CLIFFORD CHANCE

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Contentious Commentary

Contract

Faith undermined

The Court of Appeal refuses to imply an obligation not to act capriciously.

It is now trite law that if a contract gives one party a discretion, it will be implied that the discretion must be exercised in good faith and not arbitrarily, capriciously or irrationally. However, it was becoming harder to determine what constituted a discretion for these purposes. Is any contractual right a discretion? Good faith for all?

In *Mid Essex Hospital Services NHS Trust v Compass Group* [2013] EWCA Civ 200, the Court of Appeal sought to place boundaries around the discretionary doctrine. Where a party has to make an assessment or choose from a range of options, taking into account the interests of both parties, there will be an implied term. But where there is a simple decision to exercise or not an absolute contractual right, there will be no implied term. So, for example, if a party has a right to terminate a contract, that is not a discretion for this purpose. The party with the right can therefore exercise or not that right as capriciously as it wants.

Mid Essex is also an implicit riposte to any suggestion that good faith is now universally to be implied into all contracts (see *Yam Seng*, March 2013). The Court of Appeal saw no reason to imply any such obligation into the contract in question, even though it was a long-term contract requiring a close relationship.

Aircraft least

An acceptance certificate for an aircraft is conclusive proof of the aircraft's condition.

When an aircraft is leased by a financier, the lessor's aim is for the lessee to take the risk on the aircraft's condition. Financiers, after all, are not experts of such matters. This risk is passed by, inter alia, an acceptance certificate in which the lessee confirms, following inspection, that the aircraft is in the right condition. However, at first instance in *Olympic Airlines SA v ACG Acquisition XX LLC* [2013] EWCA Civ 369, Teare J took a narrow view as to what an acceptance certificate, together with a conclusive evidence clause in the lease, meant, refusing to hold that it was effective to impose risk as to the aircraft's condition on the lessee. The agreement therefore failed to achieve what the lessor wanted. However, the lessor still scraped home on the facts on the basis of an old-fashioned estoppel.

In the Court of Appeal, Tomlinson LJ gave the first instance judge a lecture on the error of likening aircraft leases to ship charters, the impossibility of being certain as to an aircraft's condition without disassembly and the need to respect the parties' desire for certainty in risk allocation. In the light of that, he held that the acceptance certificate and conclusive evidence clause were sufficient to throw the risk as to the aircraft's condition on to the lessee, without any need to resort to estoppel. Picky linguistic arguments to the contrary were cast aside. The aircraft leasing industry will be relieved.

Contents

Adult entertainment

Bondholders may be paid if they consent to a change in the bonds' terms provided that full disclosure is given.

The issuer of bonds obtained the consent of its bondholders to amendments to the terms by agreeing to pay those who voted in favour a sum of money. This was disclosed and available to all. Was it legal? In *Azevedo v Imcopa Importao, Exportao e Industira de Oleos Ltda* [2013] EWCA Civ 364, the Court of Appeal was under no doubt that the scheme was entirely hunky dory.

The main arguments against were that the scheme was a fraud on the minority or that the inducement meant that those voting in favour were not taking sufficient note of the interests of the class as a whole. The Court of Appeal thought that this was nonsense. All was disclosed. Bondholders who voted in favour got the payment; those who didn't vote in favour forewent the payment. Bondholders had a choice. There was nothing wrong (as there might well have been had there been no disclosure).

The Court of Appeal also commented that the appeal in the more interesting case of *Assénagon Asset Management SA v Irish Bank Resolution Corporation Ltd* [2012] EWHC 2090 (Ch) had been due to be heard with *Azevedo*. In *Assénagon*, an aggressive exit consent scheme was struck down by the courts.

However, the issuer in *Assénagon* went into liquidation, and the liquidator decided to drop the appeal. The Court of Appeal considered that the facts of *Assénagon* were so different that it made no comment of any sort about it.

Isda an answer?

Valuations under the 2002 ISDA Master Agreement are not the same as under the 1992 version.

Lehman's demise was always going to test the ISDA Master Agreement. We had *Firth Rixson*, and now we have *Re Lehman Brothers International (Europe), LBIE v LBF* [2013] EWCA Civ 188, which arguably departs from existing case law.

The starting point is the unusual facts. LBIE and LBF entered into a 1992 ISDA Master Agreement under which, essentially, LBIE passed to LBF the risk on LBIE's derivatives trades with LBIE's clients by LBIE and LBF entering into back to back transactions. The close-out provisions in this Master Agreement were then upgraded to those in the 2002 version. LBIE and LBF also entered into a side letter in which they

Courts

Multiplicity of derivative claims

Double and further multiple derivative claims are not subject to the Companies Act 2006.

A derivative claim may be brought by a shareholder on behalf of a company when there is wrongdoer control of the company such that the company will not itself bring the claim. Derivative claims therefore represent a procedural device to get round the rule in *Foss v Harbottle* (1843) 2 Hare 461, which provides that only a company has locus standi to bring claims for wrongs done to the company. The law on derivative claims was reformed and codified by the Companies Act 2006, which replaced the common law form of the action.

Except it didn't - at least not entirely. Section 260(1) of the Companies Act 2006 defines the scope of the legislative provisions as claims by a member of a company in respect of causes of action vested in the company. But what about multiple derivative claims? These were known to the common law before the legislative intervention, and involve the shareholder of a parent company, rather than of the company itself, bringing the derivative claim on behalf of the company because both company and parent are under wrongdoer control. Has this form of derivative claim been abolished by the Companies Act 2006 or does it remain outside the statutory framework?

In *Re Fort Gilkicker Ltd, Universal Project Management Services Ltd v Ford Gilkicker Ltd* [2013] EWHC 348 (Ch), Briggs J decided that multiple derivative claims were neither abolished by nor subject to the Companies Act 2006. This is, to put it at its lowest, a curiosity. Why should the law on derivative claims be different just because an intermediate company is involved? Why should the procedures to be followed be different? The substance is identical. Nevertheless, those who wish to evade the statutory procedures and restrictions have, potentially, a way to do so. An example of legislative short-sightedness or judicial libertinism.

agreed that, if a transaction between LBIE and a client terminated, the back to back transaction between LBIE and LBF should also terminate, and the settlement amount payable by or to LBIE under the client Master Agreement should become the sum payable to or by LBIE under the Master Agreement with LBF. LBIE therefore passed on to LBF all risk on the transactions.

Things then happened in the wrong order. The Master Agreement between LBIE and LBF terminated automatically on the insolvency of their mutual parent. The close-out provisions in the side letter were not therefore directly applicable, but it was necessary to calculate the sum due on close out of the LBIE/LBF Master Agreement. The question was whether the side letter could be taken into account in calculating the close-out sum as one of the material terms of transactions. It made a difference of $1 billion or so. Briggs J said no, but the Court of Appeal disagreed.

The answer turned on the definition of Close-out Amount in the 2002 Master Agreement. This provides that the sum due is the cost of replacing "(a) the material terms of [the] Terminated Transaction... and (b) the option rights of the parties in respect of that Terminated Transaction ". Material terms were agreed to be any terms that might affect pricing. The side letter affected pricing, but should it nevertheless be ignored because of the "value clean" principle established in *ANZ v SocGen* [2000] 1 All ER (Comm) 682 for the 1992 Master Agreement? The value clean principle is that termination valuations should be made on the basis that, but for the termination, all conditions required for full performance would have been satisfied.

The Court of Appeal considered that the changes to the close-out provisions made in the 2002 Master Agreement were sufficient to remove the value clean principle. The side letter was a material term in that it affected pricing. The wording of the 2002 Agreement therefore required the side letter to be taken into account; an abstract principle derived from the earlier agreement was not enough to overturn that conclusion. The Court of Appeal was comforted by the User's Guide to the 2002 Agreement, which said that there were significant changes to the close-out pricing scheme of the 1992 Agreement.

Few transactions have side letters of this sort. The side letter was material to pricing and, therefore, could reasonably be taken into account. But pricing in factors like a non-standard side letter is difficult. Difficulty was, however, not a sufficient obstacle to striving for the right answer.

Going for a song

A going concern letter to directors does not create a binding obligation.

If a subsidiary's finances are under strain, a parent company will commonly provide a letter of support in order to allow the directors to prepare the subsidiary's accounts on a going concern basis. But are these letters binding on the parent? In *Re Simon Carves Ltd, Carillion Construction Ltd v Hussain* [2013] EWHC 685 (Ch), the judge decided that this is a matter of construction of the letter in question but, in this case (and, probably, in most others), the letters were not binding.

The letters in *Simon Carves* were addressed to the directors of the company, and said that the parent would provide "the necessary financial and business support for [the Company] to ensure that the Company continues as a going concern." The judge thought that there was no consideration for any supposed contract between parent and subsidiary. In any event, the letters were addressed to the directors, not the company, to allow the directors to prepare the Company's accounts on a going concern basis. Even if there was a contract, it was not with the Company.

Parent companies can, therefore, sleep more easily. By indicating support for a subsidiary, they do not take on the subsidiary's debts. Greater insomnia may afflict creditors of subsidiaries in financially straitened circumstances.

Uncertainties resolved

The Court of Appeal implies terms into a contract in order to avoid it failing.

There has been a string of slightly old-fashioned cases (eg *Barbudev*) in which the courts have decided that contracts were too uncertain to be enforced. *MRI Trading AG v Erdenet Mining Corp LLC* [2013] EWCA Civ 156 is a reversion to type. The parties intended to enter into a contract, and the court did everything necessary to give effect to that intention.

MRI Trading involved a settlement agreement. This provided for the parties to enter three further contracts, the terms of which were set out in schedules to the agreement. Two of these contracts were fully performed. Difficulties arose over the third, and litigation ensued. D argued that the third contract was unenforceable because it required the shipping schedule, together with charges for treating and refining certain chemicals, to be agreed. An agreement to agree is unenforceable.

The Court of Appeal was absolutely clear (and rather disparaged the arbitrators who had decided otherwise) that since this was a long-term contract that had been partly performed, great efforts should be made to give effect to the contract rather than allowing it to subside into unenforceability. The court would imply terms that the shipping schedule and the charges should be reasonable, upon which expert evidence could be given.

A commercial solution; the theoretical problems are probably best forgotten.

All at sea

A payment provision is a condition of a contract.

If a contractual term is specified as a condition, breach brings with it the right to terminate the contract and claim loss of bargain damages, ie damages covering the full term of the contract. However, the courts have been reluctant to accept the converse, namely that if a term specifies that breach gives a right of termination, that term must be a condition leading to loss of bargain damages. However, in *Kuwait Rocks Co v AMN Bulk Carriers Inc* [2013] EWHC 865 (Comm), Flaux J came close to this view, but he did so in the rarified area of time charters, which always risks being side-lined as different from the rest of the contractual world.

Kuwait Rocks concerned a clause that gave a right of termination on non-payment, coupled with an anti-technicality clause permitting payment to count as punctual if made within two days of notice of non-payment. Flaux J concluded that this combination meant that payment was a condition of the contract. Non-payment, after the notice, was therefore a breach of condition entitling the innocent party to terminate and claim loss of bargain damages. Probably, however, not the last word on the subject.

Equity

Après moi

A secret profit is held by a fiduciary on a proprietary constructive trust.

Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd [2011] EWCA Civ 347 is a hugely controversial decision and has, as a result, generated lengthy and learned articles by lengthy and learned academics and practitioners both in favour of the decision and virulently opposed to it.

Versailles decided that property held by an errant fiduciary is only subject to a constructive trust conferring a proprietary interest on the principal in two circumstances: if the fiduciary misappropriates an asset belonging to the principal; or if the fiduciary takes advantage of an opportunity that is properly that of the principal. In all other cases, breach of fiduciary duty will still give the principal a claim against the fiduciary, but it will be a personal claim only. In reaching this conclusion in *Versailles*, the Court of Appeal followed existing English authority (*Lister & Co v Stubbs* (1890) 45 Ch D 1) rather than a contrary decision of the Privy Council (*Attorney General for Hong Kong v Reid* [1994] 1 AC 324). Unlike many common law jurisdictions, England has no remedial constructive trusts to offer discretionary proprietary interests when judges see fit.

Jurisdiction

Highland springs

An anti-suit injunction refused for dishonest evidence.

The judgment in *The Royal Bank of Scotland plc v Highland Financial Partners LP* [2013] EWCA 328 indicates, unsurprisingly, that courts do not like being misled. They will extract their pound of flesh from those who traduce them. In *Highland*, this allowed the Court of Appeal to give a wide reading to a jurisdiction clause but then to deprive the clause of one of its prime effects.

The jurisdiction clause gave the English courts exclusive jurisdiction over disputes arising out of or in connection with the agreement. The Court of Appeal considered that this applied not only to disputes between the contracting parties but also to claims brought by one party against employees of the other. C might, therefore, have expected the court to grant an injunction to restrain D from suing C and its employees in Texas.

The Court refused the injunction because those who come to equity must, proverbially, have clean hands, and C's were decidedly grubby. One of C's witnesses, whose conduct was attributed to C, had lied to the court at earlier hearings. The court was not, therefore, prepared to help C, allowing the proceedings to go ahead in Texas in breach of contract. Whether sanctioning this breach of contract by D is a punishment fitting the crime is, however, open to doubt. What will the court do when faced with a claim by C for damages for breach of the jurisdiction clause, a claim that engages a common law right rather than an equitable discretion dependent on good behaviour?

FHR European Ventures LLP v Mankarious [2013] EWCA Civ 17 was an attempt to work out the implications of *Versailles*, subject to the Supreme Court entering the fray, as it must do at some stage. The case involved an agent, D, who was charged with negotiating the purchase of a hotel for investors. This he achieved at a price of €211.5m. Unknown to the investors, D was also to be paid €10m by the seller for bringing about the sale. The issue was whether the investors had a personal claim against D, a fiduciary, for the €10m or a proprietary one.

The Court of Appeal rejected the argument that the money paid to D was paid from the investors' money. When the investors paid the seller, they lost any interest in the money.

But the investors succeeded on the opportunity basis. The Court of Appeal considered that D had exploited an opportunity belonging to the investors in order to make a secret profit. D diverted the opportunity to buy the hotel at the lowest price - the seller was prepared to take a net €201.5m. The profit was therefore subject to a proprietary constructive trust.

But, as the Chancellor recognised, the law in this area is a mess. He observed that equity lawyers tend to favour *Versailles* but common lawyers to dislike it. Ultimately, it requires a policy decision from the Supreme Court. Particularly if that decision is in favour of *Versailles*, it will also require a serious look at a number of opportunity cases in order to make the law coherent - the cases are hard to reconcile with each other let alone with the intentions behind *Versailles*. But that is for another day. As it is, *Mankarious* stretches *Versailles* almost to breaking point.

Wrongs and rights

The court has a discretion to award an account of profits for breach of confidence.

C gave confidential information to its agent, D. C later terminated the agency. D then misused the confidential information, making a profit. What is C's remedy for this breach of confidence?

In *Walsh v Shanahan* [2013] EWCA Civ 411, the Court of Appeal accepted that if D had misused the confidential information while still C's agent, C would almost certainly have been awarded an account of profits. Equity requires a rigorous response to a fiduciary's breach of his obligation of loyalty.

But D wasn't a fiduciary at the material time. In these circumstances, the Court of Appeal considered that the court had a discretion whether to award an account of profits or, instead, damages reflecting C's loss. Equitable remedies are always discretionary, and the objective is to identify the remedy appropriate to the circumstances of the wrongdoing - to make the remedy fit the wrong.

Echoing the contractual cases following *Attorney-General v Blake* [2001] 1 AC 268, the Court of Appeal decided that an account of profits was not suitable. Instead, damages should be the hypothetical fee that D would have had to pay to obtain the confidential information.

More succinctly, accounts of profits are right out of judicial fashion. Courts generally prefer to compensate the wronged party for the loss that party has actually suffered rather than strip gains from the wrongdoer.

Arbitration

Independence has its limits

An arbitration clause cannot exist without an underlying agreement.

Arbitration (and, indeed, jurisdiction) clauses are treated as agreements distinct from the rest of the contract of which they form part: section 7 of the Arbitration Act 1996. As a result, the invalidity of the underlying agreement (eg for misrepresentation) does not mean that the arbitration clause is similarly invalid. An arbitration agreement can only be impugned on grounds that relate directly to the arbitration agreement (*Fiona Trust v Privalov* [2007] UKHL 40), which often makes it impossible in practice to challenge an arbitration agreement.

In *Hyundai Merchant Marine Company Limited v Americas Bulk Transport Ltd* [2013] EWHC 470 (Comm), this point was argued in reverse. The issue was whether the parties had entered into a contract at all; if they had, it contained an arbitration clause. Arbitrators decided that there was a contract and, accordingly, an arbitration agreement allowing them to decide that there was a contract.

D challenged the jurisdiction of the arbitrators on the basis that there was no arbitration agreement. This requires a full rehearing before the court: *Dallah Real Estate v Ministry of Religious Affairs of the Government of Pakistan* [2011] 1 AC 763. However, C argued that the rehearing should only be concerned with issues that went to the validity of the arbitration part of the agreement, not the rest of the agreement. The uncertainties, needless to say, related to the rest of the agreement.

Eder J did not accept this approach. He decided that if the rest of the agreement did not come into effect, the arbitration agreement couldn't do so either. There was no evidence to suggest that the parties intended the arbitration clause to come into effect independently of the rest of the agreement. It all stood or fell as one.

Excluding third party rights

A third party cannot insist on arbitration when relying on an exclusion clause in a contract containing an arbitration clause.

The Contracts (Rights of Third Parties) Act 1999 allows the parties to a contract to confer the benefit of an exclusion clause on a third party. If the contract contains an arbitration clause, can the third party demand that any claims brought against it by contracting parties in tort are pursued by arbitration if the third party wishes to rely on the exclusion clause?

In short, no. In *Fortress Value Recovery Fund I LLC v Blue Skye Special Opportunities Fund LP* [2013] EWCA Civ 367, at first instance Blair J decided that only contractual rights conferred on third parties could be subject to a requirement to arbitrate, not defences. The Court of Appeal rejected that distinction because the Act treats exclusion clauses as if they were rights. This led the Court of Appeal to conclude that it depends upon the construction of the contract rather than on any point of law. A contract could provide that exclusion clauses can only be relied on in arbitration, forcing the contracting party to go to arbitration. That would, however, risk different forums hearing different parts of the same dispute, and was therefore undesirable. As such, plain words would be required to achieve that, and those plain words were not present in this contract.

Courts

French lettres

French defendants are ordered to give disclosure notwithstanding the French blocking statute.

They don't really do disclosure in French litigation. Further, since 1980 France has had a "blocking statute", which makes it a criminal offence to give disclosure in foreign proceedings (though there has only been one known prosecution under this statute). The English court has a discretion to excuse a party from disclosure because of the blocking statute or similar foreign law restraints. Until *National Grid Electricity Transmission plc v ABB Ltd* [2013] EWHC 822 (Ch), there had been four reported attempts by French litigants to escape disclosure because of the blocking statute; all failed. The French defendants in *National Grid* also failed.

The case was a follow-on claim from a European decision that there was an illegal cartel concerning certain electrical equipment. All the other cartelists sued by C gave disclosure, but the French Ds resisted on the basis that an application for disclosure should first be made to the French authorities under the EU's Evidence Regulation. The French Ministry of Justice declined that request in a letter of (in translation) elegant ambiguity. So the case came back to Roth J to decide whether he should order the French defendants to give disclosure even if that would involve a criminal offence in France.

Roth J ordered disclosure. He found it inconceivable that the French authorities would prosecute when the English courts had jurisdiction over the French Ds under an EU regulation (Brussels I) in respect of a claim arising from an established violation of fundamental principles of EU law. He might, more brutally, have said that the English courts had jurisdiction under Brussels I; procedure is a matter for the lex fori; if the French authorities wish to prosecute French people for complying with the laws of a forum before which they have properly been brought, that is a matter for the French authorities but it does not override English procedural requirements. However, judicial comity requires a more sympathetic bedside manner.

Before its time

Solicitors who fund disbursements on CFAs are not liable in costs.

The Jackson reforms have only just come in, but the costs war - by proxy at least - has already begun. Insurers will not in general be able to recover their costs from unsuccessful personal injury claimants because of qualified one-way costs shifting. Who else can insurers get their costs from? Solicitors are an obvious target but, in *Flatman v Germany* [2013] EWCA Civ 278, the Court of Appeal indicated that it would block this route.

The Court of Appeal reiterated that a solicitor can only be liable in costs on one of three bases: wasted costs; if the solicitor acts in breach of duty to the court; or if the solicitor acts outside the normal role of a solicitor, eg in a private capacity or as a true third party funder for someone else. The last ground was the basis in *Flatman*, but what is acting outside the role of a solicitor? Is funding a client's disbursements on a case, with no real hope of getting them back from the client if the case is lost, acting as a solicitor or as a third party funder?

The Court of Appeal considered that the Courts and Legal Services Act 1990 contemplated that a solicitor might fund disbursements. As a result, doing so could not be outside the normal role of a solicitor. Funding disbursements would not, therefore, give rise to liability in costs.

This logic might apply also to damages-based agreements (DBAs, or contingency fee agreements), which solicitors have been permitted to enter into since 1 April 2013. The Act contemplates that solicitors will fund actions on DBAs in return for a share of the proceeds. That must therefore be within the normal role of solicitors. Or does the Act contemplate that solicitors will be doing something that solicitors do not normally do as such, thereby rendering them liable in costs in the same way that commercial litigation funders are liable in costs? The former seems the more likely - and consistent - interpretation, but it gives solicitors a competitive advantage over third party funders. Solicitors and third party funders may, however, be chasing different markets.

Higher costs

A contractual indemnity for costs leads to costs on the indemnity basis. C won in *Deutsche Bank (Suisse) SA v Khan* [2013] EWHC 102 (Comm) and was awarded its costs in the usual way. But the facility agreement on which C's claim was based contained an indemnity from D against "all costs" etc incurred in connection with the enforcement of the agreement. Hamblen J construed this as entitling C to all its costs unless they were unreasonable in amount or had been unreasonably incurred. That is the equivalent of the indemnity basis under the CPR, so that is what the judge ordered. He rejected D's argument that the burden of proof should be on C to prove that its costs were reasonable rather than (as under CPR 44.4(3)) on D to show that C's costs were unreasonable.

Contentious Commentary is a review of legal developments for litigators

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