CLIFFORD

CHANCE

CONTENTIOUS COMMENTARY

A REVIEW FOR LITIGATORS

JULY 2017

CONTENTIOUS COMMENTARY - JULY 2017

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Contentious Commentary is a review of recent developments in the English courts

CONTRACT

THE BENEFIT OF TIME

An innocent party's gain following a breach of contract only reduces damages if the gain is caused by the breach.

Globalia Business Travel SAU v Fulton Shipping Inc [2017] UKSC 43 has had a see-saw history. The arbitrator decided one way; Popplewell J reversed him; the Court of Appeal then overturned Popplewell J; and the Supreme Court has now reversed the Court of Appeal. All this suggests an area of law lacking in certainty. Correct. Whether the Supreme Court has succeeded in bringing significantly greater clarity to the area is questionable.

The facts were that in August 2007, the owner of a vessel accepted an anticipatory repudiatory breach by the charterers of a charterparty, which then had two years to run. Damages for the repudiatory breach were prima facie the difference between the charterparty hire rate and the market rate at the time. There was, however, no available market for two year charters on vessels like the one in question, so damages were to be calculated from short term spot rates over the two years.

So far so good. But seeing that there was no market for rather aged cruise liners, the owner decided to cut its losses (though that is not a phrase it would have used) and sell the vessel, which it did for $23,765,000.

Then came Lehman and the GFC. If the owners had sold the vessel at the scheduled end of the charterparty in 2009, it would have obtained a mere $7 million. The question was whether the gain, or avoidance of loss, of $16,765,000 should be brought into account when calculating damages for the repudiatory breach of the charterparty (if so, the losses arising from the breach were extinguished).

The Supreme Court decided that the benefit of the early sale was not to be brought into account in assessing damages. But why not? The Supreme Court took twelve pages explaining what everyone else had said, before delivering its conclusion in a page and a half. Such succinctness did not, however, bring with it a searing certainty.

The Supreme Court started by observing that the fall in value of the vessel was irrelevant to the interest injured by the charterers' repudiation of the charterparty. That sounded as if the Supreme Court would base itself on a difference in kind between loss and benefit. But the Court then said that difference in kind between loss and benefit was not the test because it was too vague and arbitrary. Instead, the test is

> "whether there is a sufficiently close link between the two… The relevant link is causation… The benefit to be brought into account must have been caused either by the breach of the charter-party or by a successful act of mitigation."

But when is a link "sufficiently" close? (Indeed, should the word "sufficiently" be excised from the judicial lexicon?)

The Supreme Court said that the benefit here was not caused by the repudiation. The repudiation caused a loss of hire. It didn't, legally, cause the sale of the vessel, nor would there have been any need for the owner to sell the vessel at the appointed end of the charterparty. The owner made a commercial decision to sell, which had nothing to do with the charterers. The repudiation was the occasion for the sale of the vessel, not its legal cause. Of relevance might also be that if value of the vessel had increased over the two years, the owners could not have claimed that increase in additional damages.

So we are told that causation is key, but we also know that courts have often struggled with causation, regularly resorting to "common sense". The repudiation did cause the sale in the sense that the owner found itself with a vessel no one wanted to charter, so it sold the vessel instead. But that is not sufficient causation for legal purposes.

DISCRETIONARY ZEAL

There is no such thing as a free discretion.

"The Option may only be exercised with the consent of the majority of the board of directors of the Company." Can the majority of the board refuse consent for any reason it chooses, or is its ability to do so constrained in any way?

In *Watson v Watchfinder.co.uk Limited* [2017] EWHC 1275 (Comm), the judge decided that the board's ability to refuse must be constrained. If it were otherwise, the Option would not be a contractual right but only an ability to ask the Company for the benefit of the Option, which the Company would have no obligation to provide. So the judge decided that the Company really had a discretion to decide whether or not to grant the Option, which discretion was subject to the usual requirements of good faith, proper purpose and not acting in a manner that was arbitrary,

capricious or *Wednesbury* unreasonable.

The judge then had considerable difficulty in deciding what factors the board was allowed to take into account in exercising its discretion. He eventually anchored it to a few areas arising from the particular dealings between the two parties, which areas were nowhere apparent from the terms of the contact itself.

More significantly, he decided that the board had never exercised its discretion - it did not think that it needed to do so because it believed that it could agree or refuse for any reasons it liked. Certainly, there was inadequate evidence as to what the board had in fact done.

The parties accepted that if the board had not exercised its discretion, the Court should proceed as if consent had been given. So by failing to exercise its discretion, the Company lost the opportunity to do so.

STANDARD AND DELIVER

The LMA form of facility agreement is not one party's standard terms.

African Export-Import Bank v Shebah Exploration and Production Company Ltd [2017] EWCA Civ 845 has the ring of a certain type of case. Undoubted failure to pay on a loan, leading to acceleration. So the Ds argue that they have a counterclaim that dwarfs the loan, and also that there was an oral variation (rejected by the court as unarguable). But, the loan agreement contains a no set-off clause, so the counterclaim is not, even if arguable, itself an answer to an application for summary judgment on the loan. So the Ds counter that the loan agreement is on C's standard written terms within the meaning of section 3 of Unfair Contract Terms Act 1977 and that the no set-off clause is unreasonable and unenforceable. This begged the question of what standard written terms are for section 3 purposes.

The Court of Appeal said that to be standard terms, there must be evidence that a party "habitually" or "invariably" used the terms for the type of business in question, not that it sometimes did so. Further, the standard terms must exist in prior written form and be intended to be adopted automatically without any significant amendment. If there have been any "substantial" variations - if the standard terms are not "effectively untouched" - the deal won't be on the standard terms. The variations do not even have to be made to the clause in question.

In this case, the facility agreement was based on the LMA's standard form, and the Cs said that they had no standard terms themselves. The Court of Appeal decided that the Ds had not got even close to proving that the Cs had standard terms (the onus being on the Ds to raise at least an arguable case) but, in any event, "substantial" negotiations took place between the parties' lawyers.

The Court of Appeal did not accept the submission that a contract based on the LMA's standard terms could never be on one party's standard written terms: "if a lender habitually used a particular LMA form and refused to countenance any amendment, it would be difficult to say that the deal was not done on the lender's standard business terms." So the door is slightly ajar, but in this case it was hopeless.

PAPER TIGER

A confirming bank under a letter of credit must prove that it has paid.

English case law abounds with judicial comments to the effect that letters of credit deal only in documents and are the life-blood of trade. Short of clear and obvious fraud, an issuer of an LC must pay if the documents presented comply with the requirements of the LC. In *Deutsche Bank AG v CIMB Bank Berhad* [2017] EWHC 1264 (Comm), C sought to extend this approach to one aspect of the relationship between an issuing bank and a confirming bank. The issuing bank must reimburse a confirming bank that has honoured compliant documents and forwarded them to the issuer. C argued that an issuing bank was bound to accept at face value the confirming bank's statement that it had honoured the presentation, and that the issuing bank was not entitled to demand further proof.

Blair J did not accept this. It's not what UCP 600 says (and UCP 600 is applied to virtually all LCs in a manner tantamount to a governing law). The issuer could demand proof of payment, but could not go on a fishing expedition (in this case, via a Request for Further Information), searching for any defence that might be lurking in the undergrowth to save itself from exposure to an insolvent underlying buyer. Blair J was particularly keen to stress that RFIs should not be used for tactical time-wasting but only to enquire into what was strictly necessary.

EXEMPTIONS DOCKED

Neither contra proferentem nor *Canada Steamship* has much, if any, role in commercial contracts.

"Liability for any claim in relation to asbestos is excluded." Seems pretty clear. A claim against consultants for negligent advice on the extent of asbestos on a development site in Barry docks is therefore excluded. And so said the Court of Appeal in *Persimmon Homes Ltd v Ove Arup & Partners Ltd* [2017] EWCA Civ 373.

C's arguments really relied on the courts being willing to read down the exclusion clause in order to limit its effect. So, said C, in context: "for" meant "for causing"; liability for negligence was not excluded; and contra proferentem should lead to the limited interpretation that C wanted. Neither Stuart-Smith J at first instance nor the Court of Appeal was prepared to go down this route.

According to the Court of Appeal,

> "Exemption clauses are part of the contractual apparatus for distributing risk. There is no need to approach such clauses with horror or with a mindset determined to cut them down."

Building on this approach, the Court of Appeal said that to read "for" as "for causing" made no grammatical sense. It also made no sense for a consultant to limit liability only if it caused a problem with asbestos - a very unlikely eventuality - not for failing to identify the extent of an extant problem.

As to contra proferentem, the Court of Appeal said that in relation to commercial contracts negotiated between parties of equal bargaining power, "that rule has a very limited role". And that role did not extend to this case.

With regard to negligence, insofar as the rule (or guidelines) in *Canada Steamship* (ie unless negligence is expressly mentioned, an exclusion clause that could apply to liability in negligence and to liability on some other ground will apply only to that other ground) survives at all, it is more relevant to indemnity clauses than to exemption clauses (ie if a party is to be indemnified for its own negligence, the contract needs to be clear).

So the words meant what they said.

> "The contra proferentem rule requires any ambiguity in an exemption clause to be resolved against the party who put the clause forward and relies upon it. In relation to commercial contracts, negotiated between parties of equal bargaining power, that rule now has a very limited role."
>
> **Jackson LJ**
> *Persimmon Homes Ltd v Ove Arup & Partners Ltd* [2017] EWCA Civ 373, at [52]

PRIVILEGE

OFF PISTE

Litigation privilege follows legal advice privilege down a restrictive route.

When one judge (viz Hildyard J) departs from the path of probity regarding privilege, the response might be a weary sigh. But when a second (viz Andrews J) veers down the same hunched, starless path, and then dashes even deeper into the darkness, one might begin to worry. Still, these two are only first instance judges. Surely the higher courts will sort it out.

Starting with legal advice privilege, in *The RBS Rights Issue Litigation* [2016] EWHC 3161 (Ch) Hildyard J addressed the issue of who is the lawyer's "client" in a corporate context. This is important because only communications between lawyer and client can be subject to legal advice privilege. The Judge concluded that it is not the company as a whole that is the client but only those who actually want the legal advice, a group that, he thought, would comprise a small and high-ranking cadre. The key point is that the company's minions who hold the company's facts that the company's lawyers need to know in order to advise the company will often not be the client. Fact-finding communications between the lawyers and the minions will, as a result, often not attract legal advice privilege.

Hildyard J's approach (which stems from *Three Rivers (No 5)* [2003] QB 1556) undermines the purpose of legal advice privilege. Legal advice privilege exists in order to encourage clients to lay out the full facts to their lawyers so that the lawyers can give proper advice and, by doing so, keep their clients on the legal straight and narrow. Corporations, especially large ones, are limited in their ability to do this, it seems, because the communication of facts known to an employee as a result of that employee's work for the corporation will often not constitute a communication between lawyer and client.

A meagre crumb of comfort from *The Director of the Serious Fraud Office v Eurasian Natural Resources Corporation Ltd* [2017] EWHC 1017 (QB) is that Andrews J conceded that those who want the legal advice might not need to be quite so stratospheric in the corporate hierarchy as Hildyard J might have suggested. Andrews J accepted that, for example, inhouse counsel might be able to act on behalf of others and, in doing so, be either the client or the agent of the client for privilege purposes.

The good news from *Eurasian Natural Resources* ends there. Andrew J was decidedly downbeat about Snowden J's orthodox approach in *Property Alliance Group Ltd v The Royal Bank of Scotland plc* [2015] EWHC 3187 (Ch) that the communication of facts between lawyer and client could be privileged. Andrews J said that even if lawyers report their factual findings to the person who is the client for legal advice privilege purposes, that report will not be privileged unless, it seems, the report includes legal advice, in which case the facts may form part of the *Balabel* continuum of communications between lawyer and client. This seems hard to square with the view of legal advice taken in *Three Rivers (No 6)* [2005] 1 AC 610.

So that leaves litigation privilege as the possible source of privilege for an internal investigation. Litigation privilege applies to communications with third parties. Identifying the client is, therefore, not relevant (indeed, Andrews J took the view that litigation privilege applies only to communications with third parties, with legal advice privilege the only basis for privilege in communications between lawyer and client). In *Eurasian Natural Resources*, Andrews J sought to cut back the scope of litigation privilege. The context was a company that received from a whistleblower an allegation of corruption in a subsidiary. The company was accordingly concerned that the SFO might become interested in its affairs. The company instructed lawyers to investigate what had happened and to advise, including on self-reporting to the SFO in order to reduce any penalty.

Andrews J started with the unexceptionable proposition that litigation privilege applies to documents brought into being for the purpose of the conduct of the litigation. But, she said, only documents that are, effectively, the defence brief – documents created to help fight the case – were prepared for the conduct of the litigation. So, said she, documents brought into existence for the purpose of being shown to the other side (eg a position paper for a mediation) or with the aim of avoiding litigation could not fall within this category because they were not brought into existence for the conduct of the litigation. If they are communications between lawyer and client, they might be subject to legal advice privilege and, if in pursuit of settlement, they might be without prejudice, but litigation privilege evaporates. But Andrews J did accept that advice on settlement, including an accountant's report dealing with quantum, could be

privileged. Quite how these distinctions work is anyone's guess: what if you want to avoid litigation by paying a sum of money? drafts of pleadings shown to a third party?

Then there is the question of when litigation is reasonably in contemplation, an objective test according to Andrews J, though with subjective elements. She concluded that a criminal investigation is not litigation because an investigation is not adversarial (whatever it may feel like). Thus a reasonable contemplation that the SFO might launch an enquiry into a particular matter is not enough to generate litigation privilege. It is only if prosecution as a result of that enquiry is reasonably in contemplation that litigation privilege applies, and a company can only know that prosecution is reasonably in contemplation once it has established sufficient facts to know that it has or might be thought to have done something wrong.

Andrews J observed that prosecutorial authorities (unlike civil litigants) are bound by a strict test that needs to be passed in order to justify a prosecution. Thus criminal litigation is only reasonably in contemplation once an investigation has found evidence that might justify a prosecutor prosecuting. In these circumstances, an assertion of litigation privilege prior to actual prosecution begins to look like an admission of guilt.

Andrews J also decided that the documents in question were not created with the dominant purpose of the conduct of litigation because an investigation is not litigation. But even if that was wrong, Andrews J also thought that the documents were not for the purpose of the conduct of the litigation. They were to avoid prosecution or to be shown to the SFO, not part of the development of the defence.

Generally, the *Eurasian Natural Resources* undermines litigation privilege, and has rightly been condemned by The Law Society. An appeal is, it seems, coming, potentially with organs of the legal establishment seeking to intervene in support. We can only hope the higher courts will restore sanity.

A THORN IN THE SIDE

Without prejudice rule has another exception.

EMW Law LLP v Halborg [2017] EWHC 1014 (Ch) arises from somewhat unusual facts, and may appropriately be confined to those facts, but it is nevertheless potentially concerning as to the scope of the without prejudice rule.

Both parties were solicitors, C acting as the agent for D in litigation. That litigation settled on acceptance of a Part 36 offer, which led to an assessment of D's costs. C subsequently sued D to try to get paid and, in the course of that litigation, sought disclosure of D's without prejudice discussions to settle the costs assessment in the underlying litigation, having alleged that the costs assessment had been settled.

Newey J accepted that the without prejudice protection attaching to communications can be only waived with the consent of both parties to the communications. However, he decided that one party could show without prejudice communications to a third party if he so chose, adding only "at least if there is a legitimate reason for doing so". He said that if it were otherwise, a litigant would be unable to show without prejudice documents to an expert without the other side's consent. If by this Newey J meant that a legitimate reason is the (confidential) pursuit of the settlement, that may be fine. But he failed to define what might be a legitimate reason, potentially leaving it open-ended. It surely cannot be right that one party has free rein in deciding what third parties to disclose without prejudice communications to. That would render the rule on joint waiver redundant.

It is an established exception to the without prejudice rule that without prejudice documents can be considered by the court in order to establish whether or not an agreement has been reached (and also to construe that agreement: *Oceanbulk* [2010] UKSC 44). But that exception has only been applied between the parties to an alleged or actual settlement agreement, who already know what the content of the without prejudice discussions is. In *EMW Law*, Newey J decided that third parties could also obtain without prejudice documents in order to establish whether there was an agreement, as long as the third party had a "legitimate interest" in the outcome of the negotiations. This undermines the once privileged, always privileged approach taken in *Rush & Tompkins Ltd v GLC* [1989] 1 AC 1280, in which without prejudice was accepted as a ground for not disclosing documents to a third party, especially since neither of the parties entitled to assert without prejudice was actually before the court.

Quite where *EMW Law* leaves without prejudice is open to question, but it is one to watch lest the open-ended approach taken by Newey J is seized upon.

PRIVATE INTERNATIONAL LAW

THE FIRST AND LAST NIGHT

The ability to use foreign law to escape an English law contract is very limited.

If the parties choose English law to govern their contract and litigate in England, there are very few rules that allow a foreign law trump card to be played. One such rule, in article 3(3) of the Brussels Convention, is where "all the elements relevant to the situation at the time of the choice are connected with one country only"; if so, the choice of law is without prejudice to the laws of that one country that cannot be derogated from by contract (article 3(3) of the Rome I Regulation is worded slightly differently but is to the same effect).

But what will be enough to remove sufficient elements of a situation from the one country otherwise involved? *Dexia Crediop SpA v Comune di Prato* [2017] EWCA Civ 428, concerned a swap transaction between an Italian local authority and an Italian bank, with payments in Italy. Sounds pretty Italian.

Ma non. The Court of Appeal decided that the fact that the transactions were documented under the ISDA Master Agreement was, pretty nearly on its own, enough to make the situation not connected with Italy only. The Court of Appeal, following *Banco Santander Totta SA v Companhia Carris* [2016] EWCA Civ 1267, decided that it is unnecessary to identify connections with another country; aspects that are not connected with the single country in question can be enough - so something signalling internationalism suffices. Using a form produced by ISDA, a fortiori a form in English, at once introduced an international element rather than a domestic element associated with any particular country.

The Court of Appeal added that non-Italian banks had tendered for the mandate that C won and that C had hedged its swaps with D on the international markets. Hedging was the principal underlying reason given by the Court of Appeal for its very limited view of article 3(3). If you enter one transaction, hedging it with another, any differences between the two laws potentially undermines the hedging. So article 3(3) could not be used to introduce Italian law into an English law transaction.

Comune di Prato is another of the line of cases in which a public authority is trying to get out of a swap that has turned expensive. D argued that the swaps were ultra vires - a matter of Italian law - but the Court of Appeal (deciding the question of Italian law) did not agree. The Court of Appeal observed that foreign law in the English courts is treated as a question of fact, the aim being to determine what the highest relevant court in the foreign legal system would decide if the point came before it. This approach enabled the Court of Appeal in London to disregard a decision by the Court of Appeal of Bologna ("extremely vague, difficult to follow and devoid of any analysis" - not much judicial comity on display there).

But being fact, the Court of Appeal recognised that it was bound by the (English) first instance decision on foreign law, absent obvious error. Foreign law might, however, be treated less factually and more legally if it is common law based. But Italian law is, to an English lawyer, genuinely foreign and, as such, should be left to the first instance

> "In the Palazzo Comunale in the Tuscan town of Prato, there hangs a magnificent portrait by Alessandro Allori of Francesco Datini, better known to English visitors… as the Merchant of Prato. He is depicted in an overgarment of scarlet cloth, the commodity for which Prato was well-known (and indeed pre-eminent) in the Middle Ages. He was himself an elected Councillor of the Comune and is usually regarded as the founder of the City's prosperity. His statue stands outside the Palazzo holding a sheaf of bills of exchange. On the first page of each of his ledgers were the words "In the name of God and of profit", but he left his fortune to the city rather than the church. The Comune di Prato is still in existence as an Italian local authority but one feels that the facts of this appeal would cause the Merchant some dismay…"
>
> *Dexia Crediop SpA v Comune di Prato* [2017] EWCA Civ 428, paragraph [1]

judge in the light of the expert evidence s/he heard. The Court of Appeal should be reluctant to interfere.

Having lost on vires, the local authority relied on mandatory Italian laws, principally the failure to include a cooling off period in the documentation. The Court of Appeal decided that Italian laws were irrelevant to this transaction because article 3(3) did not apply but that, even if article 3(3) had brought Italian law into play, the laws concerned did not apply to this transaction. The local authority therefore had to pay up.

ARBITRAL FRAUD

Enforcement of an arbitration award is deferred until a full trial of an allegation of fraud.

Comity was also in short supply in *Stati v The Republic of Kazakhstan* [2017] EWHC 1348 (Comm), which concerned the enforcement of a Swedish arbitration award. Enforcement was resisted on grounds of public policy. K alleged that the beneficiaries of the award had failed to disclose documents showing that the cost they alleged of building a liquefied petroleum gas plant had been fraudulently exaggerated through the inclusion of overcharging by, and fees paid to, related companies.

Courts in both Sweden and the US had already rejected K's arguments because the fraud - if such it was - did not have a material impact on the award. The alleged overcharging went only to quantum, and the arbitrators had relied to determine the plant's value on a genuine bid made for the LPG plant by an independent third party, not on the underlying overcharging.

Knowles J was "troubled" by the decisions of the two foreign courts, particularly the comment by the Swedish Court that "in a procedure amenable to out of court settlement such as arbitration, it cannot be demanded that a party provide the opposing party with information which speaks against the party's own case". He conceded that the arbitrators had not relied on the alleged overcharging as such. But the bid on which the arbitrators' quantum award rested was expressly made in reliance on information provided by C, which included the alleged overcharging. If the bidder had known of the overcharging, it might have bid less, and thus the fraud was, the judge thought, potentially relevant.

The judge also thought he should not be sympathetic to someone against whom a credible allegation of fraud had been made, particularly in relation to its allegation that the other party could, with reasonable diligence, have found out about the fraud in the course of the arbitration.

Knowles J decided that the decisions by the two foreign courts did not create an issue estoppel or similar because they were decisions on US/Swedish public policy, which is not the same as English public policy.

So the judge concluded that there had to be a trial of the fraud allegation before the award could be enforced in England. Despite the English courts' much vaunted support of arbitration, Knowles J thought that credible allegations of fraud, even if only on quantum, could not be allowed to slip under the radar in that way; they had to be fully ventilated in an English court. An English court should not lend its support to an award possibly tainted by fraud.

HOME FIRES

The amount of an arbitration award can be required as a condition of challenge.

In *IPCO (Nigeria) Ltd v Nigerian National Petroleum Corporation* [2017] UKSC 16, the Supreme Court decided that the courts cannot require the amount of an overseas arbitration award to be paid into court as a condition for challenging enforcement of the award. The New York Convention does not allow this, and it is the New York Convention that governs the enforcement of overseas awards (via section 100ff of the Arbitration Act 1996).

However, in *Erdenet Mining Corporation LLC v ICBC Standard Bank plc* [2017] EWHC 1090 (Comm) (Clifford Chance acting for the successful applicant), the judge decided that section 70(7) of the Arbitration Act 1996 allows the court to order payment in of the amount of a domestic award as a condition for an appeal under sections 67, 68 or 69 of the Act.

The test for making an order under section 70(7) is that the challenge to the award is flimsy or otherwise lacks substance, and that the challenge will prejudice the ability to enforce the award. The first of these tests doesn't require the court to conclude, on a summary judgment basis, that the appeal will fail but only that it is unlikely to succeed or is shadowy. The second test will generally require a risk of dissipation of assets. The fact that the party against which the award was made was a Mongolian company whose reputation may not have been of the best made that rather easier.

COSTS

ONE STOP SHOP

A budget can only be departed from on detailed assessment if there is good reason to do so.

Harrison v University Hospitals Coventry & Warwickshire NHS Trust [2017] EWCA Civ 792 illustrates one of the problems with the Jackson costs budgeting regime. The court sets the budget for a case, which, as *Harrison* decided, can then only be departed from (either upwards or downwards) on detailed assessment if there is good reason to do so (CPR 3.18). In setting the budget the court will only look at the total figures for each phase and will not conduct a detailed assessment in advance, limiting its consideration to whether the budgeted costs fall within the range of reasonable and proportionate costs (PD3E, §7.3). But if a costs budget is likely to be determinative of the outcome of a detailed assessment how can its consideration be such a pale shadow of a detailed assessment? Or perhaps that's a good thing.

In *Harrison*, the Court of Appeal grappled with two issues that have vexed the costs community since budgeting was introduced. The first was whether a costs budget acts as a floor on costs (absent good reason) as well as a cap (again, absent good reason). The Court of Appeal decided that the effect of a costs budget is symmetrical. The paying party does not get two bites of the cherry - first, a cap in the form of the budget, and then the ability to challenge sums within that cap on normal detailed assessment grounds (eg the rates are too high). If the costs claimed are within the budget, then the receiver will be awarded those costs unless the paying party can persuade the costs judge on detailed assessment that there is a good reason why it should not be obliged to pay. This gives both parties a strong incentive to fight a costs budget tooth and nail.

The Court of Appeal's approach places a heavy emphasis on how easy it will be for a costs judge to find a "good reason" to depart from the budget. The Court of Appeal declined to answer that question, save to say that the good reason test offered "a valuable and important safeguard in order to prevent a real risk of injustice". It's not clear whether this means that the test is strict - only injustice will suffice as a good reason - or whether it is loose.

The second issue was whether the same good reason test applies to costs incurred before the budget is approved. The Court said that it does not. Incurred costs are not part of the budget, are not approved by the court, and thus fall outside CPR 3.18. On a detailed costs assessment, the costs judge therefore has a free hand in assessing pre-budget costs (subject to taking into account any comments made by the judge who set the budget: CPR 3.18(c)). This means, for example, that a costs judge could decide that the rates for incurred costs are too high, but would still have to allow those rates for budgeted costs as long as the total claimed was within the budget.

The moral is that budgets must be taken seriously. They are likely to represent what a party will have to pay by way of costs if unsuccessful, and what a party will receive by way of costs if successful. If the aim is to provide certainty to the loser, a budget might achieve that.

I'M STILL STANDING

A cross-undertaking is required as the price for security for costs from litigation funders.

The RBS Rights Issue Litigation [2017] EWHC 1217 (Ch) is a lengthy judgment by Hildyard J on an application for security for costs against the litigation funders of the claimants remaining in the litigation (most claimants had by then settled). The case has many singular features, including the Group Litigation Order and its several liability for costs amongst the numerous claimants, the fact that most of the claimants had settled, the lateness of the application and the high costs involved. Nevertheless, Hildyard J ordered a commercial litigation funder to provide security in respect of some of the forecast costs for the period after which the claimants the funder was funding were the only ones still standing.

Perhaps a little benevolently, he declined to order security from another funder which, whilst not acting solely to keep sweet the waters of the well of pure justice, was not entirely commercially driven either. He seemed to think that whether they had anticipated that they might be ordered to put up security was a relevant factor in his discretion.

More interestingly, the funders adopted with unsurprising enthusiasm the judge's own suggestion that D should be required to provide an undertaking in damages as the price for obtaining security from a litigation funder. It's not entirely clear what this would cover. If the security was provided by depositing cash, the loss would presumably be the return the funder

could have obtained by using the money elsewhere, which might be pretty hard to prove. However, expect funders now routinely to seek such an undertaking.

But it doesn't matter in *The RBS Rights Issue Litigation* because the case has now settled in its entirety.

SECURED FUNDING

After the event insurance may, or may not, be enough to escape security for costs.

There is an increasing volume of case law about whether after the event insurance can provide sufficient evidence, for security for costs purposes, that a claimant will not be unable to pay costs if it loses or, if there is reason to believe that the claimant will be unable to pay costs, whether an ATE policy can provide adequate cover. Two recent cases show that the answer is "depends", but with a slightly sceptical approach to ATE insurance. *Newwatch Ltd v Bennett* [2016] EWHC 3506 (Comm) and *Catalyst Managerial Services v Libya Africa Investment Portfolio* [2017] EWHC 1236 (Comm) both involved fraud claims, and in both the ATE policy was rejected as inadequate. The reasoning included that if the claimants went insolvent, the defendant would just be an unsecured creditor and, if the claims failed, it was not implausible to suggest that the insurers would reject cover on grounds of fraud.

INSURANCE CONFIDENTIAL

Getting hold of an insurance policy remains hard.

Potential claimants often want to get hold of their potential defendants' insurance policy to find out if the defendants are good for the money. English courts have seldom been sympathetic because an insurance policy will not be relevant to the substantive issues between the parties (eg *XYZ v Various* [2014] EWHC 4065 (QB)). Claimants must take their defendants as they find them.

A new ruse was tried in *Peel Port Shareholder Finance Company Ltd v Dornoch Ltd* [2017] EWHC 876 (TCC). It too failed. C sought pre-action disclosure from the insurer under CPR 31.16 on the basis that if C sued the insured and won (as, it said, it was sure to do), the insured might go insolvent, in which case C would have a claim against the insurer under The Third Parties (Rights Against Insurers) Act 2010 for which the insurance policy would be relevant.

Jefford J rejected the insurer's argument that the use of CPR 31.16 was impermissible because it would circumvent the disclosure regime in Schedule 2 to the Act. The Act is expressly without prejudice to other rights to obtain information. But the judge then decided that because English courts have always refused to order disclosure of insurance policies, he should exercise his discretion in that same way. Just because an insured might become insolvent if the claim succeeded was not sufficient reason to change judicial policy.

EQUITY

SURPLUS TO REQUIREMENTS

Foreign currency shortfalls cannot be claimed in an insolvency.

LBIE's "insolvency" is unusual because it has a huge surplus – indeed, it is barely an insolvency at all now. With this rare situation come issues as to how monies in the estate are to be distributed that insolvency law seldom has to face, with many parties prepared to fight hard and long to expand their share of the unexpected largesse. The Supreme Court's solution to one aspect of *LB Holdings Intermediate 2 Ltd v Lehman Brothers International (Europe)* [2017] UKSC 38 was to increase the surplus still further, perhaps by as much as £2.5 billion.

The Supreme Court addressed some abstruse elements of insolvency law (eg about contributories – themselves rarer still since most companies are limited liability), but it also looked into whether there are "non-provable claims" for currency shortfalls, which, if they exist, rank below statutory interest but above shareholders. These claims arise because foreign currency debts are converted to sterling on the date (in LBIE's case) of the administration. If sterling devalues between that date and the date of distribution - and it did - the creditor will not recover in full in the currency in which payment should have been made. Can creditors claim for the shortfall?

The Supreme Court, reversing both the first instance judge and the Court of Appeal, concluded that these currency claims do not exist. The Insolvency Rules require conversion of foreign currency debts on the date of the administration, and require calculation and payment of dividends based on the converted amount. Nowhere do the Insolvency Rules provide for foreign currency claimants to receive any more, and it is not open to the judiciary to invent new claims. The Insolvency Rules are a complete code in this regard (though not in all others).

The effect of this decision is to remove a not insignificant tranche of claims, thus making more money available to creditors further down the waterfall, eg subordinated creditors and shareholders. Those who bought LBIE's subordinated debt for a song a few years ago are laughing. There are, however, at least two further instalments of Lehman "Waterfall" litigation that could reach the Supreme Court as these parties seek to reduce further the claims of those higher up the insolvency waterfall.

The Supreme Court also considered one aspect of subordination, approaching it purely as a matter of contractual interpretation – how much subordination was intended (here, slotting in between statutory interest and shareholders). Not so long ago, there was legal concern as to whether subordination was possible at all. That concern seems now to have vanished – at least as long as the contractual terms don't try to do something impossible (eg to rank above statutory interest but below non-provable liabilities, when the statutory waterfall puts those two claims the other way round).

SHAREHOLDER POWER

The rule against reflective loss does not block specific performance.

The rule against reflective loss means that shareholders cannot recover losses suffered by the underlying company. Where the shareholder is a party to a contract under which obligations are owed to the company, the position becomes harder. The shareholder has its own cause of action for breach of contract because it is a party to the contract, but what remedy can it obtain? In *Latin American Investments Ltd v Maroil Trading Inc* [2017] EWHC 1254 (Comm), Teare J decided the shareholder could obtain specific performance of an obligation owed to the company. In this case, the alleged breaches involved failure to pay a sum due to the company and also breach of (fiduciary?) duty to the company. Teare J decided that there was no objection to the shareholders obtaining specific performance of the payment obligation and also of an account of sums due to the company.

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