Contentious Commentary

Contract

Parking the bus

The law on penalty clauses depends upon extravagance and unconscionability.

Argument about penalty clauses has traditionally focused on whether a payment due on breach of contract was higher than the damages that could ever have been awarded for the breach: if so, the clause was condemned as a deterrent against contract breach or in terrorem, and therefore unenforceable as a penalty; if not, the clause was upheld as providing for liquidated damages only. Recent cases have turned the focus towards good faith and commercial justification, but the issues have been similar, as has the judicial reluctance to condemn clauses as penalties (*Makdessi v Cavendish Square Holdings BV* [2013] EWCA Civ 1539, due in the Supreme Court in July, being a notable exception).

In *Parkingeye Ltd v Beavis* [2015] EWCA Civ 402, the Court of Appeal followed the reluctance to condemn a clause as a penalty but, in order to do so, it was forced to find somewhat expanded grounds for its refusal.

The Court of Appeal considered that the underlying reason why courts of equity struck down penalty clauses was that the clauses were extravagant and unconscionable. Clauses would often be considered as such if the sums they required to be paid were out of kilter with contractual damages, and were therefore aimed at deterring breach. However, just because the sum was higher than contractual damages could ever be was not enough on its own to render a clause unconscionable. Other factors could come into play.

Parkingeye itself concerned a car park at a shopping centre in Chelmsford. Signs at the entrance and around the car park stated that shoppers could park free for two hours, after which the fee would be £85. The operator suffered no loss of any sort if a shopper overstayed. Had the shopper left on time, the space would either have been empty or filled for free by another shopper. The parties accepted that there was a contract between the shopper and the operator and that, by overstaying, the shopper was in breach of contract (though the Court of Appeal had some doubts as to whether that was the correct analysis). Was it a penalty?

No. The Court of Appeal recognised that the only function of the payment was to deter shoppers from lingering, in breach of contract, and that the sum in question exceeded contractual damages. However, the Court of Appeal also considered that the clause was justified, not on commercial grounds as between operator and shopper but on more general grounds. It was reasonable to want to discourage shoppers (and, perhaps, non-shoppers) from occupying the car park for lengthy periods.

The Court of Appeal also considered the legal structure on which the car park was operated to be irrelevant. The shopping centre was owned by a pension fund, which had a contract with the car park operator. The operator was remunerated solely through the charges it could extract from over-staying shoppers. The Court of Appeal preferred to ignore the operator and to look at justification in the round.

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Power to the people

No term is implied requiring bondholders of one issue to take into account the interests of holders of another issue.

Where the holders of bonds have the right to vote through changes to the bonds in a manner that binds any dissenting minority, a term will be implied that the power must be exercised in good faith for the purpose of benefiting the class as a whole (eg *Assénagon Asset Management SA v Irish Bank Resolution Corporation Ltd* [2012] EWHC 2090 (Ch)). In *Myers v Kestrel Acquisitions Ltd* [2015] EWHC 916 (Ch), this was accepted, but the case had a complicating feature which made its application more problematic.

The holders of one bond issue could vote to change the terms of their bonds; if so, the issuer could then change the terms of another issue in the same way. The holders of the first bond duly voted to subordinate their bonds to other indebtedness and to extend the maturity dates; the issuer exercised its power to make the same changes to the second bond. What terms will be implied to limit the issuer's ability to make changes to the second bond?

None, according to the judge. Although the two issues were, to an extent, tethered, they remained separate issues. The judge refused to imply any term that required the holders of the first bond to take into account the interests of the holders of the second bond. The documents already included protections for the holders of the second bond, and the judge refused to imply further protections into complex documents. Further, the first bonds were freely transferable, and nothing in the documentation would have alerted buyers to any need to consider the interests of the holders of the second bonds. The tethering was only apparent from the terms of the second bonds.

The judge also refused to imply a term limiting the ability of the issuer to change the terms of the second bond. The documents provided that the issuer "may" make amendments to echo those already made to the first bond. The judge decided that this was not a discretion of the sort that attracted an implied term of good faith and an absence of perversity, arbitrariness and capriciousness (*Socimer International Bank v Standard Bank* [2008] EWCA Civ 116). It did not give C a choice from a range of options, but rather it provided C with an unrestrained contractual right of the sort recognised in *Mid Essex Hospital Services NHS Trust v Compass Group* [2013] EWCA Civ 200.

The judge accepted that the changes made had to be within the scope of the clause, which allowed only "modifications". The overall effect of the changes was to subordinate the notes to other indebtedness and to extend their maturity by eight years. This was a "modification" according to the judge, not something so radical as to cease to be a modification to the existing bonds.

Unsettled law

The falsity of an allegation made in the proceedings does not permit a settlement to be set aside.

C suffers a personal injury for which D admits liability. D pleads that C is fraudulently exaggerating his injuries, but eventually settles the claim. Two years later, C's next door neighbour comes up with stronger evidence that C was indeed exaggerating, and D applies to rescind the settlement agreement on the basis of the fraudulent misrepresentations made by C in his pleadings. Can D succeed?

The obvious answer is no. The claim, including the fraudulent exaggeration defence, has been settled. But in *Hayward v Zurich Insurance* [2011] EWCA Civ 641, the Cour of Appeal decided that the settlement, through a Tomlin Order, created no estoppel per

Insolvency

Property rules

The law of the location of security trumps the law of the location of the insolvency.

20 May 2008: bank accounts in Austria are attached in enforcement of an Austrian judgment against a German company. 4 August 2008: the German company goes into an insolvency process in Germany. 17 March 2009: money in the Austrian bank accounts is paid to the judgment creditor. Under German insolvency law, the liquidator can apply to set aside the payment; under Austrian law, the time period for doing so had expired. Which law applies?

In *Lutz v Bäuerle* (Case C-557/13), the Court of Justice of the European Union decided that Austrian law won. The law applicable to an insolvency (German law) applies to most areas of the insolvency, including rules relating to the voidness etc of prior transactions detrimental to creditors (article 4(2)(m) of the EU's Insolvency Regulation). But an exception is rights in rem, which are governed by the law of the location of the asset, but this is stated not to preclude actions under article 4(2)(m) (article 5). Article 13 then says that article 4(2)(m) does not apply if the person who has benefited from an act detrimental to creditors as a whole can show that the act is subject to the law of another member state and, under that law, there is no means of challenging the act.

The Court concluded that the act in question was the attachment, not the payment, and was therefore a prior transaction. The attachment created rights in rem in an asset located in Austria, which provided the applicable law. The inability to challenge the attachment under Austrian law because of the expiry of the time limit therefore meant that no challenge could be made. Austrian law, not German law, applied, even if the Austrian law was procedural rather than substantive.

rem judicatam and, as a result, that the rescission proceedings could go ahead. The Court of Appeal commented that, to rescind the settlement agreement, D would have to show reliance on the misrepresentations, which, given that D had contested them, would be hard.

The case proceeded, and a judge found that C had exaggerated his injuries to a significant degree. He found that the representations by C in his pleadings had influenced D in reaching the settlement, because of the risk that the judge would believe C, even though D did not itself believe the representations. This influence on C was enough to allow C to rescind the settlement agreement.

So back to a different Court of Appeal ([2015] EWCA Civ 327). This Court of Appeal upheld the settlement agreement, though Briggs and Underhill LJJ were not entirely at one as to why. To rescind a contract for misrepresentation, there must be reliance on the misrepresentation. Briggs LJ considered that merely being influenced by a representation was not enough; some belief in its truth was required. Since D expressly pleaded that the damages claimed by C were exaggerated, D could have had no belief in the truth of the representations.

Underhill LJ's favoured route was that when settling a claim, there is an implied term that a party will not seek to set aside the settlement on the basis of the falsity of the substantive allegations made or that a party does not rely on the other side's allegations when reaching a settlement. However, Underhill LJ considered that the first Court of Appeal's decision blocked him from reaching this conclusion. He therefore decided that, in the circumstances of this settlement, D could not say that it had relied on C's representations. In antagonistic litigation, there is no relationship of reliance.

On the basis of the second Court of Appeal's decision, the first Court of Appeal should never have let the case go ahead. D could never win. The underlying concern for the second Court of Appeal was that, if they had decided otherwise, no settlement of a claim involving fraud would ever be final. One party could always come back with better evidence of the fraud than it had available at the time of the settlement. The policy of finality and encouraging settlement required the avoidance of that result.

If, however, there is no fraudulent element in the claim itself, then a post-settlement allegation that the claim was made fraudulently might be enough to rescind the settlement agreement (*Callisher v Bishoffsheim* (1870) LR 5 QB 449). Likewise an allegation of a misrepresentation that is not an element in the underlying claim. But generally settlements will be final.

Settled views

Reverting to the original claim following breach of a settlement agreement is not a penalty.

A key question in any settlement is whether a failure by D (or whoever) to pay or do whatever is required in the settlement agreement only entitles C to sue for breach of the settlement agreement or entitles C to forget the settlement agreement and revert to its underlying claim. Which is the best option in any particular case will depend upon a whole host of factors but, as a general rule, if a party is prepared to forego its underlying claim in return for a payment of less than the full amount, it is probably better to rely on being able to secure summary judgment on the settlement agreement for any unpaid amounts rather than to revert to original claim, which is presumably not so straightforward given that the claimant was prepared to settle it in the first place. If the agreement provides that non-payment revives the underlying claim, the D effectively has an option to pay the settlement amount rather than an obligation to do so; breach costs D nothing.

But if the agreement allows the parties to revert to the underlying claim on breach of the settlement agreement, is that a penalty clause? The underlying claim will usually exceed the damages payable for breach of the settlement agreement. According to Andrew Smith J in *Novoship (UK) Ltd v Mihaylyuk* [2015] EWHC 992 (Comm) (albeit obiter) the answer is clearly no. But that might not be the case if the clause not only revives the underlying claim but imposes additional obligations too.

Cross-stitch

A misrepresentation to which the Misrepresentation Act 1967 applies does not have to be made by a party to the immediate contract.

Section 2(1) of the Misrepresentation Act 1967 allows a "person [who] has entered into a contract after a misrepresentation has been made to him by another party thereto" to claim damages on the fraud basis (subject to contributory negligence) unless the party making the misrepresentation can show that he was not negligent.

In the normal situation, C claims that D's misrepresentations induced C to enter into a contract with D. But in *Taberna Europe CDO II plc v Selskabet AF1.September 2008* in Bankruptcy [2015] EWHC 871 (Comm) the transaction had an extra limb. C bought from X subordinated notes issued by D, but C bought the notes on the basis of misrepresentations made by D. As a result of buying the notes from X, C ended up in a contractual relationship with D. Is that

enough to bring section 2(1) into play?

Eder J considered that it was. C was induced by D's misrepresentations to enter into a contract with D, albeit that the medium through which this was done required C first to enter into a contract with X. Section 2(1) still applied, according to the judge.

Conflict of laws

Russia calling

The Court of Appeal sends a Russian case to Russia.

In *Erste Group Bank AG v JSC "VMZ Red October"* [2015] EWCA Civ 379, the Court of Appeal decided that since all the relevant events had taken place in Russia, the litigation arising from those events should also take place in Russia. The Court of Appeal refused to allow tortious claims to be pursued in England merely because one irrelevant party had submitted to the jurisdiction of the English courts.

Erste Group involved a claim by a bank against a Russian borrower, D1, which had not repaid loans and, more significantly, against other Russian parties for conspiracy to ensure that D1's assets (all in Russia) ended up out of D1's hands so that D1 would not to be able to repay C. The decision concerned the other Russian parties' challenge to the jurisdiction of the English courts. The only connection with England was that the loan agreement was governed by English law and that D1 had submitted to the jurisdiction of the English courts.

C relied on PD6B, §3.1(3) for jurisdiction over the other Russian Ds. This required C to show that, at the time of the application for permission to serve out, there was a real issue between C and D1 that it was reasonable for the English court to try and that the other Russian Ds were necessary or proper parties to those proceedings.

The Court of Appeal decided that there was no issue between C and D1 that it was reasonable for the English court to try. C had submitted to the jurisdiction of the Russian courts by proving in the insolvency of D1 and, indeed, making various applications to the Russian courts in relation to that proof (*Rubin v Eurofinance SA* [2013] 1 AC 236 and *Stichting Shell Pensioenfonds v Krys* [2014] UKPC 41). It was too late to do an about turn and come to England.

Even if that was wrong, at the time of the application for permission to serve out, D1 had not filed an acknowledgment of service, and C could have entered default judgment. There was no reason why the English court should try the conspiracy claim against D1: the quantum of the conspiracy claim was the same as the debt claim on the loan agreement and, in any event, D1 only had assets in Russia and any enforcement would have to take place in Russia in the context of D1's insolvency proceedings. The court had jurisdiction over D1 because of the jurisdiction clause, but that did not mean that it was reasonable for the court to try the conspiracy claim. Under the overriding objective, litigation between C and D1 on the

Money laundering

Wrong way

Criminal property must be such independently of its laundering.

R v GH [2015] UKSC 24 involved consideration of what is "criminal property" for the purposes of the various money laundering offences under the Proceeds of Crime Act 2002. Criminal property is defined as "a person's benefit from criminal conduct" provided that the alleged offender "knows or suspects that it constitutes such a benefit" (a definition that confuses the distinct concepts of fact and knowledge of the fact). It is an offence, for example, to be concerned in an arrangement that the person knows or suspects facilitates the acquisition, retention, use or control of criminal property by or on behalf of another person (section 328).

The primary question in *GH* was whether the property had to be criminal property aside from the arrangement for its acquisition etc, or whether the arrangement itself could render the property criminal property. The Supreme Court was clear that the former was the case. Money laundering is concerned with the use of dirty money, not with the use of clean money for a criminal purpose. However, the property does not have to exist as criminal property when the arrangement is hatched; it is enough if it is criminal property when the arrangement acts on the property.

The facts of *GH* were that B set up a fraudulent website inviting people to apply for insurance. The monies the intending insureds paid went into bank accounts opened by H. H was accused of an offence under section 328 by being concerned in an arrangement that facilitated B's retention, use or control of criminal property. The Supreme Court rejected the charge. Money laundering offences are parasitic upon other offences. Setting up the bank accounts had not facilitated B's retention of what was already criminal property.

The Supreme Court did, however, note that H had not been charged with facilitating B's acquisition of criminal property. The SC accepted that the money became criminal property at the moment of its payment into H's account because at that point the intending insureds had been defrauded. However, the Supreme Court deprecated the use of money laundering offences in these circumstances. Prosecutors should stick to the underlying substantive offence.

conspiracy claim would have been "pointless and wasteful". The Court of Appeal therefore second-guessed C's commercial reasons for embarking on proceedings in England and, finding them wanting, decided not to hear C's claim.

C also relied on PD6B, §3.1(9), namely claims in tort where the damage was sustained within the jurisdiction or from an act committed within the jurisdiction. The Court of Appeal decided that nothing relevant had happened in England. The real action was all in Russia. Even D1's failure to pay took place in outside England. The payment was due in New York, where the account to which D1 was obliged under the loan agreement to repay the loan were located; C's accounts, in England, to which the agent would pay the monies due to C on receipt of the monies in New York were irrelevant. The torts were not even governed by English law.

Finally, C relied on PD6B, §3.1(20), a claim made under an enactment, in this case section 423 of the Insolvency Act 1986 (transactions at an undervalue). The section is extra-territorial, but there still has to be a sufficient connection with England. The Court of Appeal could see none.

Even if they were wrong about all the above, the Court of Appeal was satisfied that England was not clearly or distinctly the appropriate forum.

The claim in Spain

Even states must take care to avoid submitting to the jurisdiction.

The London Steamship Owners' Mutual Insurance Association Ltd v The Kingdom of Spain [2015] EWCA Civ 333 involves a complicated tale, but ultimately demonstrates that anyone, even a sovereign state, who wants to challenge the jurisdiction of the court must take great care to avoid any steps in the proceedings that might be treated as inconsistent with that challenge.

The case involved an oil spill from a vessel. C was the vessel's insurer. D pursued C in Spain under local laws making insurers directly liable to third parties for the costs of clearing up etc. C accepted that it was directly liable under the international treaty governing the matter but pointed out that the insurance policy contained an arbitration clause. C contended that D could only pursue C in arbitration. D rejected that argument, so C started an arbitration, which D ignored, and secured a declaration of non-liability in its favour on the basis of the "pay to be paid" clause in the policy.

C then applied to register the award as a judgment in England with a view to blocking the enforcement of any judgment that might emerge from Spain. The Court of Appeal concluded that D's claim in Spain was to be characterised as a claim on the insurance policy rather than the exercise of an independent statutory right. As a result, it fell within the arbitration clause in the policy. Accordingly, the English courts had jurisdiction under section 9(1) of the State Immunity Act 1978 (a state's agreement in writing to submit a dispute to arbitration in England) over C's application for registration of the award. The fact that D had not signed anything, even that D was not a formal party to the agreement, made no difference. D was pursing claims under a contract in writing that contained an arbitration clause, and that was enough to signify its consent to arbitration.

The Court of Appeal decided that the English courts also had jurisdiction over D under section 2(3) of the State Immunity Act because D had submitted to the jurisdiction by taking steps in the proceedings other than for the purpose of claiming immunity. The Court of Appeal accepted that the rigour of CPR Part 11 does not apply to states (for non-states, a failure to file an acknowledgment and apply within 14 days to challenge the jurisdiction of the courts constitutes a submission to the jurisdiction). States must actually do something inconsistent with sitting on their sovereign immunity in order to submit to the jurisdiction, but D had done so. D itself had made applications under section 67 of the Arbitration Act 1996 challenging the arbitrator's jurisdiction, as well as under section 72. That was enough to constitute a submission even though D was challenging the jurisdiction of the court at the time.

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