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Litigation and Dispute Resolution

Review

EDITORIAL

Two important contract cases are considered in this month's Review: one on penalties (*ParkingEye v Beavis*) and the other on contractual interpretation (*Arnold v Britton*).

In *ParkingEye*, the Court of Appeal concluded that a parking fine was not a penalty and therefore enforceable. Lord Justice Moore-Bick acknowledged that whilst the predominant purpose of the fine was to deter breach it was not extravagant or unconscionable and could (at least in part) be justified by social factors (it benefitted the community to have parking close to shops for limited periods and parking fines discouraged overstaying). The decision has already been appealed and will be heard by the Supreme Court, together with *Makdessi*, on 21 July 2015. Unusually, the Supreme Court will sit with a seven judge panel to hear the appeal. As part of this appeal the Supreme Court will consider whether or not the law on penalties has any place in contracts between commercial parties. The resulting judgment is keenly anticipated and is likely to be the leading authority on the law of penalties for many years to come (see **Contract**, page 22).

The test for contractual interpretation was recast by the Supreme Court in *Arnold v Britton*. Lord Neuberger, giving the lead judgment, set clear limits on the "commercial common sense" approach to contractual interpretation, signalling a return to a more literal approach. Jason Rix and Rainer Evers discuss the seven factors Lord Neuberger identified as important when interpreting contractual provisions (see **Contract**, page 24).

Finally, we are monitoring the position in Greece closely. We have produced a bulletin for clients on some of the key issues that arise in this context. Please contact us if you would like to receive this publication.

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Contents

Arbitration 3

Arbitration agreements and foreign laws that do not give effect to mandatory principles of EU law: *Accentuate Ltd v ASIGRA Inc; Fern Computer Consultancy Ltd v Intergraph Cadworx & Analysis Solutions Inc*

Third party bound by arbitration agreement which it never signed: *The London Steamship Owners' Mutual Insurance Association Ltd v The Kingdom of Spain & anr*

Company 9

Can the illegality defence bar a claim against a dishonest director?: *Jetivia SA & anr v Bilta (UK) Ltd (in liquidation) & ors*

Competition 12

Antitrust liability and subsidiary companies: *Tesco Stores Ltd & ors v Mastercard Inc & ors*

Conflict of laws 14

Jurisdiction clause is exclusive despite it contemplating proceedings in other jurisdictions: *Compania Sud Americana de Vapores SA v Hin-Pro International Logistics Ltd*

Resolving inconsistent jurisdiction clauses and limits to *Fiona Trust* presumption: *Trust Risk Group SpA v Amtrust Europe Ltd*

Schemes of arrangement and why loan note investors should be wary of governing law amendment mechanisms: *In the matter of DTEK Finance B.V.*

Ability to litigate in England torpedoed by foreign insolvency proceedings: *Erste Group Bank AG London Branch v J "VMZ Red October" & ors*

Contract 22

Penalty clauses: a question of context?: *ParkingEye Ltd v Beavis*

Contractual interpretation: when can you stray from the strict wording?: *Arnold v Britton & ors*

Criminal 27

Supreme Court considers money laundering offence under s328 Proceeds of Crime Act 2002: *R v GH*

Employment 30

Employer investigations: *James-Bowen & ors v The Commissioner of Police for the Metropolis*

Insolvency 32

Lehman Brothers "Waterfall Application" in the Court of Appeal: *Lehman Brothers International Europe (in administration)*

Regulatory 36

Extension of time refused for challenge of settled FSA enforcement matter: *Mohammed Suba Miah v Financial Conduct Authority*

SFO section 2 interview: When can lawyers be excluded?: *R on the application of Lord Reynolds and Mayger v Director of the Serious Fraud Office*

Forthcoming client seminars 41

Litigation Review consolidated index 2015 41

Key contacts 44

Arbitration

ARBITRATION AGREEMENTS AND FOREIGN LAWS THAT DO NOT GIVE EFFECT TO MANDATORY PRINCIPLES OF EU LAW

Accentuate Ltd v ASIGRA Inc [2009] EWHC 2655, 30 October 2009; *Fern Computer Consultancy Ltd v Intergraph Cadworx & Analysis Solutions Inc* [2014] EWHC 2908 (Ch), 29 August 2014

In 2009, a senior libel judge held that an arbitration agreement was null, void or inoperative because it purported to apply a foreign law which did not give effect to mandatory principles of EU law. More recently, a judge sitting in the Chancery Division appears to have endorsed that approach (albeit *obiter*). These decisions, neither of which was reviewed by the Court of Appeal, appear to be at odds with a seemingly long and settled line of authority on the arbitrability of mandatory principles of EU law. They also give rise to certain drafting considerations when entering into an arbitration agreement.

The decision in *Accentuate Ltd v ASIGRA Inc* (***Accentuate***) relates to the alleged wrongful termination by the defendant (**licensor**) of an agreement with the claimant (**distributor**) for the distribution of software products (the **License**). The License was governed by the laws of Ontario and the federal laws of Canada and contained an agreement to arbitrate all disputes with the arbitration to be seated in Ontario. The claimant notified the defendant that it was preparing a claim for breach of the License and a further claim for compensation under Articles 17 to 19 of the Commercial Agents (Council Directive) Regulations 1993 (the **Regulations**). The defendant promptly filed a notice of arbitration seeking a declaration that the distributor had no claims against the licensor under the License. A month later, the distributor issued a claim in the English court for breach of contract and for compensation under the Regulations and ordered that the defendant be served out of the jurisdiction (the **Order**). The defendant applied to set aside the Order and for a stay of the English proceedings pursuant to s9 of the English Arbitration Act 1996 (the **Act**).

A District Judge granted the defendant's application on the basis that it did not have jurisdiction to hear the distributor's claims. The distributor appealed to the High Court. The distributor's principal case was that an arbitration clause purporting to apply a foreign law that does not give effect to a mandatory provision of EU law is void and the parties therefore could not be a "party to an arbitration agreement" for the purposes of s9(4) of the Act. The distributor relied for this proposition on an Opinion of the Advocate General and the decision of the CJEU in *Ingmar GB Ltd v Eaton Leonard Technologies Ltd* [2000] ECR I-9305 (***Ingmar***). The relevant principles arising from this case are that (a) Articles 17 to 19 of the Regulations are mandatory in nature, and (b) a principal (such as the licensor) cannot evade mandatory EU law such as is found in Articles 17 to 19 "by the simple expedient of a choice-of-law clause". The distributor therefore argued that any contractual choice by the parties that has the practical effect of depriving the commercial agent of his compensation "will fall foul of the mandatory Reg. 17". The distributor further argued – in reliance on Case C-126/97 *Eco Swiss* [1999] ECR I-3055 (***Eco Swiss***) and *Elisa Maria Mostaza Claro v Centro Móvil Milenium* SL, C-168/05 [2006] E.C.R. I-10421 (***Claro***) – that any arbitration award "offending against a mandatory rule of EU law would itself have to be refused recognition by national courts in Member States".

Tugendhat J appears to have concurred with the distributor and allowed the appeal; in so doing, he held that an "arbitration clause would be "null and void" and "inoperative" within the meaning of s9(4) of the Act, in so far as it purported to require the submission to arbitration of "questions pertaining to" mandatory provisions of EU law".

While declining to follow *Accentuate* on a separate issue, Mann J in *Fern Computer Consultancy Ltd v Intergraph Cadworx & Analysis Solutions Inc* (***Fern***) appears to have endorsed the approach adopted by Tugendhat J to the question of the validity of the arbitration agreement in that case, which he described as "consistent with" the principle that the Regulations do not affect the proper law of the contract, except to the extent that the proper law purports to override the Regulations, in which case the Regulations prevail.

Arbitrability of mandatory EU law

It is axiomatic that some rules of EU law are mandatory in nature and form part of the public policy that the national courts of EU Member States and arbitral tribunals must apply, where relevant. This was the effect of the decision reached in the seminal *Eco Swiss* case, on which the distributor in *Accentuate* relied.

In *Eco Swiss*, the CJEU held that for the purposes of enforcement/recognition of an arbitral award, Article 85 of the EC Treaty (now Article 101 of the Treaty on the Functioning of the EU, dealing with competition law issues) "*may be regarded as a matter of public policy within the meaning of the New York Convention*" and that "*a national court to which application is made for annulment of an arbitration award must grant that application if it considers that the award in question is, in fact, contrary to Article* [101]".

There followed from *Eco Swiss* and related case law three fundamental and well-settled principles – principles which the decisions in *Accentuate* and *Fern* appear to ignore:

(a) First, questions of EU law – including those that are mandatory in nature, such as competition law issues – are, in principle, arbitrable (in addition to *Eco Swiss* itself, see eg the decision of the U.S. Supreme Court in *Mitsubishi v Soler Chrysler-Plymouth*).

(b) Second, parties cannot avoid the application of mandatory EU law by choosing a non-EU national law as the law governing the substance of their relationship (see *Ingmar*). However, as the decision in *Eco Swiss* demonstrates, this does not render the choice of law clause (or arbitration agreement) null and void. It simply means that a court or tribunal seised of the matter is required to apply mandatory principles of EU law, regardless of the parties' express choice of law.

(c) Third, and perhaps most crucially, an arbitral tribunal which fails to apply those mandatory rules of EU law faces the risk of having its award set aside or refused recognition/enforcement in an EU Member State court. This is the key principle in *Eco Swiss* and it is one which applies not just in relation to EU competition law but also, for example, to unfair terms in consumer contracts (see *Claro*).

In *Claro* (referred to in *Accentuate*), the CJEU held that, on an action for annulment of an award relating to a consumer contract, a Member State court must determine of its own motion whether the underlying arbitration agreement was void by virtue of Council Directive 93/13/EEC (the **Directive**). In reasoning which the court in *Accentuate* appears to have overlooked, the CJEU reached this conclusion because the Directive contains a list of "indicative terms" which "may be regarded as unfair", including a term that "*requires the consumer to take disputes exclusively to arbitration* …". In other words, an arbitration agreement in a consumer contract may itself be an unfair term and, if so, must be treated as being void in accordance with the terms of the Directive.

COMMENT

These are the principal reasons why the decisions in *Accentuate* and *Fern* should be treated with caution.

Certainly, there is nothing in these principles outside of the specific context of consumer contracts to suggest that parties can render their arbitration agreement "null and void" because the law chosen by them to govern their agreement does not recognise or incorporate certain mandatory EU rules or because the subject matter of the dispute is not arbitrable. As noted above, an arbitral tribunal is under a duty to apply certain mandatory norms irrespective of the parties' choice of law (and this is the effect not just of the decision in *Eco Swiss* but also of generally-applicable choice of law provisions such as those found in the Rome

Convention/Rome I Regulation). While failure to do so may result in an award that is set aside or unenforceable, that failure does not render the arbitration agreement "null and void". Similarly, the effect of a particular type of dispute being found to be non-arbitrable still leaves parties with a valid and binding arbitration agreement; it is simply that the particular dispute or category of disputes falls outside the agreement.

Until such time as the Court of Appeal has an opportunity to review the principles arising out of *Accentuate* (and *Fern*), there is unfortunately a risk of meddlesome claims about the enforceability of arbitration agreements and even arbitral awards where EU law is at play. In an attempt to minimise these risks, parties should consider carefully their choice of law when drafting an arbitration agreement, if mandatory principles of EU law are likely to have a significant impact on any future disputes. This might be the case, for example, in a distributorship agreement or any other contract where the Regulations might be engaged or any contract where competition law issues are likely to arise.

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THIRD PARTY BOUND BY ARBITRATION AGREEMENT WHICH IT NEVER SIGNED

The London Steamship Owners' Mutual Insurance Association Ltd v The Kingdom of Spain & anr [2015] EWCA Civ 333, 1 April 2015

In the context of a right of direct action by an injured party (Spain and France) against a D&I insurer, Spain and France were held bound by an arbitration agreement contained in an insurance policy which they never signed. The case is an illustration of the circumstances in which state immunity will be waived and defines who is a "party" to an arbitration agreement contained in an insurance policy. It is also a reminder of the very limited category of disputes that will be inarbitrable under English law.

The *Prestige* sank off the west coast of Spain in 2002. It was carrying 70,000 tonnes of fuel oil which polluted the Atlantic coastline of Spain and France.

The Spanish and French authorities commenced criminal court proceedings against the ship's officers, its owners and the owners' protection and indemnity insurers (the **Club**), seeking (*inter alia*) damages resulting from the pollution. The claims against the Club, including for indemnification relating to the owners' vicarious liability for the acts of the officers, were brought under Article 117 of the Spanish Penal Code which allows an injured party to pursue a right of **direct action** against the defendant's insurer (the **Spanish claims**).

The Club refused to take part in the proceedings in Spain, instead commencing arbitration in London seeking declarations that Spain and France were bound by the arbitration clause in the Club's rules and that it was not liable under the relevant contract of insurance (the **Club's Policy**). The tribunal issued an award in the Club's favour, which the Club then sought to enforce under s66 Arbitration Act 1996 (the **Act**).

Spain and France opposed the application, relying on state immunity. During the course of the proceedings disposing of the application, Spain and France issued their own applications under ss67 and 72 of the Act seeking a declaration that the tribunal lacked jurisdiction in respect of the matters addressed in their award. Spain and France argued that the rights they sought to enforce in the Spanish courts were not rights under the Club's Policy (containing the arbitration agreement) but rather independent rights under Spanish statute.

At first instance, Hamblen J held (*inter alia*): (a) that the claims were English law claims under the Club's Policy, not statutory claims and were therefore *prima facie* caught by the arbitration agreement in the Club's Policy; (b) that Spain and France had become parties to the

arbitration agreement in the Club's Policy and had therefore waived immunity; and (c) that the claims against the Club arising under statute and in criminal proceedings in Spain were arbitrable. Spain and France appealed against these aspects of the decision.

Spain and France bound by the arbitration agreement in the Club's Policy

The central question before the Court of Appeal was whether Spain and France were bound to pursue the Spanish claims against the Club in arbitration pursuant to the terms of the Club's Policy. This depended on the nature of the right which they sought to enforce – was it statutory or contractual?

If the right was contractual (ie arose out of the Club's Policy), the Spanish claims were in breach of the arbitration agreement in the Club's Policy and (subject to the issue of immunity) the tribunal had jurisdiction over those claims. If the right arose under the Spanish Penal Code, the award was issued without jurisdiction.

Spain and France argued that they were enforcing rights which arose independently of the Club's Policy, under Article 177 of the Spanish Penal Code (focusing on the source and essential nature of the right). The Club argued that the Spanish claims reflected the terms of and arose from the Club's Policy, and not the Spanish statute (focusing instead on the content of the liability).

The Court of Appeal agreed with the Club and upheld the judgment of Hamblen J. While acknowledging that direct action claims inevitably involve both statutory and contractual rights, the Court of Appeal nevertheless found that the right of Spain and France to seek compensation from the Club gave rise to issues arising from the Club's Policy, was governed by English law and fell within the scope of the arbitration agreement contained in the Club's Policy.

Central to this was the Court of Appeal's characterisation of the nature of the right that the Spanish legislation conferred on Spain and France against the Club. The Court of Appeal determined that the statutory right of direct action effectively mirrored the rights under the Club's Policy. Critical to this finding was the fact that the Spanish legislation entitled the Club to raise in its defence any defences that would have been available had the action been brought by the owners of the Prestige under the Club Policy itself, including the "pay to be paid" clause. The underlying nature of the right was therefore founded in and its content defined by the Club's Policy and it must therefore be enforced in accordance with the Club's Policy, including its arbitration agreement. Only if the legislation "prevents the insurer from relying in defence of a claim on important provisions [of the insurance contract] which define the scope of his liability" might the court conclude that the legislation has created a new right. In that case, the claim would instead be governed by the law of the country whose legislation created the right in the first place.

Were Spain and France nevertheless entitled to state immunity?

Having determined that the Spanish claims fell within the scope of the arbitration agreement in the Club's Policy, the Court of Appeal next had to determine whether Spain and France were in any event immune from the jurisdiction of the English court with respect to the applications under ss66, 67 and 72.

The Club argued that Spain and France had waived immunity because: (a) they had taken a step in the English proceedings by failing to challenge the court's jurisdiction, by failing to file an acknowledgement of service and by bringing their own applications under ss67 and 72 of the Act; (b) they had submitted themselves to the jurisdiction of the English court within s9(1) State Immunity Act 1978 because they had agreed to arbitrate the dispute relating to jurisdiction and the Club's liability; and (c) the proceedings in the English court (under s66 of the Act) related to a contractual obligation which fell to be performed in the United Kingdom, within the meaning of s3(1)(b) State Immunity Act 1978.

(a) Had Spain and France taken a step in the proceedings?

The Court of Appeal found that Spain and France had taken a step evidencing an unequivocal decision to waive immunity and allow the court to determine the claim on the merits.

The failure to file an acknowledgement of service and formal challenge to the court's jurisdiction were not waivers of immunity because the steps taken by Spain in that regard were taken solely for the purpose of claiming immunity.

However, by the application under ss67 and 72, Spain and France sought a declaration that the arbitrator did not have jurisdiction because there was no arbitration agreement between themselves and the Club. That, the Court of Appeal found, was clearly directed at the substantive grounds for setting aside the award and had nothing to do with Spain and France's right to claim immunity. The fact that Spain and France had made that application when they did only in order to comply with the compressed timetable imposed by the court was irrelevant.

(b) Had Spain and France agreed in writing to submit the Spanish claims to arbitration?

The Court of Appeal also held (by reference to the decision in *Through Transport Insurance Association (Eurasia) Ltd v New India Assurance Co Ltd* [2003] EWHC 3158 (Comm) and of the Court of Appeal in *Svenska Petroleum Exploration AB v Lithuania (No 2)* [2005] EWHC 2437 (Comm)) that by the Spanish claims, Spain and France had consented to arbitration.

The mere existence of a statutory right to enforce a claim arising out of a contract containing an arbitration agreement will not, in itself, constitute an agreement in writing to submit a certain type of dispute to arbitration. However, the fact that Spain and France had commenced proceedings in Spain in reliance on that right was found to be sufficient for that purpose. Applying the principles in *Through Transport*, the Court of Appeal found that, in availing themselves of the statutory right, Spain and France had become a person claiming through or under an insurance policy containing an arbitration agreement and thereby a "party" to that arbitration agreement for the purpose of s82(2) of the Act. In so holding, the Court of Appeal rejected the argument that a State will only fall within the scope of s9(1) State Immunity Act 1978 if it has expressly consented to arbitrate a dispute by signing the arbitration agreement.

On the basis of its findings in relation to the first two questions, the Court of Appeal declined to consider the third question, noting only that the answer to the question "is not straightforward".

Were the Spanish claims arbitrable?

Having dealt with the scope of the arbitration agreement in the Club Policy, the Court of Appeal also had to address the question of whether the Spanish claims were arbitrable, grounded as they were in statute and relating to criminal offences.

Spain and France argued that the Spanish claims were inherently inarbitrable because a criminal conviction was an essential element of the cause of action under Article 117 of the Spanish Civil Code. The Court of Appeal disagreed. The cause of action depended on proof of an insured liability, not on a criminal conviction. However, the Court of Appeal went on to hold that even if the criminal conviction were a pre-condition to the right to recover, there would still be no reason why the arbitrator should not determine the claim. While the arbitrator could not formally convict any person of a criminal offence, he or she could take into account whether or not the required pre-condition had been met for the purpose of determining civil liability.

COMMENT

There are several points of interest arising out of this case relating to four inter-related but distinct themes: the scope of an arbitration agreement, issues of state immunity and the arbitrability of statutory (or other) claims involving potential criminal liability. They are as follows:

(a) **Scope of the arbitration agreement**. Whether claims relying on rights of direct action created by statute are caught by an arbitration agreement contained in the underlying policy of insurance will depend on a proper characterisation of the right in question. If the legislation limits the right of the insurer to rely on contractual defences against the party claiming under the statute, this will be an indication that the right is an independent one, created by statute and falling outside of the arbitration agreement. If not, the statutory claim will

be treated as one arising under the policy and will be subject to any jurisdiction or arbitration agreement contained therein.

(b) **Immunity**. In deciding whether or not a State has waived its right to immunity, the determining factor will be the conduct of the State in the proceedings and not any statement of its intention to challenge jurisdiction. An application seeking declaratory relief in respect of the substance of the claim at issue (here, whether or not the arbitral tribunal had jurisdiction) is clearly a "step in the proceedings", even if it was done in order to ensure compliance with a compressed timetable.

(c) **Immunity**. A State may be taken to have waived immunity for the purpose of s9(1) State Immunity Act 1978 even if it has not signed the arbitration agreement in question. That will be so where, for example, the State brings a claim as a "party" within the meaning of s82(2) of the Act (as in Through Transport) by relying on a statutory right of direct action against the insurer.

(d) **Arbitrability**. There are accepted categories of dispute which are inherently unsuitable for determination by private arbitration – they are "inarbitrable". While there is no accepted definition of the term, a claim will be inarbitrable where the dispute involves an issue of public policy, public rights or the interests of third parties, or where the dispute in question is covered by a statutory regime which provides for inalienable access to the courts. It is accepted that crime, generally, is inarbitrable and that a tribunal has no jurisdiction to convict a person of a criminal offence (just as a tribunal has no jurisdiction to make orders that are the exclusive preserve of the court, such as the winding up of a company: see *Fulham Football Club (1987) Ltd* v *Richards & anr* [2011] EWCA Civ 855). However, as the Court of Appeal in this case confirmed, a tribunal may make findings of fact which constitute a criminal offence (such as whether or not a bribe has been paid) or may even find that a criminal offence has been committed. The decision of the Court of Appeal on the arbitrability of the Spanish claims in this case therefore confirms the increasingly limited reach of arbitrability in defeating claims that it is said belong in arbitration.

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Company

CAN THE ILLEGALITY DEFENCE BAR A CLAIM AGAINST A DISHONEST DIRECTOR?

Jetivia SA & anr v Bilta (UK) Ltd (in liquidation) & ors [2015] UKSC 23, 22 April 2015

The Supreme Court has ruled on the law of corporate attribution and the "illegality defence", which holds that a party cannot pursue a legal remedy that arises in connection with its own illegal act. The Supreme Court unanimously found that the illegality defence could not bar Bilta's claim against the directors and the appellants because the directors' acts, being committed in breach of their duties to Bilta, could not be attributed to Bilta in the context of a claim by Bilta for a breach of their duties. The court resisted making findings on the wider principle of illegality other than to the extent necessary for this decision, leaving the law in this area in an uncertain state.

Background

The liquidators of Bilta (UK) Ltd (**Bilta**) sued its two former directors, its CEO, and Jetivia SA in relation to a carousel fraud that caused losses to Bilta (a GBP 38 million liability to HMRC). Bilta alleged that this scheme involved a breach by the two directors of their fiduciary duties, dishonestly assisted by its CEO and Jetivia SA (together, the appellants).

The appellants applied to strike out the claims, relying on the illegality defence in arguing that the directors' fraudulent acts should be attributed to the company, thus making the fraudulent transaction the company's own illegal act. As such, the appellants argued, the company should be prevented under *ex turpi causa* from pursuing a legal remedy from the appellants because such remedy arose in connection with the company's own illegal act. This application failed at first instance and the Court of Appeal rejected the appellants' appeal, which then came before the Supreme Court.

The Supreme Court unanimously found that the illegality defence could not bar Bilta's claim against the directors and the appellants because the directors' acts – being committed in breach of their duties to Bilta – could not be attributed to Bilta in the context of a claim by Bilta for a breach of their duties. The Justices took different approaches to their analysis but reached the same outcome nonetheless.

Attribution: the nature and context of the claim is key

The Justices were in agreement that the appellants should not be able to attribute the directors' dishonest breaches of duty to Bilta so as to bar Bilta's claim against the appellants for their own dishonest assistance in the directors' breaches. All shared the view that the nature of the claim is central to the attribution outcome, and reinforced the distinction (established in *Bilta* in the Court of Appeal and in *Moulin Global Eyecare Trading Ltd (in liquidation) v Commission of Inland Revenue* [2014] HK CFA 22 in the Hong Kong Court of Final Appeal) between so-called "redress" and "liability" cases (though without always expressing the distinction in these terms). In cases that involve a company bringing proceedings against its fraudulent directors (and accomplices, as in the case of the appellants here) – the "redress" scenario – the directors' dishonest acts and/or state of mind will not be attributed to the company, as to do so would be contrary (in one way or another) to common sense and justice.

In contrast, in "liability" cases in which a company faces a claim from a third party in relation to a wrong committed against that third party arising out of the company's directors' breach of duty, the rules of agency will generally apply so as to attribute the act and state of mind of the director/employee to the company. The third party is the innocent victim and its interests take priority

over the loss the company suffers at the hands of its own directors.

It is not entirely clear how other factual scenarios would fit into this analysis. Lords Toulson and Hodge suggest that in claims by a company against a third party attribution will depend on the nature of the claim, but where the third party participated in the breach of duty by the company's directors (eg a claim for conspiracy or dishonest assistance) there is no good policy reason why the knowledge of the dishonest director should be attributed to the company. In some ways the company can still be seen as the victim here and the same arguments would seem to apply for avoiding a perverse outcome whereby a fraudulent party (be that the dishonest director or third party accomplice) can defeat a claim by the company by attributing their acts to the company itself and seeking to rely on an illegality defence on this basis.

Although one can detect some divergence between the Justices as to which analytical tools they find most useful to approach this point, in the end all were more or less in agreement that the focus must be on the nature and factual context of the claim at hand, when asking "*whose act (or knowledge or state of mind) was for this purpose intended to count as the act etc of the company*" (per Lord Hoffmann in *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500).

Illegality

The court only needed to go so far in this case as to determine that the illegality defence could not be used to bar Bilta's claims against the appellants. As to the application of the illegality defence more widely, the Justices resisted tackling the issue head-on, taking the view that this was not the case in which to do so since wider arguments about the application of the doctrine had not been pleaded. Bilta, then, does not add anything decisive to this already-confused area of law and highlights the range of possible interpretations of the existing, extensive case law.

Lord Sumption devoted much space in his judgment to an analysis of the illegality case law and its developments over time, expressing his view that the law in this area had by the end of the 20th century "become encrusted with an incoherent mass of inconsistent authority" featuring "a mass of sub-rules, each appropriate to its own context." In a bid to overcome this situation, the courts started to move towards suggesting that the process of applying the illegality principle might be better considered discretionary in nature. However, the House of Lords in *Tinsley v Milligan* [1994] 1 AC 340 shifted back from this path and re-asserted that the illegality defence is a rule of law rather than a matter of discretion and pragmatism, a view that was reaffirmed by the Supreme Court in *Les Laboratoires Servier v Apotex Inc* [2014] UKSC 55 which determined (in Lord Sumption's words) that "*the illegality defence is based on a rule of law on which the court is required to act…It is not a discretionary power on which the court is merely entitled to act, not is it dependent upon a judicial value judgment about the balance of equities in each case*." Here the Justices part company: Lords Toulson and Hodge (the former who dissented in *Les Laboratories*) clearly favour the more pragmatic approach and took from the Supreme Court's decision in *Hounga v Allen* [2014] UKSC 47 a return to a broader view of context and competing public policy aims which seemed to conflict with *Tinsley v Milligan.*

In this context, Lords Toulson and Hodge held that they would also decide the case on a statutory public policy basis; ie on the grounds that to allow attribution (and thus the illegality defence) in this instance would run counter to the directors' duties under the Companies Act 2006 (CA06) and indeed "make a nonsense" (per Lord Neuberger) of the duty imposed on directors by s172(3) CA06 to have regard to the interests of creditors of an insolvent/prospectively insolvent company, and indeed deprive the statutory duties that the directors owed Bilta of all content.

It is not entirely clear from the judgments where this analysis fits into the overall attribution/illegality landscape. While Lord Neuberger read Lords Toulson and Hodge as suggesting that they would resolve the attribution question itself by applying broad policy statements, it seems that in fact all of the Justices were broadly in agreement as to the basic structure of the law on attribution. Instead, Lords Toulson and Hodge's

emphasis on statutory policy is better seen as a separate ground on which they conclude that this case should be resolved as part of their analysis of how the illegality defence should work (ie as a question of factual context and competing public policy objectives; in this case, the competition being between the CA06 public policy and the public policy rooted in the illegality doctrine). The other Justices either did not agree with Lords Toulson and Hodge (in the case of Lord Sumption) or did not take their analysis down this route, leaving it aside as part of the question of how the illegality defence works (which they decided not to engage with more generally in this case).

We are left, then, with a situation in which the Supreme Court has given recent judgments that can be interpreted as taking different approaches to the application of the illegality defence and whose effect remains in dispute even between the Justices. Unfortunately, the judgment in Bilta has not provided any clarity on the Supreme Court's view on which approach ought to be taken in this area, which was acknowledged by Lord Neuberger, who noted that this issue needs to be dealt with as soon as the appropriate case comes before the court.

Comment

While on the one hand the decision on attribution in this case adds further certainty to this field by reinforcing other recent approaches in the case law, the picture on illegality is less comforting. The apparent conflict between a number of recent decisions of the same court on illegality leaves the law in this area distinctly uncertain and – as the Supreme Court emphasised – in real need of urgent resolution. Whether the law should be anticipated to move in a principles-based direction or towards a more discretionary, context-specific approach remains entirely unclear. It remains to be seen whether the Law Commission, which had previously explored putting this area on a statutory footing, might pick up the mantle again or whether, as the Supreme Court suggests, we will have to wait patiently for the right case to come before the Supreme Court and for the court to take the opportunity to articulate its decisive view on this area.

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Competition

ANTITRUST LIABILITY AND SUBSIDIARY COMPANIES

Tesco Stores Ltd & ors v Mastercard Inc & ors [2015] EWHC 1145, 24 April 2015

Mastercard was unsuccessful in attempting to strike out the claimants' (Tesco Stores and others) antitrust claim in relation to the setting of multilateral interchange fees. Summary judgment was also refused. Mastercard had argued that Tesco Bank was part of the same economic entity as the Tesco claimants, and had been engaging in similar allegedly anticompetitive conduct as Mastercard. The claim against Mastercard for breach of competition law rules will now proceed to trial. Although this is an interlocutory judgment, the judge's remarks shed new light on the application of the *Akzo Nobel* precedent to the question of when "horizontal" liability can be imputed from one to another subsidiary of the same group.

The issues in this case arose from litigation brought by Tesco Stores against Mastercard for a breach of EU and national competition law through the imposition of multilateral interchange fees. The defendants (**Mastercard**) sought to strike out the application under the principle of *ex turpi causa* on the ground that Tesco Bank, a wholly owned subsidiary of Tesco Stores, had participated in the same allegedly unlawful conduct as the defendants. In the defendants' view, the fact that Tesco Bank and Tesco Stores belonged to the same economic entity barred Tesco Stores' claim from proceeding to trial.

Mrs Justice Asplin DBE dismissed the defendants' request for summary judgment and ordered that the case proceed to trial. The case was not suitable for a strike out because it involved difficult questions of law in a developing area. Four issues were specifically addressed by the court:

(1) **Single economic entity: are Tesco Stores and Tesco Bank part of the same economic entity?** The test is whether the two companies form a unitary organisation of personal, tangible and intangible elements which pursue a specific economic aim on a long-term basis. There is a presumption that a parent company exercises decisive influence over its wholly owned subsidiary and it is for the company denying liability to rebut such presumption. In this case the court recognised that Tesco plc had decisive influence over both the claimant Tesco Stores and Tesco Bank, however the question was whether joint and several liability could be imputed on two subsidiaries "horizontally" when there was no question of the "vertical" relationship with the parent company. Asplin J relied on *Case C-97/08 P Akzo Nobel v Commission* to hold that a wide range of factors should be considered before coming to a conclusion as to whether joint and several liability could be imposed on Tesco Stores for Tesco Bank's conduct. In particular, the court would need to first reach a view on the specific nature of the infringement and the activities involved before deciding whether liability can be imposed on a different entity within the Tesco group. In summary, even if it were found that the two entities operating horizontally in this case formed a single economic entity, it could be said that the claimants had a "realistic as opposed to a fanciful" prospect of success in showing that the alleged infringement by Tesco Bank should not be imputed to Tesco Stores. The judge remarked that responsibility within an economic entity is not imposed on the basis of strict liability only and instead requires a degree of "decisive influence" being exercised by one entity over the other entity's

conduct. The judge did not express a view as to the exact degree of influence that is required.

(2) **Did Tesco Bank participate in the alleged infringement?** The court held that, given the absence of disclosure amongst other factors, it was not at this stage merely fanciful to suggest that the claimants may succeed in showing that Tesco Bank was not a party to the infringement in question. Thus the case should proceed to trial.

(3) **Does the English law principle of *ex turpi causa* apply?** In order to determine whether the principle of *ex turpi causa* applied to this case, the court would need to establish each of the claimants' knowledge and/or joint state of knowledge regarding the unlawful conduct, in accordance with Lord Sumption's test in *Les Laboratoires Servier & anr v Apotex Inc & ors* [2014] 3 WLR 1257. Therefore the issue should be reconsidered at trial.

(4) **Does Tesco Bank bear a significant responsibility for the infringement?** Asplin J held that the issue was fact-specific and was thus to be decided on the basis of factual evidence at trial.

COMMENT

This case is yet further proof that courts are not willing to strike out claims that involve complex issues in developing areas of the law. The judge makes interesting remarks regarding the extent to which joint and several liability can be imputed horizontally on an undertaking that is part of the same group of entities yet not necessarily in a position to exercise decisive influence on the undertaking which engaged in the allegedly unlawful behaviour. The case emphasises that, in light of the *Akzo Nobel* case, the question of joint and several liability requires a complex consideration of a wide range of factors that cannot be determined summarily. In addition, it appears that the imputation of liability on another undertaking is a factual question which can only be answered by reference to the specific factual framework within which the alleged unlawful conduct took place, eg by asking whether in fact Tesco Stores had any control or influence over Tesco Bank's behaviour in relation to multilateral interchange fees. Another point that is worthy of note is the court's recognition that, in accordance with Lord Sumption's analysis in *Apotex*, the principle of *ex turpi causa* in English law should generally only apply to criminal or "quasi criminal" conduct. Therefore in order to establish a defence of *ex turpi causa* it might be necessary to prove the requisite mental state.

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Conflict of laws

JURISDICTION CLAUSE IS EXCLUSIVE DESPITE IT CONTEMPLATING PROCEEDINGS IN OTHER JURISDICTIONS

Compania Sud Americana de Vapores SA v Hin-Pro International Logistics Ltd [2015] EWCA Civ 401, 23 April 2015

A jurisdiction clause was found to be exclusive despite expressly providing for proceedings in other courts in certain circumstances. The finding of exclusivity was based on several factors including the choice of an English governing law and the mandatory language used ("*shall be subject to*"). The doctrine of *contra preferentum* has limited value in determining whether a jurisdiction clause is exclusive or not.

During 2012 and 2013 the appellant (**Hin-Pro**) began various separate proceedings against the respondent (**CSAV**) in the Chinese maritime courts. The bills of lading under which Hin-Pro's claims were brought were on CSAV's standard terms and contained the following jurisdiction clause:

> "*23. Law and Jurisdiction*
>
> *This Bill of Lading and any claim or dispute arising hereunder shall be subject to English law and the jurisdiction of the English High Court of Justice in London. If, notwithstanding the foregoing, any proceedings are commenced in another jurisdiction, such proceeding shall be referred to ordinary courts of law. In the case of Chile, arbitrators shall not be competent to deal with any such dispute and proceedings shall be referred to the Chilean Ordinary Courts*."

Despite CSAV obtaining a without notice anti-suit injunction from the English court, Hin-Pro continued with the Chinese proceedings, and damages were awarded against CSAV in at least two of the Chinese cases.

In the English Commercial Court CSAV sought, *inter alia*, a declaration that Hin-Pro was obliged by clause 23 to litigate disputes in relation to the contracts evidenced by the bills of lading in England.

Cooke J held that Hin-Pro was indeed obliged by clause 23 to litigate its claims before the English High Court. The Chinese actions therefore breached clause 23. Cooke J granted a permanent injunction precluding Hin-Pro from pursuing or taking any further steps in the Chinese courts.

Clause 23 is an exclusive jurisdiction clause

On appeal, Hin-Pro submitted that clause 23 was not an *exclusive* jurisdiction clause because the clause does not refer to exclusive jurisdiction, and does not say that no other court may have jurisdiction. On the contrary, the second and third sentences recognise that proceedings may be commenced outside England and make provision for that eventuality.

Hin-Pro also submitted that, at the very least, the wording of clause 23 leaves room for doubt as to whether CSAV (as *proferens* of the clause) was to have the benefit of exclusivity – it should therefore be construed *contra preferentem*.

In upholding the decision of the Commercial Court, Clarke LJ decided that clause 23 was, in effect, an exclusive jurisdiction clause:

(1) First, the words "*shall be subject to*" are imperative and directory. By selecting such wording, the parties did not agree only to submit to English jurisdiction if and when English jurisdiction is invoked. On the

contrary, they agreed to submit any claim to the jurisdiction of the English courts.

(2) Second, whilst a non-exclusive English jurisdiction clause is not necessarily worthless or otiose when there is express provision for English law as the governing law, the natural purpose of a clause like clause 23 is to stipulate (a) what law will govern; and (b) which court will be *the* court having jurisdiction over any dispute. The parties made English law mandatory and therefore must (absent any convincing reason to the contrary) be taken to have intended that English jurisdiction should also be mandatory. When the parties agreed that claims and disputes should be determined by the English High Court they were, by necessary inference, agreeing that they should not be determined elsewhere.

(3) Third, there is obvious commercial sense in making both English law and English jurisdiction mandatory. Whilst foreign courts may (but will not necessarily) apply English law if that is what the parties have agreed, England is the best forum for the application of its own law.

(4) Fourth, the phrase "[i]*f, notwithstanding the foregoing, any proceedings are commenced in another jurisdiction*" would not be necessary if the first sentence of clause 23 made English jurisdiction optional.

(5) Fifth, the second and third sentences are designed to cover a situation where the first sentence is ineffective, for example where a country whose jurisdiction is invoked does not recognise the intended effect of an exclusive jurisdiction clause (as is the case, in some circumstances, in China and Canada).

(6) Sixth, the *contra preferentem* rule applies to the interpretation of a contract at the time it was drafted, not to the result of a particular suit. An exclusive English jurisdiction clause can benefit either party depending on the circumstances, meaning the doctrine has limited value in determining whether a jurisdiction clause is exclusive or non-exclusive.

(7) Finally, whilst the previous authorities involving different provisions in different contracts are not binding (and are, at best, a useful guide), the tenor of the English authorities is that an agreement for English law and jurisdiction in this form is likely to be interpreted as being exclusive.

COMMENT

Although the word "*exclusive*" did not appear in clause 23, Clarke LJ's analysis of the language of the clause reveals that it is, in fact, an exclusive jurisdiction clause. However, given that the clause expressly contemplates the possibility of alternative competent jurisdictions, this result was far from a foregone conclusion. The case therefore demonstrates the importance of accuracy when drafting jurisdiction clauses.

For example, where the parties want an exclusive jurisdiction clause, it is always worth including the word "*exclusive*" for the avoidance of any doubt.

Conversely, when the parties want to combine a mandatory governing law provision with a non-exclusive jurisdiction clause, care should be taken to avoid the application of the former's mandatory language to the latter. Similarly, any provisions designed to deal with the possibility of alternative jurisdictional options should be carefully considered.

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RESOLVING INCONSISTENT JURISDICTION CLAUSES AND LIMITS TO FIONA TRUST PRESUMPTION

Trust Risk Group SpA v AmTrust Europe Ltd [2015] EWCA Civ 437, 30 April 2015

The Court of Appeal held that when resolving competing jurisdiction clauses in two different agreements where one is entered into at a later date, the correct approach was to apply a careful and commercially-minded construction of the contracts and not the *Fiona Trust* "one-stop shop" presumption. This was despite the risk of disputes becoming fragmented. This case further limits the circumstances in which the *Fiona Trust* presumption applies.

This was an appeal from a High Court decision covered in our February/March 2015 issue, *AmTrust Europe Ltd v Trust Risk Group SpA* [2014] EWHC 4169 (Comm) concerning whether the English court had jurisdiction in a dispute between the Italian broker appellant and the UK insurer respondent.

In 2010 the parties entered into a Terms of Business Agreement (**TOBA**), which was subject to English law and jurisdiction. In 2011 they signed a Framework Agreement, governed by Italian law and providing for disputes to be determined by arbitration in Milan. The TOBA was included as a schedule to the Framework Agreement. The respondent alleged that the appellant had misappropriated premiums received from insured persons which were to be paid into a trust account for the benefit of the respondent. A dispute arose as to which contract this dispute was in respect of and, as a result, which dispute clause applied.

Blair J held that there was a "good arguable case" that the English courts had jurisdiction under the English jurisdiction clause in the TOBA. The appellant however argued that the Framework Agreement superseded the TOBA and that the arbitration agreement in the Framework Agreement applied to the dispute between the parties. The respondent countered that the TOBA continued as a freestanding agreement and that, as a result, any disputes arising out of the TOBA were subject to the English jurisdiction clause contained therein.

On appeal, the Court of Appeal focused on the scope of the *Fiona Trust* presumption (deriving *from Fiona Trust & Holding Corp & ors v Privalov & ors* [2007] EWCA Civ 20 and explained below) that the parties are likely to have intended that any dispute arising out of their relationship be decided by the same tribunal – the "one-stop" approach. *Fiona Trust* concerned the interpretation of an arbitration clause in one agreement. First, in order to determine whether and to what extent the *Fiona Trust* presumption applied, the court had to determine the contractual relationship between the parties; was there a single agreement (ie the Framework Agreement) or two separate agreements?

One or two agreements?

It was necessary for the court to determine whether there was a single agreement or two freestanding agreements because only where there was a single agreement would the *Fiona Trust* presumption apply.

In interpreting the Framework Agreement and the TOBA, Beatson LJ noted that the court's job was to discern the intention of the parties, objectively speaking from the words used, in the relevant context and against the factual background.

The starting point is the words used. Both sides raised linguistic arguments based on the wording of the agreements. However, a linguistic analysis alone could not provide clarity as to whether the two agreements were in fact one contract.

The court considered that there might be more scope to resort to the apparent commercial purpose of the agreements as an aid to construction than there otherwise would be in a well-drawn contract. It also suggested that in such a situation it was less likely that detailed linguistic analysis would be of assistance in construing the terms of the contract. However, this approach has its

limits as both parties are often able to provide differing commercial "common sense" approaches.

The court ultimately found that there were two freestanding agreements on the basis that each dealt with different parts of the parties' relationship. The next issue was how to resolve the competing jurisdiction clauses.

Limits on the *Fiona Trust* presumption

The Court of Appeal, whilst acknowledging that *Fiona Trust* was helpful, held that there could be no such presumption where there were two or more different jurisdiction clauses in different agreements which governed different aspects of the parties' relationship.

Beatson LJ, giving the lead judgment in the Court of Appeal, considered two fairly recent Court of Appeal decisions relating to the construction of conflicting jurisdiction clauses in financial transactions. First, in *UBS Securities LLC v HSH Nordbank AG* [2009] EWCA Civ 585, the Court of Appeal considered the "commercial centre" of a transaction governed by multiple contracts entered into as part of one package in order to determine the applicable jurisdiction clause. Secondly, in *Sebastian Holdings Inc v Deutsche Bank AG* [2010] EWCA Civ 998, the Court of Appeal distinguished UBS and found that where a claim arose under a particular agreement, the jurisdiction clause in that agreement would apply even if it resulted in a fragmentation of proceedings.

Beatson LJ drew a distinction between, on the one hand, a single contract establishing a relationship between the parties which is later supplemented by a subsequent contract and, on the other, agreements concluded at the same time that represent a complete package. It is easier to conclude in the former case that the parties have chosen different jurisdictions to deal with different aspects of their relationship. There could be no presumption that the provisions in the later agreement were intended to capture disputes arising out of the earlier agreement. This was held to be the case even if there was a risk of fragmentation of the overall process for dispute resolution.

The Court of Appeal concluded that the jurisdiction clause in the TOBA was not affected by the conflicting jurisdiction clauses in the Framework Agreement. The clauses related only to matters arising out of the agreements in which they were contained.

COMMENT

When contrasted with the *UBS* and *Sebastian* decisions, this case identifies the two distinct factual patterns that affect the court's approach to resolving seemingly inconsistent dispute resolution provisions: (1) where two freestanding agreements are entered consecutively, with the latter dealing with different aspects of the relationship; and (2) where there are multiple contracts entered simultaneously about a single transaction between the parties. In the former, as in this case, it may be easier for the court to conclude that the parties chose to have different jurisdictions to deal with different aspects of the relationship.

There is no presumption that a dispute resolution clause in a more recent agreement is intended to capture disputes arising out of a previous agreement.

There are often good reasons for parties to enter into different agreements with different jurisdiction clauses, despite the risk that claims may not neatly fall under just one contract. As this case demonstrates, the context in which contracts which contain competing jurisdiction clauses are entered into will have a significant impact on the approach of the court to resolving the conflict. If different jurisdiction clauses are required in different contracts, it is important that they are drafted as clearly as possible to avoid disputes as to which mechanism applies.

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SCHEMES OF ARRANGEMENT AND WHY LOAN NOTE INVESTORS SHOULD BE WARY OF GOVERNING LAW AMENDMENT MECHANISMS

In the matter of DTEK Finance B.V. [2015] EWHC 1164 (Ch), 28 April 2015

A change in the governing law of loan notes from New York law to English law was sufficient to found jurisdiction for the English court to sanction a scheme of arrangement between a Dutch company and holders of loan notes issued by that company.

A company, DTEK Finance B.V. (**DTEK**), incorporated in the Netherlands, applied to have the English High Court sanction a proposed scheme of arrangement with the holders (**Scheme Creditors**, or **Noteholders**) of certain loan notes (the **Notes**) under the Companies Act 2006.

DTEK was part of a group of companies carrying on a vertically integrated energy business (including mining coal, generating power, and distributing and selling electricity), with its core customers located in the Ukraine. DTEK's core function was to raise finances for the group, which it in turn distributed to other group companies.

In line with that overall group structure, in 2010, DTEK had issued the Notes to the Noteholders, in the principal amount of USD 500 million (although USD 300 million had earlier been bought back by DTEK) bearing interest at a rate of 9.5%. DTEK had duly on-lent the proceeds of the Notes to other companies in the group, and it, in return, had taken certain guarantees from those group companies. The Notes, as originally issued, were governed by New York law.

The Notes were due to mature on 28 April 2015. However, as the maturity date approached, the wider group had encountered financial difficulties due to complications in the Ukraine: in particular, the devaluation of the Ukrainian currency, as the group received its revenue in the Ukrainian currency but serviced its borrowings in USD or EUR. As such, at the time of the hearing in April 2015, the group was in the process of undertaking a wide-ranging restructuring and party to on-going negotiations with lenders.

Regardless of the outcome of those negotiations, it was certain that DTEK would not have the funds to pay the Noteholders in full on the maturity date, such that, absent the approval of the scheme of arrangement in respect of the Notes, DTEK would default, which would in turn trigger defaults on the part of other group companies and thereby lead to insolvency proceedings.

DTEK was therefore seeking the English court's approval of a scheme of arrangement (the **Scheme**) with respect to the Notes, with the support of over 90% of the Noteholders. The Scheme was straightforward, involving DTEK acquiring and then cancelling Notes, and in return, issuing Noteholders with new notes for 80% of the par value of the Notes (with a 2018 maturity date and the same interest rate), and cash for the remaining 20% of the par value of the Notes.

Analysis

While, ultimately, the court did not take any issue in exercising its discretion to sanction the Scheme itself, or with the due satisfaction of the statutory requirements, the key substantive issue of interest for determination was whether the court itself had the necessary jurisdiction to sanction the Scheme under the Companies Act 2006.

Rose J surveyed the applicable law, noting that the jurisdiction to sanction a scheme of arrangement under the Companies Act 2006 arose in respect of any company liable to be wound up under the Insolvency Act 1986. As a foreign company may be wound up as an unregistered company under that Act, jurisdiction would arise where the Court was satisfied that the relevant company had a "sufficient connection" with England (applying *Re Drax Holdings* [2004] 1 WLR 1049).

Authority demonstrates that a "sufficient connection" arises where English law is the governing law of the instruments to be compromised by the proposed scheme. In this case, the original governing law of the Notes was New York law – however, the governing law had very recently been changed from New York law to English law by a collective decision of the Noteholders. The terms of the Notes permitted changes to the governing law on a majority basis, and provided that such changes would bind all Noteholders (regardless of their agreement). As such, according to the originally-governing New York law, the governing law of the 2015 Notes was indeed successfully changed to English law.

The change of governing law had been approved by Noteholders on the express basis that it was being effected so as to create a link with the English court, in order to enable DTEK to seek approval from the English courts for a scheme of arrangement under the Companies Act (in the event that the 98% support threshold required for a voluntary exchange of the Notes was not met).

Applying *Re APCOA Parking Holdings GmbH* [2014] EWHC 3849 (Ch), Rose J held that the connection created to the English court was no less "sufficient" because it was made for that express purpose shortly before the sanctioning of the Scheme. In particular, the Court observed that "part of the bargain that the Noteholders signed up to" was the mechanism to effect changes to the governing law (in accordance with the originally-governing New York law).

As such, the requisite sufficient connection was held to exist (supported by the fact that DTEK had also moved its centre of main interest to England and held significant assets in England) and, in light of additional expert legal opinions that the Scheme would be of practical effect in the Netherlands and other relevant jurisdictions, it was ultimately duly sanctioned by the court.

COMMENT

The case is an interesting reminder that it is important not only to consider the selection of governing law, but also the mechanism for effecting any changes to that governing law, at the drafting and negotiation stage. It is clear that, in line with *APCOA*, the English courts (at least) will not look behind any such changes of governing law in a cynical or disapproving manner, even if the purpose of such changes is, in effect, to frustrate and deliberately override the fact that a requisite number of creditors (under the original governing law) have not given approval to a scheme of arrangement, and may attract companies to English schemes of arrangement in undertaking a restructuring. From a practical point of view, it is interesting to note DTEK's adoption of the judge's comments in Re *APCOA* in expressly notifying the Scheme Creditors of the purpose of the change of governing law and providing the requisite expert evidence to show that the Scheme would be of practical effect.

Note that the Brussels Regulation was not relevant as insolvency matters are excluded from its scope.

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ABILITY TO LITIGATE IN ENGLAND TORPEDOED BY FOREIGN INSOLVENCY PROCEEDINGS

Erste Group Bank AG London Branch v J "VMZ Red October" & ors [2015] EWCA Civ 379, 17 April 2015

The filing of claims by a creditor in foreign insolvency proceedings, and the full participation of the creditor in those proceedings, results in the submission to and acceptance of the jurisdiction of the foreign courts in relation to all issues arising in the insolvency proceedings. Creditors should therefore consider very carefully the consequences of filing claims in foreign insolvency proceedings (and/or participating in the foreign insolvency proceedings) as doing so may have unintended consequences.

Russian insolvency proceedings were commenced in respect of the Russian incorporated Red October steel company and Red October's Russian incorporated parent. A lender to Red October filed claims in the insolvency proceedings (against Red October on the basis of an English law governed loan agreement and the parent on the basis of an English law governed guarantee – both agreements were subject to the exclusive jurisdiction of the English courts). It was alleged by the lender that various companies in the Red October group had engaged in a conspiracy to hive down Russian assets to a subsidiary and to put assets out of reach of creditors. On this basis, the lender sought to bring legal proceedings before the English courts against Red October, the parent and the related companies that were allegedly involved in the alleged conspiracy. The Russian insolvency proceedings had not been recognised in England and no application for recognition had been made. The High Court allowed service out of the jurisdiction on the related companies (it was not necessary to obtain permission to serve out on Red October or its parent). Two of the related companies challenged jurisdiction, seeking to set aside the service of proceedings upon them. They lost their challenge in the High Court but appealed to the Court of Appeal.

One of the three jurisdictional gateways relied upon by the lender to obtain permission to serve out of the jurisdiction had required the lender to show that there was a real issue between the lender and Red October (and its parent) which it was reasonable for the English court to try and that the related companies were necessary or proper parties to the proceedings.

The appellant companies argued before the Court of Appeal that there was not a real issue between the lender and Red October or its parent that it was reasonable for the English court to try.

The Court of Appeal held (on the basis of the decision of the Supreme Court in *Rubin/New Cap* and the Privy Council in *Stichting Shell Pensioenfolds v Krys*) that, in the context of considering whether it was reasonable for the English court to try the claim against Red October and its parent, the filing of claims by the lender (and the subsequent participation in the insolvency proceedings) amounted to a submission to and acceptance of the jurisdiction of the Russian courts by the lender in relation to all issues arising in the insolvencies. In this case, this included both claims which were derived from the insolvency proceedings (ie those brought under the relevant insolvency legislation – essentially claims which only arise because of the opening of insolvency proceedings) and claims under the general law (ie the tortious claims for conspiracy), because there was no relevant difference between the claims for which the lender proved and the claims for which it did not prove. As such, it was not reasonable for the English court to try the claim between the lender and Red October and its parent and therefore not appropriate to give permission to serve out of the jurisdiction on the related companies.

The Court of Appeal further held that, irrespective of whether the lender had submitted to the Russian proceedings, there was no real issue that it was reasonable for the court to try as between the lender and Red October and its parent for a number of other reasons, including that there was no suggestion that the

contractual indebtedness of Red October was being disputed and there was no utility in hearing the claims when any judgment would either not change the recovery in or have no effect in the Russian insolvency process. Further, the Court of Appeal found that the fact that Red October and its parent were bound by English jurisdiction clauses in the relevant documents did not mean that it would be reasonable for the court to try such claims. The English court clearly had jurisdiction over the claims against Red October and its parent which, in the absence of any submission, it would probably accept. But the question was not whether the court should or was obliged to accept jurisdiction, rather, in the context of an application for permission to serve out of the jurisdiction on third parties, the question was whether, in all the circumstances, it was reasonable to try such claims against the "anchor" defendants. Here it was not. The Court of Appeal therefore allowed the appeal and set aside the service out of the jurisdiction.

Essentially the court viewed the lender as having made a choice by the filing of claims in the Russian insolvency proceedings. The court also pointed to the fact that the lender had: (i) taken part in creditors' meetings; (ii) been represented in the court proceedings determining whether the guarantee would be voided on the basis of Russian law; and (iii) comprehensively engaged with the Russian officeholder. As the court put it the lender's participation in the Russian insolvency proceedings had been "full-blooded". The Court of Appeal also rejected the lender's attempts to rely on other jurisdictional gateways and, in considering its general discretion to determine whether England was the appropriate forum, found that there was no doubt that the clearly appropriate forum for the determination of the dispute was Russia.

What does this mean?

While the lender had done far more than simply file a claim in the Russian insolvency proceedings, it is now clear that filing a claim in any jurisdiction's insolvency proceedings: (i) will result in submission to the jurisdiction in relation to the enforcement of claims that the creditor may have against the assets of the insolvent party; and (ii) that this will cover claims in respect of which a creditor did not prove. Furthermore, by filing a claim in the insolvency proceedings and then participating fully in insolvency proceedings, the creditor may be taken to have submitted to the jurisdiction of those courts in relation to all issues arising in the insolvency proceedings. Creditors should therefore seek legal advice before taking any step in respect of foreign insolvency proceedings. By taking such a step a creditor could waive its rights to have a wide range of connected issues determined by the English court.

The Court of Appeal confirmed that it may be possible for a creditor, in respect of claims which are not derived from the foreign insolvency proceedings, to apply to the English court in appropriate circumstances for a determination of issues governed by English law. Such a decision could then assist the foreign insolvency court in establishing whether there is a debt which is capable of being proved. This option was rejected by the Court of Appeal in Red October because the court was of the view that such an order from the English courts would be of no utility, the question of the quantum and validity of the claims filed in the Russian insolvency proceedings by the lender having already been determined by the Russian courts. There may therefore be some merit for parties to seek to "get in early" before the English courts; although whether such action will be beneficial will be highly fact specific.

The decision does not consider the effect that having a "presence" in the jurisdiction of the foreign insolvency proceedings may have. The question for the courts in the future may be whether, by having a presence in the jurisdiction of the foreign insolvency proceedings, the party has "submitted" to the jurisdiction of the foreign insolvency courts, simply because of its activities in the State in which the foreign insolvency proceedings have been commenced (even if the party has taken no step at all in respect of the foreign insolvency proceedings). The question that would then arise is whether it should be taken to have submitted in relation to all issues in those proceedings, or only for the purposes of seeking to enforce its claims against the assets of the insolvent estate.

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Contract

PENALTY CLAUSES: A QUESTION OF CONTEXT?

ParkingEye Ltd v Beavis [2015] EWCA Civ 402, 23 April 2015

In a dispute about the non-payment of a GBP 85 parking fine the Court of Appeal has explored the fundamental principles of the rule against penalties and given an indication of the courts' understanding of the jurisprudence in this area.

Mr Beavis refused to pay a GBP 85 fine after overstaying the free parking period of two hours in a car park in Chelmsford managed, but not owned, by *ParkingEye*. The fine was displayed on various prominent signs. *ParkingEye* filed a claim in the county court for the unpaid fine. Mr Beavis alleged the fine was an unlawful penalty. Judge Maloney QC at first instance found in favour of *ParkingEye*. This is the appeal of that decision.

Reminder of the law on penalties

Moore-Bick LJ reviewed many of the significant cases on the rule against penalties, including *Clydebank Engineering & Shipbuilding Co Ltd v Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6 and *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co. Ltd* [1915] AC 79 to derive the following general principles:

– The essence of a penalty is a payment of money intended to deter; the essence of liquidated damages is a genuine pre-estimate of loss.

– A sum payable on breach will be held to be penalty if it is extravagant and unconscionable in comparison with the greatest loss that could conceivably be proved to have followed from the breach.

– It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties.

Moore-Bick LJ also considered *El Makdessi v Cavendish Square Holdings BV* [2013] EWCA Civ 1539 (reported in the January 2014 Litigation Review) and concluded that the modern approach is that a clause providing for the payment on breach of a sum of money that exceeds the amount that a court would award as compensation, or which requires a transfer of property for no consideration or at an undervalue, may not be regarded as penal if it can be justified commercially and if its predominant purpose is not to deter breach. However, there is now a greater measure of flexibility and a willingness to recognise the underlying principles

on which the doctrine of penalties as a whole rests in order to determine the outcome in any particular case.

A question of context

The challenge that faced the court in this case was that the decisions in which the modern approach to the doctrine of penalties has been developed have largely concerned commercial contracts under which the parties' respective interests can usually be measured without too much difficulty in financial terms. Moore-Bick LJ felt that, if commercial justification means anything more than justification as compensation for financial loss of some kind (as it appeared to him it must), it was difficult to see why justification for payment of a sum unrelated to financial loss should depend solely on commercial as opposed to some other kind of consideration.

In purely financial terms, *ParkingEye* suffered no direct financial loss if an individual motorist overstayed the period of free parking, because it has no interest in the land over which the licence was granted and suffered no immediate loss in terms of income that might otherwise have been derived from another motorist using the car park, as it would if customers were charged a flat rate for using it.

Moore-Bick LJ acknowledged that one of the principal purposes of imposing a parking fine was to deter motorists from abusing the facility by staying beyond the period of free parking. Christopher Clarke LJ in *El Makdessi*, while not ruling out the possibility altogether, had found it difficult to conceive of a situation in which a clause could be commercially justifiable despite the fact that its dominant purpose was to deter. Moore-Bick LJ felt that his remarks were made in a different context and he had already recognised a tendency on the part of the courts to return to the fundamental test of extravagance and unconscionability. Ultimately, Moore-Bick LJ held that the judge at first instance, faced with a novel situation, felt that the parking charge was not extravagant or unconscionable and that the contract was therefore enforceable at common law. In Moore-Bick LJ's view the judge was right.

Sir Timothy Lloyd agreed. A provision of this kind should not be struck down, merely on the basis that it is a disincentive, or deterrent, against overstaying. This is different from an ordinary financial or commercial contract where terms which require the payment of compensation going far beyond that which the law allows, in the absence of any contract provision, should be struck down. The rules about penalties applied in the present case. If the charge was grossly disproportionate, it could fall foul of the rule. It would be extravagant and unconscionable. On the facts it was not.

Comment

In the present case it was possible to present the charges, as the judge did, as commercially justifiable, but Moore-Bick LJ held "*in truth they are justified by a combination of factors, social as well as commercial*". In the commercial context a "dominant purpose of deterrence" has been equated to extravagance and unconscionability, but in another context that need not be the case. This, to the author, albeit in a non-commercial context, represents a novel interpretation of the rule against penalties (which the author confesses he had always assumed would have rendered parking charges unlawful).

The court noted that it could have been argued that the parking charge was no more than a conditional payment which the motorist could choose whether to incur or not. Had this been the case the authorities on penalties for breach of contract would have been of no relevance. This method of drafting a contract so that the payment is conditional and not referenced to a breach remains the cleanest way to avoid the rule against penalties.

POSTSCIPT

Mr Beavis has appealed this decision and the appeal is to be heard by the Supreme Court on 21 July 2015 by seven Supreme Court Justices alongside the appeal of *Makdessi*. His appeal is part-funded by money raised on the crowdsourcing website Indiegogo.

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CONTRACTUAL INTERPRETATION: WHEN CAN YOU STRAY FROM THE STRICT WORDING?

Arnold v Britton & ors [2015] UKSC 36, 10 June 2015

For businesses and lawyers, a new test set out by the Supreme Court will help inform when one can stray from the literal words of a contract and adopt an interpretation that accords with commercial common sense. The Supreme Court has supported a literal interpretation of a 1974 service charge clause in a lease even though it means that it is harsh for the individual tenants. In doing so it has set clear limits on the "commercial common sense" approach to the interpretation of English law contracts. This interpretation meant that the tenants will be paying over GBP 1 million per annum each at the end of their 99-year leases.

There were a number of 1974 leases, with variable wording. However, this article focuses on the following sample clause which provided that the lessee was:

"To pay to the Lessor without any deductions in addition to the said rent as a proportionate part of the expenses and outgoings incurred by the Lessor in the repair maintenance renewal and renewal of the facilities of the Estate and the provision of services hereinafter set out the yearly sum of Ninety Pounds and Value Added tax (if any) for the first Year of the term hereby granted ***increasing thereafter by Ten Pounds per hundred for every subsequent year or part thereof****."*
[emphasis supplied]

The lessor argued that the service charge provisions provided for a fixed annual charge of GBP 90 for the first year of the term, increasing each year by 10% on a compound basis. The current lessees primarily argued that this interpretation gave such an increasingly absurdly high annual service charge in the later years of each lease that it could not have been intended. They argued that, properly read, each service charge clause requires the lessee to pay a fair proportion of the lessor's costs of providing the services, subject to a maximum, and it was that maximum, or cap, that was GBP 90 in the first year, and which increased every year by 10% on a compound basis. In other words, the clause should be read as follows "*…the provision of services hereinafter set out* ***up to*** *the yearly sum of Ninety Pounds…*" The phrase "up to" being implied or read into the clause.

The following table illustrates the issue (the inflation figures were not in evidence but were taken from the Bank of England's published figures):

Year	Annual (GBP)	Actual inflation (GBP)
1974	90	90
1980	159	219
1985	257	310
1988	342	350
2000	1,073	557
2012	3,366	794
2072	1,025,004	N/A

A new approach to commercial common sense

The focus of the debate, and the importance of the decision, centres around the limits of the so-called "commercial common sense" (also referred to as "business common sense") approach to the interpretation of contacts. Over the past 45 years, the House of Lords and Supreme Court have discussed the correct approach to be adopted to the interpretation, or construction, of contracts in a number of cases starting with *Prenn v Simmonds* [1971] 1 WLR 1381 and culminating in *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50 (see November 2011 Litigation Review).

When interpreting a written contract, the court has to identify the intention of the parties by reference to "*what a reasonable person having all the background knowledge which would have been available to the*

parties would have understood them to be using the language in the contract to mean", to quote Lord Hoffmann in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38 (see August/September 2009 Litigation Review).

It does so by focusing on the meaning of the relevant words, in their documentary, factual and commercial context. Lord Neuberger (providing the leading judgment in this case) held that that meaning has to be assessed in the light of: (i) the natural and ordinary meaning of the clause; (ii) any other relevant provisions of the contract; (iii) the overall purpose of the clause and the contract; (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed; and (v) commercial common sense; but (vi) disregarding subjective evidence of any party's intentions.

Lord Neuberger emphasised seven factors, which will no doubt form the basis of any subsequent analysis of the commercial common sense approach to contractual interpretation:

First, the reliance placed in some cases on commercial common sense and surrounding circumstances should not be invoked to undervalue the importance of the language of the provision which is to be construed. Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract.

Second, when it comes to considering the centrally relevant words to be interpreted, it is accepted that the less clear they are, or, to put it another way, **the worse the drafting**, the more ready the court can properly be to depart from their natural meaning. However, that does not justify the court embarking on an exercise of searching for, let alone constructing, drafting infelicities in order to facilitate a departure from the natural meaning.

Third, commercial common sense is **not to be invoked retrospectively**. The fact that a contractual arrangement, if interpreted according to its natural language, has worked out badly, or even disastrously, for one of the parties is not a reason for departing from the natural language.

Fourth, while commercial common sense is a very important factor to be considered when interpreting a contract, a court should be **very slow to reject the natural meaning** of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed.

Fifth, when interpreting a contractual provision, one can only **take into account facts or circumstances** which existed at the time that the contract was made, and which were known or reasonably **available to both parties**. Given that a contract is a bilateral arrangement involving both parties, it cannot be right, when interpreting a contractual provision, to take into account a fact or circumstance known only to one of the parties.

Sixth, in some cases, **an event subsequently occurs** which was plainly not intended or contemplated by the parties, judging from the language of their contract. In such a case, if it is clear what the parties would have intended, the court will give effect to that intention. An example is *Aberdeen City Council v Stewart Milne Group Ltd* [2011] UKSC 56, where the court concluded that "any … approach" other than that which was adopted "would defeat the parties' clear objectives", but the conclusion was based on what the parties "had in mind when they entered into" the contract.

Seventh, and specific to leases, reference was made in argument to service charge clauses being construed "restrictively". Lord Neuberger was unconvinced by the notion that service charge clauses are to be subject to any special rule of interpretation.

Having examined the clauses (and their variations) in detail, Lord Neuberger was not persuaded that anything had gone wrong with the wording. He was also far from convinced, given when the leases were entered into, that the original lessee's agreement was commercially far-fetched (though he acknowledged that it had become so). He didn't even think that reading the words "up to" into the clauses made sense since that would render the cap was so high as to be ineffective. He therefore upheld the literal reading of the clause.

But what about the poor tenants?

Lord Carnwath, in the only dissenting judgment, was concerned about the plight of the tenants. He believed the clauses to be "wretchedly conceived" and regarded the consequences of the lessor's interpretation as so commercially improbable that only the clearest words would justify the court in adopting it. He held that the limited addition proposed by the lessees did not do such violence to the contractual language as to justify adopting the alternative reading which led to a result which he felt was commercial nonsense. In this respect, he noted that there appear to be two conflicting elements in the clause. Initially it appears to be aimed at ensuring tenants pay "a proportionate part of the expenses and outgoings incurred by the Lessor". However, it then abruptly changes tack, so that the tenants are obliged to pay an absolute amount which bears no apparent relationship to the costs incurred by the landlord in providing the services which the service charge covers. Further, the two halves of the clause do not appear to have any, or any adequate, conjunctive language, such that the proportionate and absolute elements just sit side by side, without being linked.

COMMENT

For many years, the English courts have moved away from the historic and very strict approach which supposedly used to characterise contractual interpretation. The courts have introduced the "factual matrix" and "commercial common sense" tests, as well as implied terms to cater for cases where a literal reading might otherwise produce extreme or absurd results.

However, "commercial common sense" has a risk of being in the eye of the beholder, and it has been difficult to set useful limits on how and when it might be applied. In this case, recent inflation rates have produced seemingly absurd results for the tenants. However, compounding service charges at 10% annually in 1974 – when some of the leases were first entered into – would equally have resulted in the landlord having to pay considerably more to provide the services than s/he could recover from the tenants who received those services. Viewed in this light, there was nothing inherently offensive to commercial common sense in the construction of the agreement adopted by the majority. Rather, chance meant that the bargain has turned out – so far – to be severely disadvantageous for one side, and highly beneficial for the other. The position could, of course, reverse itself, depending on future inflation rates. Equally, the bargain could have turned out, or could still turn out, to be roughly equal for both sides.

It is notable that Lord Neuberger seems to have concentrated on this element, rather than on the question of the lack of clarity of the clause – in particular, whether service charges were to be set as a "proportionate part" of the costs the landlord incurred, or by virtue of a fixed formula which did not necessarily bear any relation to the landlord's actual costs.

In this sense, it might be said that both he, and Lord Carnwath, found the answer from the part of the clause that they focused their analysis on, but did not necessarily say why one element of the clause should take precedence over another.

For businesses and lawyers, the test set out by Lord Neuberger is likely to help inform when one can stray from the literal words and adopt an interpretation that accords with commercial common sense.

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Criminal

SUPREME COURT CONSIDERS MONEY LAUNDERING OFFENCE UNDER SECTION 328 PROCEEDS OF CRIME ACT 2002

R v GH [2015] UKSC 24, 22 April 2015

The Supreme Court has ruled on the constituent elements of an offence under s328 Proceeds of Crime Act 2002 (**POCA**). The case is unusual in that the arrangements in question began before any "criminal property" for the purposes of s328 of POCA existed.

An individual, "B", established four websites that falsely purported to offer customers cut-price motor insurance. One of the websites was established in the name of AM Insurance and was live from 1 September 2011 to January 2012. B recruited an associate, "H", who opened two bank accounts into which customers from the website paid money during the period in which the website was live, as payment for non-existent insurance cover. This case relates to H and is unusual in that the arrangement began before any "criminal property" existed. The prosecution conceded that H may not have known the details of B's fraud. However, the circumstances in which H was asked to open the bank accounts were such that H must have known, or at least suspected, that B had some criminal purpose. B had already pleaded guilty to a number of offences.

H stood trial at the Old Bailey on the charge of entering into or becoming concerned in a money laundering arrangement contrary to s328(1) of POCA, which states that a person commits an offence if he:

> "*enters into or becomes concerned in an arrangement which he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person*".

At trial, H submitted that he had no case to answer because at the time he opened the bank accounts, thereby entering into the arrangement at issue, no "criminal property" existed. Under s340(3) of POCA, property is "criminal property" if:

> "*(a) it constitutes a person's benefit from criminal conduct or it represents such a benefit (in whole or part and whether directly or indirectly), and (b) the alleged offender knows or suspects that it constitutes or represents such a benefit*".

Under s340(5) of POCA, a person benefits from conduct "*if he obtains property as a result of or in connection with the conduct*".

The following question was referred to the Supreme Court as a point of law of general importance:

> "*Where, by deception, A induces the payment of money to a bank account opened for that purpose by B (pursuant to an arrangement with A to receive and retain that money) then may B commit an offence contrary to s328 of POCA, on the basis that the arrangement to receive and retain money in that bank account can be treated as both rendering the property "criminal property" and facilitating its retention, use or control?*"

The judgment

In order to determine whether H was guilty of an offence under s328, the Supreme Court considered the following four issues:

– Does the commission of an offence under s328 require the property to constitute criminal property prior to the arrangement coming into operation?

– Does the property have to exist at the time when the defendant enters into or becomes concerned in the arrangement?

- Did the sums received into the respondent's account constitute criminal property before being paid into those accounts?
- Was the *actus reus* of the offence committed by reason of the arrangement facilitating the retention, use or control of the money paid into the accounts?

Does the commission of an offence under s328 require the property to constitute criminal property prior to the arrangement coming into operation?

The Supreme Court upheld the Court of Appeal's interpretation of "criminal property" as being property that is already "criminal" by reason of criminal conduct which is separate from the conduct alleged to constitute the money laundering offence itself. In making this decision, the Supreme Court noted that:

> "*a wider interpretation would have serious potential consequences for third parties including banks and other financial institutions. They already have an onerous reporting obligation if they know or suspect, or have reasonable grounds for knowing or suspecting, that another person is engaged in money laundering*".

Does the property have to exist at the time when the defendant enters into or becomes concerned in the arrangement?

As to the question of whether the property has to exist at the time when the defendant enters into or becomes concerned in the arrangement, the Supreme Court again upheld the Court of Appeal's decision that it is irrelevant whether criminal property exists at the time of the arrangement; the key point is that the property is criminal when the arrangement begins to operate on it.

Did the sums received into the respondent's account constitute criminal property before being paid into those accounts?

The prosecution argued that property amounts to "criminal property" if it constitutes or represents a benefit of criminal conduct and, therefore, if there was an underlying chose in action (as in the definition of "property" under s340(9) of POCA) that money paid into the account represented, the money paid would satisfy the definition of criminal property. The Supreme Court did not disagree with the prosecution's reasoning, but stated that the prosecution had failed to identify such a chose in action given that the contracts of insurance were between AM Insurance and the victims of the fraud, rather than with H.

Was the *actus reus* of the offence committed by reason of the arrangement facilitating the retention, use or control of the money paid into the accounts?

The Supreme Court restated the conventional view that the *actus reus* of the s328 offence is entering or being concerned in an arrangement that in fact facilitates the acquisition of criminal property and the *mens rea* required is knowledge or suspicion. By the arrangement H had entered into with B, H had facilitated the retention, use and control of the money by or on behalf of B. The key question for the Supreme Court to consider, therefore, was whether the arrangement fell within s328 on the basis that the money was "criminal property" because it was the proceeds of a fraud. On this point, the Supreme Court distinguished the present case from the leading authority, *R v Geary* [2010] EWCA Crim 1925. In *R v Geary*, the property paid to the defendant remained the lawful property of Mr Harrington who had transferred it to the defendant. The defendant argued that he had been approached in order to help hide the money from Mr Harrington's wife as he was about to become involved in divorce proceedings. The Supreme Court in the present case stated that *R v Geary* was not, therefore, "a case of the defendant holding proceeds originating from a crime independent of the arrangement made between them". In the present case, although the money paid into the accounts was lawfully held by the purchasers of contracts of insurance, it was paid into H's account due to a fraud. As a result, the Supreme Court held that the money became "criminal property" when it was transferred into H's account not because of the arrangement he had made with B, but because the money had been obtained by fraud.

The Supreme Court did not consider it artificial, as the Court of Appeal had, to acknowledge the transformation of previously "clean" money into the proceeds of crime upon receipt of the money in H's account. Accordingly, the Supreme Court allowed the appeal, holding that:

- The Court of Appeal's ruling that B had no case to answer was erroneous.
- The arrangement H had entered into with B was capable of constituting an offence under s328 POCA.

The Supreme Court stated that the same reasoning could be applied to the ss327 and 329 offences, but cautioned that "*the courts should be willing to use their powers to discourage inappropriate use of the provisions of POCA to prosecute conduct which is sufficiently covered by substantive offences, as they have done in relation to handling stolen property*". Accordingly, the prosecution should only add additional counts under the ss327, 328 and 329 offences if there is a "proper public purpose in doing so", such as in cases where it can be proved that a thief concealed what he must have known or suspected was stolen property, but there is doubt as to whether the prosecution can prove that he was the thief himself.

Comment

In practice, the Supreme Court's judgment in *R v GH* is unlikely to affect banks' and other financial institutions' reporting obligations under POCA. In situations where a bank suspects that an account is being opened in which to deposit the proceeds of crime, for example, the results of the bank's existing AML checks would preclude the account from being opened and it is difficult to see how any changes could (or should) be made as a result of this judgment.

The SFO is currently updating the money laundering chapter of its Operational Handbook which, when published, will hopefully clarify the SFO's intentions with regard to the prosecution of money laundering offences in the future. The Supreme Court's decision in *R v GH* suggests that the SFO should avoid prosecuting a money laundering offence where other substantive offences are available. It appears unlikely, therefore, that there will be an overall increase in prosecutions for money laundering offences as a result of the judgment in *R v GH*.

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Employment

EMPLOYER INVESTIGATIONS

James Bowen & ors v The Commissioner of Police for the Metropolis [2015] EWHC 1249 (QB) 1 May 2015

The High Court has ruled on the conflicting interests that arise during an employer's investigations into claims against it, where those allegations concern its employees. Although no duty of care towards the employees was made out on the facts in this case, the case highlights that employers need to be mindful of their employees' interests when conducting investigations into claims and/or deciding how to defend or settle litigation or regulatory matters. This is because the employer could be held to have breached its duty of care to its employees if it does not defend the claim in a manner consistent with the employees' interests.

The case concerned four police officers' claims against the Metropolitan Police Commissioner (the **Commissioner**) (their quasi-employer) for the way the Commissioner handled a claim by a suspected terrorist alleging police brutality by those four police officers. The principles are equally applicable in a commercial context.

The suspected terrorist claimed that the Commissioner was vicariously liable for the officers' torts. No separate claim was brought against the officers, nor did the Commissioner seek an indemnity or contribution from the officers.

At the outset of the suspected terrorist's claim, a meeting was held with the Commissioner and his legal advisers, which the officers attended as witnesses to the claim. The officers alleged that during this meeting they were informed that the claims would be "vigorously defended", that if "special measures" to protect the officers' identity were not forthcoming then they would not be required to give evidence and that the Commissioner's legal team was also acting for and in the officers' interests.

Later, the Commissioner's legal team informed the officers that they were no longer instructed to protect the officers' interests. The Commissioner then proceeded to settle the claim with the suspected terrorist and also provided an admission of liability and an apology for the "gratuitous violence".

Disciplinary charges were brought against the officers near the time of the alleged event with the suspected terrorist, but these were dismissed. After the Commissioner settled the matter with the suspected terrorist, criminal charges were brought against the officers, but a jury acquitted the officers after video-footage came to light which largely supported the officers' version of events.

The officers' claim against the Commissioner

The officers sued the Commissioner for breach of contract and for negligence, alleging that the Commissioner had failed to conduct a competent defence to the suspected terrorist's claim and that he had failed to explain why his legal team had ceased to represent their interests. The officers alleged that a duty of care arose and it was foreseeable that, in the event of breach, the officers might suffer loss and damage to their health.

Jay J dismissed the claims.

Did the retainer between the Commissioner and his legal advisers extend to protecting the officers' interests?

No, the judge held that a decisive factor here was that the officers were not parties to the underlying claim brought by the suspected terrorist and therefore this counted against the existence of an express or implied retainer. Also, the officers attended meetings with the legal team as witnesses, not as clients. Although the outcome of the claim by the suspected terrorist would impact on the officers' reputations, that in itself was not a reason for implying a contractual nexus between the officers and the Commissioner's legal team. In the absence of an express contract of retainer, no contractual nexus existed.

Was it fair, just and reasonable to impose a duty of care on the Commissioner?

No, it was not fair, just and reasonable to impose a duty of care on the Commissioner to the officers in respect of the way in which he pursued the litigation. The officers were not parties to the claim by the suspected terrorist, the Commissioner's lawyers owed a sole duty to the Commissioner, and the Commissioner himself had a "duty" to protect his own interests.

Further, the psychiatric injury alleged by the officers was not made out, in any case. It was foreseeable that anger and distress may have resulted from the manner in which the Commissioner conducted the claim (eg settling the claim, providing an admission of liability and an apology), but not psychiatric injury (as no special vulnerability was pleaded).

Had the officers relied on assurances that their interests would be protected?

No, the officers had no direct interest in the litigation and therefore the comment made in the first meeting that the legal team would protect the officers' interest was not enough to prove reliance. The officers claimed that if they had had a timely warning that their interests were no longer being protected by the Commissioner's legal team, they may have sought joinder as parties. The judge dismissed this as "quite fanciful".

COMMENT

This case serves as a caution to other employers conducting investigations, such as into alleged fraud or regulatory investigations. Although the officers' claims were dismissed, it is clear that employers need to be mindful of their employees' interests when conducting investigations and litigation into claims concerning their employees. This is because the employer could be held to have breached its duty of care to its employees if they do not defend the claim in a manner consistent with the employees' interests. This will be particularly so if the employee is specifically named in the litigation claims (such as a colleague's discrimination claim) or by the FCA in a regulatory investigation.

Companies are advised that "Upjohn" (or Corporate Miranda) warnings should be given at the start of interviews with employees in connection with investigations. Upjohn warnings are where the legal advisers make it clear that they are representing the company and its interests and not the employee or their interests. However, this type of formal warning at the outset of an interview risks unsettling the employee and he or she may decide to withhold information or minimise disclosure.

The Upjohn warning often leads to employees seeking to protect their own interests, such as requesting separate representation, and asking for them to be present at interviews and meetings held in connection with an investigation. However, mindful of the points raised in this case, an employee may also seek to protect their interests further before proceeding with the investigation. This could include employees trying to agree an indemnity agreement with the employer, requiring it to search for evidence in support of the employee's version of events or to reach agreement on the form of any public statement made about the matter.

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Insolvency

LEHMAN BROTHERS "WATERFALL APPLICATION" IN THE COURT OF APPEAL

Lehman Brothers International Europe (in administration) [2015] EWCA Civ 485,14 May 2015

Litigation from the collapse of Lehman Brothers continues to break new ground in English insolvency law. This latest decision of the Court of Appeal both clarifies several aspects of the "insolvency waterfall" (ie the order in which creditors are paid from the assets of an insolvent company) and deals with some unusual issues arising from the insolvency of an unlimited company in the Lehman Brothers group.

Background

In *Re Nortel GmbH* [2013] UKSC 52, [39] Lord Neuberger summarised the order of priority in which creditors are paid from the assets of a company in administration or liquidation:

(1) Fixed charge creditors

(2) Expenses of the insolvency proceedings

(3) Preferential creditors

(4) Floating charge creditors

(5) Unsecured provable debts

(6) Statutory interest

(7) Non-provable liabilities

(8) Shareholders

This order of priority is called the insolvency waterfall. *Re Lehman Brothers International Europe (in administration)* was widely known as the "Waterfall Application" because it raised a number of important issues concerned with the order of priority in which creditors of Lehman Brothers International Europe (**LBIE**), including the principal shareholder Lehman Brothers Holdings Intermediate Ltd (**LBHI2**) which held certain subordinated debt issued by LBIE, would be paid out from LBIE's estate.

Many of the issues raised in the Waterfall Application were relatively untested because, typically, a company's assets run dry before creditors at stage (5) of the waterfall are paid in full. There is nothing left to flow down to stages (6)-(8). However, the LBIE estate will have a surplus after paying all creditors in full at stage (5). As such, the focus has shifted to the lower stages of the waterfall.

Some of the other issues at stake in the Waterfall Application arose from LBIE's status as an unlimited company. This also took the Court of Appeal into waters that were, as Briggs LJ put it, "either uncharted or for which the available charts are very old indeed" because (to mix his judicial metaphor) "the unlimited company has, for the last hundred years at least, been such a rare species".

Currency conversion claim

This aspect of the appeal was concerned with stage (7) of the waterfall. Non-provable liabilities are liabilities of a company in administration or liquidation which either do not fall within the definition of "provable debts" under the Insolvency Rules or which are otherwise barred from the proof process (eg claims arising or lodged after the cut-off date for admitting proofs in an insolvency).

Some of LBIE's creditors were owed debts in foreign currencies but, as creditors in an English administration process, were now to be paid out in sterling using the exchange rate on the date that LBIE had entered into administration, ie 15 September 2008 (the Insolvency

Rules, r2.86(1), see also r4.91 for liquidations).
In economic terms, these creditors suffered a loss where sterling depreciated against the contractual currency post insolvency.

The issue is best illustrated by an example. Imagine a creditor who has a right to payment in dollars and has a claim of USD 150 which is fixed at GBP 100 at the date of the debtor's insolvency (ie using an exchange rate of USD 1.5 to GBP 1). If sterling then depreciates to a rate of USD 1.2 to GBP 1 when the insolvency dividend is paid, then the GBP 100 claim will only be worth USD 120 at the date of payment. In that case, the creditor will have suffered a shortfall of USD 30 as a result of the currency movements in the intervening period.

The question before the Court of Appeal was whether creditors could claim for this shortfall as a non-provable liability.

As Lord Hoffmann noted in *Wight v Eckhardt Marine Mmbh* [2003] UPKC 37, insolvency processes are "*a process of collective enforcement of debts. .... The winding up leaves the debts of the creditors untouched. It only effects the way in which they be enforced*." An insolvency process thus affects creditors' substantive rights only to the extent that they are paid out or in certain defined cases (eg insolvency set-off). In the Waterfall Application, the Court of Appeal judges split on whether the two provisions in the Insolvency Rules that stipulated the use of the sterling exchange rate on the date of a company entering administration or liquidation should be construed as either (i) a procedural insolvency requirement or (ii) a substantive change to the rights of creditors.

The majority in the Court of Appeal held that the relevant provisions of the Insolvency Rules fell into category (i). They noted that both provisions in the Insolvency Rules used the same formula: "*…for the purpose of proving…*". The conversion was therefore for a "*specific limited purpose*" and not intended "*as a substantive permanent alternative of the creditor's contractual rights*".

Lewison LJ gave a strong dissenting judgment: "it is impossible to support than when [the provisions of the Insolvency Rules] were introduced that Parliament intended to split a unitary obligation to pay a sum of money in a foreign currency into two claims, one of which was provable and the other of which was not". The majority's decision bucked the approach of Parliament and the courts in widening the scope of provable liabilities (ie stage (5) in the waterfall) and narrowing the scope of non-provable liabilities (ie stage (7) in the waterfall). It also went against the grain of various official reports (including the Cork Committee) published before the passing of the Insolvency Act 1986 (the **1986 Act**). Moreover, previous authorities suggested that the conversion was not merely procedural but substantively replaced the company's debt.

Post-administration interest

The next issue related to stage (6) of the waterfall. Statutory interest in an administration is payable on debts "*outstanding since the company entered administration*" (r2.88(7)). Statutory interest in a liquidation is payable on debts "*outstanding since the company entered liquidation*" (the 1986 Act, s189(2)). The question was whether, if LBIE were to shift from administration into liquidation, the right to recover interest accrued since September 2008 would be lost.

At first instance, David Richards J held that the right to recover interest would be lost upon a move to liquidation. On a "straightforward reading" of the provisions, statutory interest in a liquidation was only payable from the date that the company entered liquidation. The resulting "*black hole*" would have to be resolved by legislative amendment.

The Court of Appeal disagreed. The right to statutory interest survived the transition to liquidation as the surplus after stage (5) of the waterfall was "burdened" with the "statutory instruction" to pay interest from the date of the earlier administration.

It is worth noting that these provisions of the Insolvency Rules have now been amended to remove this "black hole" but this amendment does not take effect retrospectively so as to cover LBIE's administration.

LBIE's subordinated debt

A large part of LBIE's regulatory capital comprised USD 2.225 billion of subordinated loans from its principal

shareholder LBHI2. LBHI2 was therefore a significant creditor of, as well as a shareholder in, LBIE. The loans were made by way of a standard form agreement referred to in the FSA rules in force at the time that LBIE went into administration in 2008.

There is no policy reason against creditors agreeing to move their debt down the waterfall. The question before the Court of Appeal was simply the extent of the contractual subordination, ie whether LBHI2, as creditor, had agreed that it should be paid out at the end of (or below) stages (5), (6) or (7) of the waterfall. The answer turned on construction of the subordination clauses.

The standard form loan made repayment contingent on LBIE otherwise being able to pay its liabilities. The contractual definition of "liabilities" was extremely wide but LBHI2 submitted that it had only been intended that LHBI2's position as creditor should be moved to the bottom of stage (5) and not out of that stage altogether. However, the Court of Appeal, heavily influenced by the regulatory capital purpose of the loans, held that the debt had been subordinated until creditors at stage (7) had been paid out.

Shareholders' contributions with respect to the waterfall

Under s74(1) of the 1986 Act, when a company is wound up in a liquidation shareholders must contribute to its assets to allow for the payment of its debts and liabilities, expenses of winding up and the "adjustment" of contributions between the shareholders themselves. For historical reasons, these provisions do not apply in an administration. The liability of shareholders in limited companies is limited to the amount unpaid on the shares (the 1986 Act, s74(2)(d)). Liability of shareholders in unlimited companies is, however, unlimited.

LBIE was an unlimited company. Its shareholders were LBHI2 and Lehman Brothers Ltd (**LBL**, together the **Shareholders**), both of whom were limited companies that were also in administration. The question before the Court of Appeal was concerned with the extent to which the Shareholders' liability ran all the way down the waterfall, if LBIE were to move from administration to liquidation. The Shareholders disputed that they were required to make contributions with respect to stages (6) and (7), ie statutory interest and non-provable liabilities. This was, essentially, on the basis that s74 used the word "liabilities" to mean provable liabilities only.

The Court of Appeal rejected this limited reading of "liabilities", noting that liquidators were under a duty to pay a company's non-provable liabilities if possible. Moreover, it was not realistic to suggest that statutory interest was not a liability. The relevant provisions provide "*that statutory interest "shall be" paid. I can see no good reason why a statutory requirement for payment of a sum out of assets of a company to persons entitled to it should not be regarded as a liability of the company*". The Shareholders must therefore contribute with respect to the whole insolvency waterfall if LBIE is placed into liquidation.

The Contributory Rule

The final issue in the Waterfall Application considered the converse position. Could the Shareholders recover anything (including in their capacity of creditors) in LBIE's administration until they had discharged their potential liabilities under s74 (were LBIE to go into liquidation and make a call)?

In liquidations, there is a rule preventing shareholders from proving in the insolvent company's estate until they have discharged their liabilities as contributories under s74 (the **Contributory Rule**). LBIE sought an extension of this rule to distributing administrations. The Court of Appeal regarded this as a "radical extension" and declined to do so. Should LBIE want to resist making distributions to its Shareholders, "all that needs to be done is to put the company into liquidation and thereby enable to liquidator to make a call upon the insolvent contributory. The contributory rule would then disable the insolvent contributory from receiving anything in that liquidation until the call had been fully paid".

COMMENT

This Court of Appeal judgment is to be welcomed. It clarifies the nature of insolvency processes, the residual importance of non-provable liabilities and the scope of shareholders' obligations to contribute to the assets of a company in liquidation. It only overturns David

Richards J's sensible first instance decision with respect to the recoverability of post-administration interest in a subsequent liquidation, which on a practical level is to be commended. After the first instance decision, the creditors stood to lose 8% interest running since 2008 on their provable claims in the event of LBIE entering liquidation on the basis of what was accepted to be a drafting oversight in the Insolvency Rules. Conversely, LBIE staying in administration prevented the insolvency officeholders from making calls on the Shareholders to provide assets to meet all of LBIE's provable debts and accrued statutory interest. It also allowed the Shareholders to prove in LBIE's administration before meeting any potential calls, thereby reducing the assets available to LBIE's other creditors. LBIE's administrators and creditors were therefore left stuck between a rock and a hard place. The Court of Appeal has rescued them from that position.

The most interesting *dicta* in the Court of Appeal decision arose from the split within the court on the question of the currency conversion claim. Though Lewison LJ's position was perhaps the better supported by precedent, the preferable approach is that taken by the majority. Where there remains a surplus of company assets after stages (1)-(6) of the waterfall, as a matter of policy it is right that they are first applied to meet any amounts still owed to creditors as regards non-provable liabilities before any payments are made to shareholders.

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Regulatory

EXTENSION OF TIME REFUSED FOR CHALLENGE OF SETTLED FSA ENFORCEMENT MATTER

Mohammed Suba Miah v Financial Conduct Authority [2015] UKUT 0181 (TCC) (FS/2014/0011), 2 May 2015

Mohammed Miah applied to the tribunal for an extension of time in order to allow him to challenge enforcement action that had been taken against him by the FSA (as it then was) more than six years ago. The tribunal refused to grant this extension of time and emphasised the finality of FSA (now FCA) settlement agreements.

FSA enforcement action against Mr Miah and other parties

In February 2008, the FSA issued a final notice in respect of Mr Miah and imposed a financial penalty of GBP 21,000 on him, as well as a prohibition order, for breaching various provisions of the FSA Statements of Principles and Code of Practice for Approved Persons (**APER**) in relation to the sale of high risk securities to clients.

Several months after the publication of the final notice, the FSA also took enforcement action against the firm that Mr Miah worked for and one of Mr Miah's colleagues at the firm, Baljit Somal. The FSA's enforcement action in these cases related to the same underlying conduct that was the subject of the final notice (the sale of high risk securities to clients). The firm was fined GBP 250,000 and Mr Somal was fined GBP 16,000.

Time limits for referring matters to the Upper Tribunal

Under s133(1) of the Financial Services and Markets Act 2000 (**FSMA**) and the Tribunal Procedure (Upper Tribunal) Rules 2008 (SI 2008/2698), references to the Upper Tribunal must be made no later than 28 days after notice was given of the decision in respect of which the reference is made.

However, r5(3)(a) of the Upper Tribunal rules gives the tribunal a discretionary power to extend the time limit for complying with any of the Upper Tribunal rules. The exercise of a discretionary power under the Upper Tribunal rules requires the tribunal to give effect to the overriding objective of dealing with cases fairly and justly (r2 of the Upper Tribunal rules). This means that, in considering whether to exercise its discretion to extend the time within which a matter must be referred to it, the tribunal should have regard to all the circumstances of a case and undertake a balancing exercise, weighing the respective prejudice to the parties in granting or refusing the application for an extension of time. In particular, the tribunal will consider the following questions (derived from *Data Select Ltd v Revenue and Customs Commissioners* [2012] UKUT 187 (TCC)):

- What is the purpose of the time limit in relation to which an extension is requested?
- How long ago was the delay that led to the request for an extension of time?
- Is there a good explanation for the delay that led to the request for an extension of time?
- What will be the consequences for the parties of an extension of time?
- What will be the consequences for the parties of a refusal to extend time?

While it is not unheard of for the tribunal to grant an extension of time for parties who wish to refer a decision taken by the FCA to it after the 28 day time limit has

expired, the tribunal will only do so if there is good reason for granting an extension.

Mr Miah's application to the Upper Tribunal for an extension of time

In October 2014 (over six years since the final notice was published), Mr Miah applied to the Upper Tribunal for an extension of time to refer the FSA's findings as set out in the final notice and the sanction imposed on him to the tribunal. The rationale for Mr Miah's application was that he felt the FSA had treated him unfairly and had imposed harsher sanctions on him than it had done on the firm and Mr Somal for what was essentially the same underlying conduct.

Mr Miah's reasons for the delay in him making a reference to the tribunal were as follows:

- He was unaware of the possibility that he could refer the FSA's case against him to the tribunal until mid-2012.
- He was in prison between mid-2012 and late 2014 (in connection with a separate matter) and had no internet access or access to materials relating to the FSA's case against him. Prior to that, from the time of his arrest in mid-2009, his bail conditions did not permit him to have access to any electronic material or to communicate by email.
- His reference to the tribunal was made within 14 days of the last steps taken in the context of ongoing county court debt proceedings that had been brought against him as he had failed to pay the financial penalty imposed on him by the FSA.
- The FSA had failed to respond to some of his correspondence sent between 2008 and 2010.

The tribunal rejected these submissions and refused Mr Miah's application for an extension of time on the basis that there "was no good reason, indeed no reason at all, for the substantial and significant delay in making the reference" to the tribunal.

The tribunal also found no evidential basis to support Mr Miah's allegation that he had been treated unfairly and more harshly than the firm and Mr Somal.

In principle, could Mr Miah have overturned his settlement agreement with the FSA?

Prior to the FSA issuing the final notice, Mr Miah signed a settlement agreement with the FSA. By signing the settlement agreement, Mr Miah agreed (among other things) to the publication of the final notice and to waive his rights to refer the FSA's findings against him to the FSA's Regulatory Decisions Committee (**RDC**) and the Upper Tribunal.

Even though the tribunal declined to grant Mr Miah's application for an extension of time, Berner J briefly considered whether Mr Miah would, in principle, have been able to overturn the settlement agreement and refer the FSA's findings against him (as set out in the final notice) to the tribunal.

As a starting point, the tribunal acknowledged that nothing in FSMA expressly prevents an individual who has entered into a settlement agreement with the FSA or the FCA from referring the subsequent enforcement action taken against them by the FSA/FCA to the tribunal. Rather, whether or not a settled FSA/FCA enforcement action may be challenged before the tribunal depends on the wording of and circumstances surrounding the settlement agreement entered into with the FSA/FCA.

Mr Miah argued that his settlement agreement should be overturned for a variety of reasons, including that the settlement agreement was uncertain and imprecise and that the terms of the settlement agreement were unfair to him, meaning that the settlement agreement constituted an unconscionable bargain. All of these arguments were rejected by the tribunal.

Although Berner J stopped short of characterising Mr Miah's attempt to overturn the settlement agreement as an abuse of process, he did conclude that there is, in matters concerning references of FCA decisions to the tribunal:

> "*an interest in the finality of litigation, just as there is on an appeal from a judicial decision… Both parties, and in the context of this application in*

particular the [FCA] *were entitled to assume that matters had been finally settled. There is no basis at all for disturbing that position in the circumstances of this case*" (per Data Select at 37).

Variation or revocation of prohibition orders

Under s56(7) of FSMA the FCA may, on the application of an individual who is the subject of a prohibition order, vary or revoke a prohibition order which has been imposed under s56(1) of FSMA.

As part of his application for an extension of time, Mr Miah also applied to the Upper Tribunal and asked it to vary or revoke the prohibition order that had been imposed on him when the final notice had been issued in February 2008.

The tribunal commented that an application for an extension of time to refer the FSA's findings against him to the tribunal was not the appropriate way for Mr Miah to attempt to request that the FCA vary or revoke his prohibition order. Rather, the tribunal stated that Mr Miah should make an application to this effect directly to the FCA. In the event that the FCA refused to vary or revoke Mr Miah's prohibition order, he could then refer this decision to the tribunal under s58(5) of FSMA.

COMMENT

The facts of this case are quite unusual, not least due to the amount of time that had passed before Mr Miah decided to try and challenge the FSA's findings against him before the Upper Tribunal. However, the tribunal's judgment in this case nonetheless emphasises that:

- The tribunal will generally only grant an extension of the time limit for a matter to be referred to it if there is a good reason for granting an extension, considering the principles set out in Data Select.
- It may be difficult to overturn or challenge the enforceability of an FSA or FCA settlement agreement in practice given the interest in the finality of litigation.

Although the tribunal found that there was no evidence to support Mr Miah's allegation that the FSA had treated him more harshly than Mr Somal or the firm, the tribunal did not comment on what it would have done in the event that Mr Miah had been able to establish that he had been treated more harshly by the FSA than these other parties. It is increasingly common for the FCA to try and take enforcement action against multiple parties in connection with the same case. As a result, this may lead to more individuals trying to claim that the FCA has treated them unfairly on the basis that they have been treated differently or more harshly than others who are also the subject of FCA enforcement action.

In another recent case, Mr Carimjee challenged the FCA on the basis that it was proposing to make more serious findings against him than it had done in respect of another individual, despite the fact that the FCA was seeking to rely on broadly the same evidence against both him and the other individual. In this case, although the tribunal stopped short of indicating that the FCA is bound by its previous decisions, it did emphasise the importance of the FCA being seen to take a consistent approach towards similar cases which rely on broadly the same evidence.

In practice, although subjects of FCA enforcement investigations may remind the FCA of its public duty to act rationally and be consistent in its approach to taking enforcement action, only if subjects of enforcement investigations refer their cases to the tribunal and the FCA's proposed findings against them and other individuals are laid out in public may such arguments be made to their full effect. Otherwise, as was emphasised in this case, if the subject of an FCA enforcement investigation enters into a settlement agreement with the FCA, it is likely to be challenging to overturn this at a later date on the grounds that the terms of the settlement were unfair or harsher than those agreed by other parties.

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SFO SECTION 2 INTERVIEWS: WHEN CAN LAWYERS BE EXCLUDED?

R (on the application of Lords Reynolds and Taylor) v Director of the Serious Fraud Office [2015] EWHC 865 (Admin), 18 February 2015

The High Court has upheld a decision taken by the SFO to prevent lawyers, acting for a company under investigation, from also representing certain employees of that company who were not suspects at their section 2 witness interviews. The SFO's rationale for this decision was that, in the particular circumstances of that investigation, allowing the company's lawyers to attend these witness interviews would prejudice its investigation. Although this case has attracted relatively little publicity, it is likely to have a significant impact for the future conduct of SFO section 2 interviews. This is especially so as we understand that the SFO is intending to amend its policy regarding the attendance of lawyers at section 2 interviews in light of the High Court's judgment.

SFO's policy regarding the attendance of lawyers at s2 interviews

The SFO's policy is contained in its Operational Handbook which states that a lawyer may accompany a person who is required to attend an interview conducted under s2 of the Criminal Justice Act 1987 provided that their attendance *"does not unduly delay or in any way prejudice the investigation*" and "*they understand their role*". The SFO's Operational Handbook also states that lawyers *"acting for companies may ask to be present when an employee is interviewed. This is not always appropriate, as in some cases there may be a conflict of interest between the interests of an employer and employee*". Reference is also made to the Law Society's guidance regarding conflicts of interest.

Background

A company (the **Company**) is the subject of an SFO investigation. As part of its investigation, the SFO compelled three of the Company's employees who are not suspects to attend interviews using its powers under s2 of the Criminal Justice Act 1987 (the **Interviewees**).

The Interviewees advised the SFO that lawyers acting for the Company (the **Company's Lawyers**) would be representing them at their interviews. The SFO informed the Interviewees that they were not permitted to have any legal representation at their interviews. Following representations from the Company's Lawyers, the SFO amended its position to allow the Interviewees to have legal representation but not from the Company's Lawyers. The SFO's rationale for its position was that in the context of the particular investigation they were undertaking, permitting the Company's Lawyers to attend the interviews might risk prejudicing its investigation into the Company. For example, the SFO argued that:

– the Company's Lawyers would be obliged to disclose the contents of the section 2 interviews to the Company, regardless of whether the Interviewees instructed them to do so; and

– the Interviewees may speak with less candour if the Company's Lawyers were present at the interviews.

The Interviewees applied to the High Court for permission to judicially review the SFO's decision not to permit the Company's Lawyers to represent them at their section 2 interviews. The issue to be determined by the High Court was whether the SFO was entitled to refuse the Interviewees' wishes to be accompanied by the Company's Lawyers simply because these lawyers also acted for the Company which is a subject of the SFO's investigation.

High Court judgment: Application for permission for judicial review refused

The High Court refused the Interviewees' application for judicial review and held that:

– there is no common law right to be represented by a lawyer at a section 2 interview;

– the SFO's policy regarding the presence of lawyers at section 2 interviews as set out in its Operational Handbook was lawful;
– the SFO was entitled to rely on its policy in this case in order to exclude the Company's Lawyers from the section 2 interviews; and
– the reasons given by the SFO for applying its policy in this case to exclude the Company's Lawyers from the section 2 interviews were "reasonably and properly open to it".

Practical implications of the High Court's judgment

Overall, the High Court's judgment indicates that interviewees do not have a right to be represented by a lawyer at a section 2 interview or, where legal representation is allowed, an unfettered right to choose which lawyer represents them. However, this case was an application for permission for judicial review which was refused and therefore there was no substantive application. As a result, the High Court's judgment should not be taken as indicating that future decisions by the SFO to refuse to permit lawyers acting for a company under investigation from also representing employees of that company at their section 2 interviews will necessarily be upheld. This case also concerned witnesses who were invited to attend section 2 interviews as opposed to suspects.

However, as the SFO's policy was found to be lawful, this means that the SFO may, in principle, refuse to allow a lawyer to attend a section 2 interview without having to establish that their presence at the interview will prejudice its investigation. It is enough based on the wording of the current policy for the SFO to establish that there is "*potentially a real risk of prejudice to* [its] *investigation*". As a result of this case, we understand that the SFO is proposing to amend the section of its Operational Handbook that relates to legal representation at section 2 interviews to this effect.

In cases where a company's lawyers are not permitted to attend an employee's section 2 interview, this may give rise to practical challenges regarding confidentiality and access to relevant evidence. The issue might be acute in circumstances where the company is itself conducting an internal investigation and has refrained from interviewing its employees at the request of the SFO: the company is kept in the dark about information relevant to its internal affairs including, potentially, the steps that might be necessary to remediate its systems and controls. The SFO typically requires interviewees to keep the contents of their section 2 interview confidential. If the company's lawyers are not permitted to attend an employee's section 2 interview then they and the company may find that they are prevented from having access to important evidence relating to an ongoing SFO investigation. This is an issue that was briefly considered by the High Court in this case – Davies LJ commented that "*there is no obvious bar to the* [Interviewees] *themselves telling* [the Company] *about the contents of the interviews*". As a result, if the SFO is intending to take the stance that a company's lawyers may not attend an employee's section 2 interview, the SFO may need to clarify or amend its stance in terms of what confidentiality restrictions are imposed on those who attend section 2 interviews.

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FORUM SELECTION – SHOULD RECENT DEVELOPMENTS CHANGE YOUR APPROACH?

Wednesday 8 July 2015, 5-30pm − 6.30pm

Presented by: Sarah Garvey, Counsel – Litigation

Karen Birch – Counsel – Litigation

Sarah Garvey and Karen Birch will lead a client seminar on forum selection, considering a number of significant developments in this area, including the EU's ratification last week of the Hague Convention on Choice of Court Agreements.

Registration will take place from 5pm, with drinks and canapés from 6:30pm.

Litigation Review consolidated index 2015

Arbitration

Arbitration agreements and foreign laws that do not give effect to mandatory principles of EU law: *Accentuate Ltd v ASIGRA Inc; Fern Computer Consultancy Ltd v Intergraph Cadworx & Analysis Solutions Inc* (Jun)

Third party bound by arbitration agreement which it never signed: *The London Steamship Owners' Mutual Insurance Association Ltd v The Kingdom of Spain & anr* (Jun)

CJEU potentially opens the back door to court ordered anti-suit injunctions in the EU: *Gazprom OAO* (May)

Arbitration awards: when does an amendment amount to a new award?: *Union Marine Classification Services v The Government of the Union of Comoros* (May)

GBP 200 million e-borders arbitration award set aside: *Home Department v Raytheon Systems Ltd* (**Raytheon I**) and (**Raytheon II**) (Apr)

Company

Corporate attribution, the illegality defence and dishonest directors: *Jetivia SA & anr v Bilta (UK) Ltd (in liquidation) & ors* (Jun)

Competition

Antitrust liability and subsidiary companies: *Tesco Stores Ltd & ors v Mastercard Inc & ors* (June)

Conflict of laws

Jurisdiction clause is exclusive despite it contemplating proceedings in other jurisdictions: *Compania Sud Americana de Vapores SA v Hin-Pro International Logistics Ltd* (Jun)

Resolving inconsistent jurisdiction clauses and limits to *Fiona Trust* presumption: *Trust Risk Group SpA v Amtrust Europe Ltd* (Jun)

Schemes of arrangement and why loan note investors should be wary of governing law amendment mechanisms: *In the matter of DTEK Finance B..V* (Jun)

Ability to litigate in England torpedoed by foreign insolvency proceedings: *Erste Group Bank AG London Branch v J "VMZ Red October" & ors* (Jun)

Competing dispute resolution clauses between settlement agreement and underlying contract: *Monde Petroleum SA v WesternZagros Ltd* (May)

Jurisdiction battle lost and *Fiona Trust* considered: *Deutsche Bank AG London Branch v Petromena ASA* (Apr)

Applicable law for whether a contract has been validly executed by foreign company: *Integral Petroleum SA v SCU-Finanz AG* (Apr)

Resolving potentially inconsistent jurisdiction and arbitration provisions in commercial contracts: *Amtrust Europe Ltd v Trust Risk Group SPA* (Feb/Mar)

Third state jurisdiction clause respected – *Owusu* considered*: Plaza BV v Law Debenture Trust Corp plc* (Feb/Mar)

CJEU rules on jurisdiction in prospectus liability claim: Request for preliminary ruling: *Kolassa v Barclays Bank plc* (Feb/Mar)

Contract

Penalty clauses: a question of context?: *ParkingEye Ltd v Beavis* (Jun)

Contractual interpretation: when can you stray from the strict wording?: *Arnold v Britton & ors* (Jun)

Issuer liability to secondary market investor: disclaimers ineffective: *Taberna Europe CDO II plc v Selskabet (formerly Roksilde Bank A/S) (In Bankruptcy)* (May)

Contractual discretion: how to get it right: *Braganza v BP Shipping Ltd & anr sub nom The British Unity* (May)

Forced sale of security: court considers duties owed by bank*: Rosserlane Consultants Ltd & anr v Credit Suisse International* (May)

Changes to loan notes: good faith not implied*: Dennis Edward Myers & anr v Kestrel Acquisitions Ltd & ors* (May)

Meaning of "material" and "material adverse effect" in termination provision: *Decura IM Investments LLP & ors v UBS AG, London Branch* (Apr)

Netting and set-off under the 1992 ISDA Master Agreement: *MHB-Bank AG v Shanpark Ltd* (Apr)

Access to target's documents post-sale: *Alfa Finance Holding AD v Quarzwerke GmbH* (Apr)

Effect of agent's surreptitious dealing: *Tigris International NV v China Southern Airlines Co Ltd & anr* (Feb/Mar)

Standard of reasonableness in contract with public body: *Wednesbury* not applied: *David Krebs v NHS Commissioning Board (As successor body to Salford Primary Care Trust)* (Jan)

Costs

Part 36 offer taken into account on costs even though beaten at trial: *Sugar Hut Group Ltd & ors v AJ Insurance* (Jan)

Criminal

Supreme Court considers money laundering offence under s328 Proceeds of Crime Act 2002: *R v GH* (Jun)

Money laundering offences apply to conduct occurring entirely outside the UK: *R v Rogers & ors* (Apr)

Disclosure

Application too late for disclosure of bank's regulatory benchmark documentation and training materials in mis-selling claim*: Peniuk & ors v Barclays Bank plc* (May)

Employment

Employer investigations: *James-Bowen & ors v The Commissioner of Police for the Metropolis* (Jun)

Gender pay gap reporting (Apr)

Claim which was time-barred from continuing in the Employment Tribunal may still be pursued in the High Court: *Nayif v The High Commission of Brunei Darussalam* (Jan)

Injunctions

Full and frank disclosure obligation breached but injunction upheld: *JSC Mezhdunarodniy Promyshlenniy Bank & anr v Sergei Viktorovich Pugachev* (Feb/Mar)

Insolvency

Lehman Brothers "Waterfall Application" in the Court of Appeal: *Lehman Brothers International Europe (in administration)* (Jun)

Limitation

Investor's knowledge bars mis-selling claim: *Susan Jacobs v Sesame Ltd* (May)

Contractual warranty claims: when does time begin to run? *The Hut Group Ltd v Oliver Nobahar-Cookson & anr* (Jan)

Effect of cross-border insolvency on contractual time bar: *Bank of Tokyo-Mitsubishi UFJ Ltd v Owners of the MV Sanko Mineral* (Jan)

Procedure

Supreme Court confirms that merits of a party's case are generally irrelevant to enforcement of case management decisions: *Prince Abdulaziz v Apex Global Management Ltd & anr* (Jan)

Public procurement

Public procurement: automatic suspensions to the award of contracts: *Bristol Missing Link Ltd v Bristol City Council* (May)

Review of authority's decision to cancel tender process: *Croce Amica One Italia Srl v Azienda Regionale Emergenza Urgenza* (Jan)

Regulatory

Extension of time refused for challenge of settled FSA enforcement matter: *Mohammed Suba Miah v Financial Conduct Authority* (Jun)

SFO section 2 interview: When can lawyers be excluded?: *R on the application of Lord Reynolds and Mayger v Director of the Serious Fraud Office* (Jun)

What due diligence should fund managers undertake before making an investment? *Alberto Micalizzi v The Financial Conduct Authority* (May)

FCA fines retired accountant for committing market abuse: *Final Notice issued against Kenneth George Carver* (May)

FCA Business Plan 2015/16: Key messages for litigators (Apr)

FCA decision on market abuse overturned: *Tariq Carrimjee v the Financial Conduct Authority* (Apr)

FCA takes enforcement action against compliance officer for being knowingly concerned in a breach of regulatory requirements committed by the firms he worked for (Apr)

New Senior Insurance Managers Regime (Jan)

Service

Commercial Court clarifies test for retrospective alternative service of claim form: *Michael Norcross v Chrislos Georgallides* (Feb/Mar)

Settlement

Fraud will not always unravel a settlement agreement: *Hayward v Zurich Insurance Co plc* (May)

Inter-solicitor email exchange held to amount to a binding settlement of a complex litigation: *Raymond Bieber & ors v Teathers Ltd (in liquidation)* (Feb/Mar)

State Aid

State aid recovery rates ordered against Irish airlines: Case T-473/12 *Aer Lingus Ltd v Commission* and Case T-500/12 *Ryanair Ltd v Commission* (Apr)

Tort

Disclaimer precludes third-party reliance on auditor reports: *Barclays Bank PLC v Grant Thornton UK LLP* (Apr)

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