & ors v N M Rothschild & Sons Ltd* [2018] EWHC 958 (Comm), 1 May 2018

A claimant failed to bring a time-barred financial mis-selling claim against its bank via the "backdoor" of an unfair relationship claim under s140A and s140B Consumer Credit Act 1974 (**CCA**). The judgment provides useful guidance on factors that a court will take into account when determining whether there is an unfair relationship, and how commonly used 'basis clauses' fit into this analysis.

The claimants, British expats living in Spain, had borrowed funds from the bank, secured against their properties, to enable them to enter into investments designed to reduce the Spanish equivalent of inheritance tax. They engaged the services of an independent financial adviser (**IFA**) throughout the process.

The investments underperformed and the claimants sued the bank for their loss, alleging that the bank had given them wrong advice, and made serious misrepresentations about the investments and tax implications. Their sole claim was under s140A and s140B CCA – namely that an unfair relationship arose between the claimants and the bank out of the loan agreements. The principal relief claimed was the removal of their indebtedness to the bank under the loan agreements and the discharge of the security. It appears from comments in the judgment that other types of claims were time barred.

The bank denied that any advice was given or any actionable representations were made, and if they were that they were not false, but insofar as necessary, it relied on certain "basis clauses" in the loan agreements. The claimants, however, alleged that those clauses themselves gave rise to, or contributed to, the purported unfair relationship and so could not be relied upon.

**The loan agreements**

The loan agreements were headed by an "important notice", indicating that the claimants were advised to seek independent legal and tax advice.

They also included the following clauses:

- the bank made no recommendations as to the suitability, quality or future performance of any of the collateral;
- the bank had acted as the provider of finance only and had not provided any tax, legal or investment advice;
- the claimants had appointed a named IFA who was acting as their agent and not as agent for the bank; and
- a "whole agreement" clause which provided that the agreement constituted the whole agreement and that

there was no reliance on any representation made by or on behalf of either party unless expressly contained in that agreement (together, the **relevant clauses**).

**The law on unfair relationships**

The court commented that where the alleged behaviour giving rise to an unfair relationship also constitutes a standalone cause of action, such as misrepresentation or negligence, the legal test for that cause of action must still be made out. However, the court noted that the burden of proof was on the lender to show that the relationship was not unfair.

On causation, the court held that if the borrower would have entered into the relevant agreement in any event, then this "must surely count against a finding of an unfair relationship under s140A".

The fact that there had been no breach of a relevant regulatory rule might, in the court's view, be "highly relevant", but would not be considered "determinative". By contrast, if the lender's conduct would have amounted to a breach of such a regulatory rule, then that "can be relevant" even if that rule does not actually apply to it.

As to whether a clause itself gives rise to unfairness, the court held the following factors to be relevant:

- whether the clause is commonplace
- whether there are sound commercial reasons for the clause
- whether it represents a legitimate and proportionate attempt by the lender to protect its position
- to the extent that a clause is solely for the benefit of the lender, whether it exists to protect him or her from a risk which the borrower does not face
- the scale of the lending and whether it was commercial or quasi-commercial in nature (a court is less likely to find unfairness in a high-value lending arrangement between commercial parties than in credit agreements affecting consumers)
- the strength of the borrower's bargaining position
- whether the terms have been individually negotiated or are standard terms and, if so, whether they were presented on a "take it or leave it basis"

**The underlying complaints**

In the context of assessing whether there had been an unfair relationship, the court considered each element of the advice and misrepresentation causes of action:

- **No breach of advisory duty**. The court concluded that the bank had not given material advice and had never assumed an advisory role. Crucially, the claimants had an IFA whose role had been specifically to advise on the elements of the scheme, whereas the loan agreement and an article included in the IFA's newsletter made it clear that there was no advisory role for the bank.
- **No misrepresentation**. The court held that the bank had made no actionable misrepresentations or, to the extent any were made, they were not false. Even if the misrepresentations had been made, the court held that the claims would have failed on causation and expressed doubt as to whether the alleged misrepresentations had been relied on.

In case its findings that there was no breach of advisory duty and no misrepresentation were incorrect, the court went on to consider whether the bank would be entitled to rely on the relevant clauses to counteract the claimants' allegations.

**The clauses were basis clauses, not exclusion clauses**

Basis clauses do not exclude a liability that would otherwise exist. Instead they define the parties' obligations towards one another from the outset. Unlike basis clauses, exclusion clauses are regulated by the Unfair Contract Terms Act 1977 (**UCTA**) (now replaced by the Consumer Rights Act 2015 (**CRA**) in the consumer context) and the Misrepresentation Act 1967, and are subject to the requirement of reasonableness.

While the court accepted that distinguishing between basis and exclusion clauses was not often easy, it held it is necessary to consider the following (non-determinative) factors:

- the natural meaning of the language of the clause in its contractual context

- the factual context in which the agreement containing the clause was made
- the format and location of the clause within the contract: if a clause was simply one of many standard terms, this might point to it being exclusionary

For its part, the court did not consider the relative bargaining positions of the parties to be particularly relevant.

The court concluded that the relevant clauses were basis clauses, ie clauses purporting to delineate the scope of the parties' primary relationship, and which established a contractual estoppel against the claimants. They defined the scope of the relationship as not advisory and confirmed the absence of any representations made by the bank and/or any reliance thereon.

**Basis clauses and unfair relationship claims**

The court stated that the assessment of unfairness under the CCA was not the same as that which would be conducted under other regimes because of the "different and wider exercise" entailed by the unfair relationship provisions. Nevertheless, it held that the assessment is best made by reference to the other regimes, such as UCTA and the CRA. If a clause is found to be reasonable for the purposes of UCTA or the CRA, then it is less likely to be unfair for the purposes of s140A CCA.

In this case, the court held that even if the relevant clauses were exclusion clauses (and therefore subject to statutory control), they were "manifestly reasonable" and that, although the question was one of unfairness rather than reasonableness, the analysis and result should be the same: "if these particular clauses were reasonable for the purpose of UCTA, then there is no reason to say that they were nonetheless unfair for the purpose of s140A".

**Unfairness on other grounds**

No unfairness arose from the regulatory codes, principles and other provisions relied on by the claimants, which either had not been breached or were irrelevant.

The court concluded that the bank had clearly satisfied the burden of showing that there was no unfair relationship.

## COMMENT

This is a welcome decision for financial institutions. The court's general comments in respect of having to prove all the elements to a standalone cause of action where that cause of action is alleged to have led to an unfair relationship are helpful, as they should reduce attempts to bring time-barred mis-selling claims via the backdoor of an unfair relationship claim.

The court's finding concerning the basis clauses in the loan documentation is also positive. Basis clauses have historically been upheld by the English courts but this was the first time that the courts had considered (and upheld) their "fairness" in the context of an unfair relationship claim.

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# Service

## PROCESS AGENTS – MEANING OF AN "IRREVOCABLE" APPOINTMENT

*Cargill International Trading PTE Ltd v Uttam Galva Steels Ltd* [2018] EWHC 974 (Comm), 17 April 2018

An undertaking to appoint a process agent "irrevocably" describes the nature of the obligations as between the contracting parties, not the manner of the process agent's appointment. Therefore, if one of the parties subsequently decides to revoke the appointment of the process agent, service on that agent is nonetheless "good service".

A dispute arose between an Indian steel supplier (**Uttam** – the defendant) and an English company (**Cargill** – the claimant). Cargill wanted to sue Uttam in England. Although Uttam had agreed in the transactional documents to irrevocably appoint an English process agent, that appointment had been revoked by Uttam and an Indian address had instead been given for the service of process. The question for the English court was whether, given that Uttam had agreed with Cargill to irrevocably appoint an English process agent, that process agent could be served with an English claim form despite no longer being appointed and Cargill knowing this.

**The process agent clause – "irrevocably and unconditionally"**

The steel supply contract between the parties contained a process agent clause which provided that Uttam undertook to:

"…irrevocably and unconditionally… appoint Law Debenture Corporate Services limited… as its agent for service of process before the courts in England (and agrees that service on such agent shall be deemed due service for the purpose of proceedings in such courts) and covenants that, during the Term of this Agreement, it will maintain an agent in England for such purpose".

**The attempts to serve Uttam**

When a dispute arose, Uttam asked Cargill to serve any notices of court proceedings at its New Delhi address. Uttam then terminated Law Debenture's appointment as its English process agent.

Cargill subsequently attempted to serve an English claim form on Uttam by email and post to Law Debenture. Cargill also emailed the documents to Uttam's managing director, couriered them to the company's address in New Delhi, and sent them by email and courier to Uttam's Indian lawyers.

Uttam disputed that it had been properly served.

**The commercial purpose of process agent clauses**

Popplewell J noted that the reason process agent clauses feature in contracts is to attempt to avoid disputes about service and delays which can be caused when serving out of the jurisdiction. He noted that service in the Indian courts typically takes around eight months, and can often be considerably longer.

**The meaning of "irrevocable"**

The court held that the requirement that a process agent is appointed "irrevocably" describes the nature of the obligation as between the contracting parties (ie Cargill

and Uttam), not the principal and agent relationship between Uttam and Law Debenture. Uttam had promised Cargill that service on Law Debenture was good service irrespective of whether Law Debenture's appointment had in fact been revoked. Cargill's service on Law Debenture was therefore valid.

**The construction of "during the Term of this Agreement"**

Uttam argued that its obligation to maintain a process agent in England was expressed to continue only "during the Term of this Agreement". The agreement had expired on 7 April 2016, and therefore, Uttam contended, it was no longer obliged to maintain a process agent in England.

The Judge's analysis focussed on the meaning of the word "during". Many disputes would be expected to arise after the term of the contract; if the word was intended to limit the obligation to appoint a process agent (as Uttam contended), then this would seriously undermine the commercial purpose of the process agent clause. Popplewell J therefore held that "during" did not operate as a temporal limitation on the obligation to maintain a process agent, but instead tied the undertaking to maintain a process agent in England to such period as the obligations and rights conferred by the agreement subsist. Popplewell J also considered that the way the word "during" was used elsewhere in the agreement supported his analysis.

**Waiver, estoppel and laches**

Uttam further submitted that Cargill's silence for a year after being notified of Law Debenture's termination as Uttam's process agent amounted to a waiver of its right to contest the efficacy of the termination, thus Cargill was estopped from relying on service on Law Debenture as valid, or Cargill otherwise prevented from so doing by the operation of laches.

Uttam was unable to establish that it would suffer any inequity if Cargill enforced its legal rights: this was sufficient to dispose of Uttam's attempt to rely on the equitable doctrines of estoppel and laches. Uttam was similarly unable to establish that Cargill had waived its contractual rights.

Cargill therefore succeeded in obtaining a declaration that its service on Uttam was valid.

## COMMENT

This ruling confirms that, as a matter of English law, by describing the appointment of a process agent as "irrevocable", service of an English claim form on that process agent is good service, even if the appointing party chooses to revoke the appointment of its process agent. The "irrevocable" nature of the appointment of the process agent describes the obligations as between the contracting parties, not the manner of the process agent's appointment.

Parties are therefore ill-advised to revoke the appointment of a process agent which is expressed as irrevocable – those who do so risk being unaware of claims being validly served upon them. As Cargill did in this case, claimants may nonetheless wish to ensure that any claims are brought to the attention of the defendant in circumstances where the appointment of the defendant's process agent may have lapsed or been revoked.

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# Tort

## SWAP CLOSE-OUT COSTS – CAUSATION BUT NO ASSUMPTION OF RESPONSIBILITY BY AUDITORS

*Manchester Building Society v Grant Thornton UK LLP* [2018] EWHC 963 (Comm), 2 May 2018

A building society sued its auditors for the close-out costs of interest rate swaps entered into on reliance on advice that they could be accounted for as hedges. The High Court found negligence, which was the cause of the loss and that the close-out costs were reasonably foreseeable loss. However, applying the Supreme Court's recent decision in *Hughes-Holland v BPE Solicitors*, the High Court found that there was no assumption of responsibility for losses of the type of the close-out costs, and so the auditors were not liable.

**A faulty hedge accounting policy**

In 2013, the Manchester Building Society (**MBS**) discovered that it could not apply hedge accounting to certain long-dated interest rate swaps under the International Financial Reporting Standards (**IFRS**). It had been doing so for five years (2006-2011), in accordance with its hedge accounting policy (the **Policy**), which had been incorrectly approved as being IFRS compliant by its auditors, Grant Thornton LLP (**GT**).

MBS had entered into the swaps to hedge risk arising out of lifetime mortgages offered in the UK and Spain. Hedge accounting benefitted MBS because it did not have to recognise the majority of the volatility of the fair value of the interest rate swaps in its profit and loss accounts. GT gave unqualified audit opinions on MBS accounts for the relevant years.

As a result of the historic falls in interest rates since 2008, recognising the full fair value of those swaps in MBS's 2011 accounts resulted in a regulatory capital deficit of GBP17.9m, and a reduction in profit of 180% and net assets of 75%. MBS decided (under regulatory pressure to address its capital deficit) to close out its remaining swaps, incurring GBP32.7m of close-out costs.

**A claim against the auditors**

MBS claimed damages for negligent advice from GT, of which the close-out costs formed the largest element. Although GT accepted it had been negligent in advising MBS that the Policy was IFRS compliant, in giving the subsequent audit opinions it:

- denied it knew of MBS's intention to hedge the lifetime mortgages with interest rate swaps when approving the Policy
- argued that its negligence was not the effective cause of MBS's losses
- argued that the losses were not within the scope of GT's duty of care or in accordance with the principles of *South Australia Asset Management Corp v York Montague Ltd*
- alleged that MBS's losses had been substantially caused by its own contributory negligence

**Negligent advice caused loss**

Teare J found that GT had known of MBS's intention to hedge the lifetime mortgages with interest rate swaps when approving the Policy, and that but for GT's negligence MBS would not have entered into swaps after April 2006 and would not have suffered the costs of breaking the swaps in 2013. The judge rejected GT's

argument that the effective cause of the losses was not its negligence, but MBS's commercial decision to enter into the swaps and/or the collapse in interest rates since 2008. The negligent advice had been critical to MBS's decision to enter into the swaps, and was thus an effective cause of MBS incurring the close-out costs when the true accounting position was understood.

**But GT did not assume responsibility for close-out costs**

Following the Supreme Court's recent decision in *Hughes-Holland v BPE Solicitors* [2017] 2 WLR 1029, Teare J identified the key question for the court in determining whether a defendant assumed responsibility for a loss as: "whether the loss flowed from the particular feature of the defendant's conduct which made it wrongful". Questions of reliance and reasonable foreseeability were necessary but not sufficient to show that a defendant had assumed responsibility for a type of loss.

Teare J accepted that MBS had relied on GT's advice in entering into the swaps, and that being forced to break the swaps was a reasonably foreseeable consequence of that advice being negligent. He also thought there was a cogent argument that the close-out costs did flow from the particular feature of the advice that was negligent, ie whether hedge accounting could be used to mitigate the risk of exposure of MBS's balance sheet to the volatility of the fair value of interest rate swaps. However, viewing the case "in the round", he concluded that GT did not assume responsibility, for two reasons:

- it would be "a striking conclusion to reach that an accountant who advises a client as to the manner in which its business activities may be treated in its accounts has assumed responsibility for the financial consequences of those business activities"
- neither an objective bystander nor the parties themselves would have said that GT had assumed responsibility for MBS being out of the money on the swaps in the event of a sustained fall in interest rates. That loss ultimately stemmed from market forces for which GT did not assume responsibility. A critical element of Teare J's reasoning was that the same losses would have been sustained by MBS if a counterparty closed the swaps, and GT could not be said to have assumed responsibility for the very same losses that would flow in that circumstance

Therefore MBS could not recover the GBP32.7m of close-out costs.

**Contributory negligence**

Teare J allowed recovery of certain other heads of loss, but found MBS to have been contributory negligent on two counts: (i) in deciding to buy 50-year swaps, exceeding the likely duration of the lifetime mortgages; and (ii) deciding to enter into 50-year rather than shorter dated interest rate swaps on the basis that they were cheaper, assuming interest rates would remain constant. Teare J thus reduced the remaining heads of damages by 25%, awarding MBS 75% of GBP420,460.

## COMMENT

This case serves as a reminder that an assumption of responsibility for the claimed damages is vital for a successful damages claim, even if negligence can be straightforwardly established.

It is also a sharp illustration of how the law on the recoverability of damages in tort can simultaneously point to one conclusion and contain enough flexibility to allow a judge to reach the exact opposite conclusion. Teare J's summary of the relevant legal principles led him to the conclusion that they could be cogently applied to award the close-out costs to MBS, but viewing the case "in the round" he came to the opposite conclusion.

It also shows that an argument that fails on one element of the tests for causation and remoteness may succeed on another. In relation to the effective cause, GT submitted that a distinction should be drawn between the accounting treatment of an interest rate swap and its economic consequences, arguing that it was the latter (ie the effect of a fall in interest rates on the swap economics) that was the effective cause of the close-out costs. Teare J rejected that argument at that stage, but essentially accepted it at the assumption of responsibility stage, finding that GT did not assume responsibility for the economic risks of the swaps.

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# Key contacts

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