WATSON FARLEY
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DISPUTE RESOLUTION BRIEFING

INTERNATIONAL COMMERCIAL DISPUTES

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CONTENTS

NOTE FROM THE EDITOR

Welcome to the latest edition of WFW's International Commercial Disputes Briefing, in which we reflect on a number of significant cases in relation to international commercial litigation and arbitration from the courts of England and Wales.

In this edition we consider decisions concerning the enforcement of foreign arbitration awards and the effect of judgments made by the supervisory courts in relation to such awards; the use of disclosed documents in separate proceedings and the latest position on applications for relief from sanctions; whether credit should be given for benefits resulting from a breach of contract; and whether a bribe received by an agent will be held on trust for its principal. We also consider a recent WFW win regarding the payment provisions under the 1992 ISDA Master Agreement.

We hope that you find this briefing useful and would welcome any comments that you have. If you would like to discuss any of the matters raised in the briefing, please feel free to contact me or your usual contact at Watson Farley & Williams.

Andrew Savage – Head of Dispute Resolution, London

ARBITRATION

"…THE ENGLISH COURT HAS REINFORCED ITS PRO-ARBITRATION STANCE IN A DECISION WHICH SHOULD BE WELCOMED BY THE INTERNATIONAL ARBITRATION COMMUNITY."

Will the court enforce an arbitration award which has been set aside by the supervisory court?[1]

Although an arbitration award will usually be final and binding on the parties, it may still be possible to apply to the supervisory court to challenge the award. In England such challenges may be made on the basis that the tribunal did not have substantive jurisdiction; that there was a substantial irregularity affecting the tribunal, the proceedings or the award; or, unless the parties agree otherwise, on a point of law. However, where an award is set aside by the supervisory court, the question arises as to whether it can still be enforced in other jurisdictions. That issue was considered in the recent decision of *Yukos Capital SARL v OJSC Oil Company Rosneft*.

The case concerned four arbitration awards in favour of the claimant which had been made by a tribunal seated in Russia. However, the awards had been annulled by the Moscow Arbitrazh Court. Nevertheless, the claimant sought to enforce the awards in England under the common law and the New York Convention. The principal sums awarded eventually came to be paid, but the English proceedings continued with the claimant seeking post-award interest. The English court noted that, at common law, a foreign award can be enforced provided it is made in accordance with a valid agreement to arbitrate and is final and binding according to its governing law. The awards in this case were, therefore, *prima facie* enforceable. However, the defendant contended that as a result of the Russian court's annulment decisions, the awards no longer existed in a legal sense and therefore could not be enforced by the English court as "nothing comes of nothing" (*ex nihilo nil fit*). It was therefore necessary to determine whether the English court had to recognise the Russian annulment decisions.

The judge noted that, under conventional English conflict of law principles, it is possible for a party to contend that no effect should be given to a foreign judgment on the basis that it was obtained by fraud, that it would be contrary to public policy to enforce the judgments, or that the judgments were obtained in breach of the rules of natural justice. It would be unsatisfactory and contrary to principle for the English court to be bound by a foreign judgment which offended against such basic principles and in this case the claimant had contended that the annulment decisions should not be recognised for just those reasons. The judge therefore held that there was no *ex nihilo nil fit* principle which precluded the enforcement of the awards, commenting that his conclusion accorded with earlier judicial comments on the issue, including statements in *Dallah Estate and Tourism Holding Company v The Ministry of Religious Affairs of Government of Pakistan* (2009) (in which WFW successfully represented the Government).

This was a judgment on a preliminary question and, as the court acknowledged, if the claimant failed to prove at trial that no effect should be given to the Russian annulment decisions on principles of honesty, natural justice or public policy, the English court would recognise those judgments and refuse to give effect to the arbitration awards. However, in holding that there is no principle that, because the supervisory court has annulled or set aside an arbitration award it will automatically be unenforceable in another jurisdiction, the English court has reinforced its pro-arbitration stance in a decision which should be welcomed by the international arbitration community.

[1] *Yukos Capital SARL v OJSC Oil Company Rosneft* [2014] EWHC 2188 (Comm)

Will a foreign court's finding that an arbitration award is not binding give rise to an issue estoppel?[2]

Meanwhile, the recent case of *Diag Human Se v Czech Republic* considered the question of whether a finding by a foreign court that an award is not yet binding will give rise to an "issue estoppel" in English enforcement proceedings.

Under English law an issue estoppel will generally prevent a party reopening an issue which has already been litigated and determined in subsequent proceedings between the same parties to which the same issue was relevant. The decision of a foreign court can give rise to such an estoppel, provided that the foreign court is recognised under English private international law as a court of competent jurisdiction, its decision was final and conclusive and was "on the merits". In this case the claimant sought to enforce a Czech arbitration award in England. However, the defendant contended that the award should not be enforced as a "review" process had not concluded and so it was not yet binding, and that since the Austrian courts had already determined this question in its favour, there was an issue estoppel between the parties preventing the claimant from reopening the issue.

"UNDER ENGLISH LAW AN ISSUE ESTOPPEL WILL GENERALLY PREVENT A PARTY REOPENING AN ISSUE WHICH HAS ALREADY BEEN LITIGATED AND DETERMINED IN SUBSEQUENT PROCEEDINGS BETWEEN THE SAME PARTIES TO WHICH THE SAME ISSUE WAS RELEVANT."

The judge accepted that special caution is required before a foreign judgment can be held to give rise to an issue estoppel. However, he did not agree with the claimant that an issue estoppel could not arise in relation to applications to enforce in England. Although questions of arbitrability and of public policy may be different in different states, and a foreign court's decision not to enforce an award on public policy grounds will not ordinarily give rise to an issue estoppel in England, that did not mean that a decision that an award is not binding could never give rise to an issue estoppel. The judge went on to hold that such an issue estoppel did arise in this case, and that therefore the claimant's application to enforce the Czech award should be set aside.

Although in *Yukos Capital SARL v OJSC Rosneft Oil Co* (2012) the Court of Appeal proceeded on the basis that an issue estoppel could arise in relation to an application to enforce an arbitration award, on the facts of that case it was held that no such estoppel arose. The decision in *Diag Human Se* is therefore significant in finding that an estoppel did preclude enforcement. Where parties have a choice of where to enforce their award and there is a risk that the award will not be considered binding, they should therefore consider carefully where to bring enforcement proceedings, in order to avoid the risk of an estoppel arising.

[2] *Diag Human Se v Czech Republic* [2014] EWHC 1639 (Comm)

BRIBERY

"…BOTH PRACTICALITY AND PRINCIPLE SUPPORTED THE CLAIMANTS' ARGUMENT THAT A BRIBE RECEIVED BY AN AGENT WOULD BE HELD ON TRUST FOR THE PRINCIPAL."

Will a bribe received by an agent be held on trust for his principal?[3]

Where an agent receives a benefit in breach of his fiduciary duty to his principal, the agent is obliged to account to the principal for such a benefit and to pay a sum equal to the profit by way of equitable compensation. In some cases, however, the law also provides that, where an agent acquires a benefit which came to his notice as a result of his fiduciary position, the agent is to be treated as having acquired the benefit on behalf of his principal so that it is beneficially owned by the principal and a proprietary remedy can be sought. Now, after several years of legal debate, the Supreme Court has held that this rule also applies where the benefit is a bribe or secret commission obtained by an agent in breach of his fiduciary duty to his principal.

In *FHR European Ventures LLP & Ors v Cedar Capital Partners LLP* the claimants had purchased the issued share capital in a company which owned a long leasehold interest in the Monte Carlo Grand Hotel for €211.5 million. The defendant had acted as the claimants' agent in negotiating the purchase and accordingly owed them fiduciary duties. However, the defendant had also entered into an "exclusive brokerage agreement" with the vendor which provided for it to be paid a fee of €10 million following a successful conclusion of the sale. The claimants brought proceedings to recover the €10 million, contending that the defendant had not made proper disclosure to them of the brokerage agreement. At first instance it was held that the defendant was liable to pay such sum to the claimants, but the court refused to grant the claimants a proprietary remedy in respect of the monies. However, the Court of Appeal disagreed, declaring that the defendant received the €10 million fee on constructive trust for the claimants absolutely. The defendant appealed.

The Supreme Court considered that both practicality and principle supported the claimants' argument that a bribe received by an agent would be held on trust for the principal. This verdict would be consistent with the fundamental principles of the law of agency, had the merit of simplicity and certainty and aligned the circumstances in which an agent is obliged to account for any benefit received in breach of his fiduciary duty and those in which his principal can claim the beneficial ownership of the benefit. The Court observed that it would be paradoxical if a principal whose agent wrongly received a bribe or secret commission was worse off, because they would only have a claim for equitable compensation in relation to that benefit, than a principal whose agent had obtained a benefit in less opprobrious circumstances, where the principal would have a proprietary claim. Further, the objectionable nature of bribes and secret commissions meant one would expect the law to be particularly stringent in this area. Although it was accepted that the previous authorities on the issue were inconsistent, taken as a whole they favoured the claimants' case, and the Supreme Court considered that a wrong turn had been taken in two Court of Appeal decisions which had gone the other way.

This significant decision by the Supreme Court means that it will now be more straightforward for claimants seeking to recover monies from fiduciaries who had received bribes or secret commissions, particularly in the event of the fiduciary's insolvency, where the ability of the claimant to seek a proprietary remedy means it will be afforded priority in relation to monies paid by way of bribery over unsecured creditors.

[3] *FHR European Ventures LLP & Ors v Cedar Capital Partners LLP* [2014] UKSC 45

CIVIL PROCEDURE

“THESE CASES DEMONSTRATE THAT THE COURTS RECOGNISE THE IMPORTANCE OF MAINTAINING THE RULES AGAINST COLLATERAL USE OF DISCLOSURE DOCUMENTS.”

Can documents disclosed in one set of proceedings be used in another?[4,5]

One of the cornerstones of the English litigation process is disclosure. However, the courts acknowledge that compulsory disclosure involves an invasion of a person’s right to keep their documents to themselves. As a result, the common law, and more recently the rules on civil procedure, have limited the ways in which such documents can be used by the receiving party. These limits have recently been considered by the English courts in a number of different cases.

In *IG Index Ltd v Cloete*, the defendant had brought a claim against his former employer before an employment tribunal. In the course of that dispute he disclosed copies of confidential documents belonging to the employer which he had originally provided to the Information Commissioner in relation to his concerns about data security. Although despatch of the documents to the Information Commissioner may have been legitimate, retention of the copies by the defendant for the purposes of the employment proceedings was not. The employer therefore brought separate High Court proceedings seeking delivery up of all confidential information belonging to it from the defendant. At first instance it was held that, as the High Court proceedings were brought on the basis of documents which had been disclosed in the employment proceedings, the High Court proceedings were an abuse of process and should be struck out. On appeal it was accepted that the rules on collateral purpose applied and prevented the confidential documents, information derived from them, or indeed the provenance of such documents, being used in subsequent proceedings without the employee's consent or the court's permission. However, the Court of Appeal considered that permission to use the documents should have been granted. The failure to seek permission at the outset was neither deliberate nor reckless, and had permission been sought it was clear it would have been given. It was wrong therefore to characterise the whole action as an abuse of the process of the court of sufficient gravity to justify striking it out.

Meanwhile, in *Tchenguiz & Ors v The Serious Fraud Office*, the applicant sought permission to use certain documents which had been disclosed in English proceedings by the Serious Fraud Office in proceedings before the Guernsey Court of Appeal. The judge, carrying out a balancing exercise to determine where the interests of justice lay, recognised the applicant’s interest in seeking to deploy the documents in the Guernsey proceedings, as well as the potential relevance of those documents to the proceedings. However, he noted that the documents in question related to a criminal investigation carried out by the Serious Fraud Office and there was therefore a very strong public interest against permitting the use of such documents for collateral purposes. That public interest was fortified by the fact that the documents related to the interaction and cooperation between the SFO and the relevant Guernsey authorities pursuant to a specific request from the SFO for mutual legal assistance, and the fact that permitting documents of this kind to be used for a collateral purpose potentially jeopardised the willingness of foreign states to cooperate in respect of similar criminal investigations in the future. Permission to use the documents in the Guernsey proceedings was therefore refused. This decision has recently been upheld by the Court of Appeal.

These cases demonstrate that the courts recognise the importance of maintaining the rules against collateral use of disclosure documents. However, there is some flexibility to those rules, and the court may decide to give retrospective permission

[4] *IG Index Ltd v Cloete* [2014] EWCA Civ 1128
[5] *Tchenguiz & Ors v The Serious Fraud Office* [2014] EWHC 2597 (Comm) and *Tchenguiz v Director of the Serious Fraud Office & Ors* [2014] EWCA Civ 1409

for the use of disclosed documents where justice so requires.

What assets will the standard form freezing order cover?[6]

Freezing orders play a vital role in the conduct of commercial litigation, enabling a party to stop their opponent from dissipating assets until a claim can be brought and judgment enforced. A standard form freezing injunction is provided by the courts and can be modified as appropriate. Although the order will typically cover assets belonging legally or beneficially to the respondent, including bank accounts, shares and immoveable property, in the recent case of *Lakatamia Shipping Company Ltd v Nobu Su & Ors* an issue arose as to whether the standard form will also cover assets of companies where the defendant is 100% shareholder.

A claim for nearly $50 million had been made against the defendant, Mr Su, and a worldwide freezing order was obtained in support of that claim. The freezing order was largely identical to the standard "narrow" form freezing injunction, which omits additional wording in the definition of assets designed to catch assets of which the defendant has legal but not beneficial ownership. However, a question arose as to whether certain companies, which Mr Su was a shareholder in, could still use their assets in any way that their directors saw fit. At first instance it was held that Mr Su effectively controlled and indirectly owned the companies which owned the relevant assets, such that they were covered by the definition of assets in the order. The companies appealed.

"…TO EXTEND THE SCOPE OF THE STANDARD FORM ORDER TO ASSETS OF COMPANY WHICH THE DIRECTOR OR SHAREHOLDER DOES NOT HAVE A BENEFICIAL INTEREST IN WOULD REQUIRE ADDITIONAL WORDING…"

On appeal it was accepted that Mr Su was not entitled to procure a diminution in the value of his shareholdings and thus, it was held, he was restrained from procuring the company to make a disposition likely to result in such a diminution. For practical purposes that was likely to mean that dispositions other than in the ordinary course of business were enjoined by the freezing order. The debate was thus a little unreal. However, given the fact that a freezing order attracts penal consequences, it was important that the basis upon which such an order was made was capable of being clearly understood. The Court of Appeal therefore emphasised that although the first instance judge had reached the correct decision, his reasoning could not be supported. It was not correct to say that the companies' assets were plainly and intendedly within the definition of assets in the order. They were not – they were only "covered by" the order because dealing with them had the potential to diminish Mr Su's shareholdings in the companies. However, to extend the scope of the standard form order to assets of company which the director or shareholder does not have a beneficial interest in would require additional wording, even if the director is a sole director or the shareholder is a 100% shareholder in the company.

This is a useful decision which further clarifies the limits of the standard form freezing order and emphasises that parties should give proper consideration to whether it may be appropriate to vary that wording. However, it is important to remember that any amendments to the standard form will need to be pointed out to the court when applying for a freezing order, and parties will therefore need to be ready to justify the change. Given that in this case in effect the standard form freezing order covered the risk of dissipation, parties may therefore decide that they do not need to go any further.

[6] *Lakatamia Shipping Company Ltd v Nobu Su & Ors* [2014] EWCA Civ 636

How willing are the courts now to grant relief from sanction?[7]

Since the decision in *Mitchell v News Group Newspapers* (2013) (see the previous edition of this newsletter) set out a strict new approach to be adopted in relation to court orders and directions the courts have been inundated with applications for relief from sanction. This was the cause of immense consternation within legal profession, with concern that the courts were no longer interested in seeing justice done between the parties, and instead were taking an excessively prescriptive stance. Now, in *Denton & Ors v TH White Ltd & Ors*, the Court of Appeal has revisited its previous judgment and clarified the approach to be taken.

This matter involved three conjoined appeals relating to applications for relief from sanction under CPR 3.9. In the first case a generous approach was adopted to late witness evidence being permitted which resulted in a trial being adjourned. However, in the other two cases a more strict approach was taken and relief was refused, leading to the second claim being struck out due to a court fee being paid late and recoverable costs being limited in the third as a result of a 45 minute delay in filing a costs budget and a further failure to comply with an order requiring the claimant to notify the court of the outcome of negotiations. The Court of Appeal, accepting that although the guidance set out in *Mitchell* remained substantially sound it had been misunderstood and misapplied by some courts, set out a new three stage test to be adopted when considering an application for relief from sanction:

“THE COURT OF APPEAL … SET OUT A NEW THREE STAGE TEST TO BE ADOPTED WHEN CONSIDERING AN APPLICATION FOR RELIEF FROM SANCTION.”

1. The court should identify and assess the seriousness and significance of the relevant failure to comply and not, as was previously suggested, its “triviality”. If the breach is neither serious nor significant, the court is unlikely to need to spend much time on the second and third stages.

2. The court must then consider why the default occurred. The Court of Appeal endorsed the examples it had given in *Mitchell* of good and bad reasons for a failure to comply.

3. Finally, the court should evaluate "all the circumstances of the case”, so as to enable it to deal justly with the application, including the need for litigation to be conducted efficiently and at proportionate cost and the need to enforce compliance with rules, practice directions and orders. An application will not automatically fail simply because there is a serious or significant breach for which there is no good reason.

Applying this test, the Court of Appeal considered that all the claims had been determined in error. In the first claim the judge had been too lenient, given that the trial date had to be vacated, and relief should not have been granted. In the second claim, although the failure to pay the court fee on time was serious, it was near the bottom of the range and had not prevented the litigation being conducted efficiently and at proportionate cost. Finally, in the third claim, the delay in filing the cost budget was neither serious nor significant and although the failure to notify the court was a factor which could be taken into account at the third stage of the test, that was also neither serious nor significant and could not turn the earlier breach into something worse than it originally was.

It is to be hoped that the Court of Appeal’s refreshed guidance will end the tide of satellite litigation that *Mitchell* appeared to have promoted and the conflicting decisions that arose as a result. It should also encourage parties to take a more cooperative approach to litigation. However, the Court of Appeal has certainly not undone everything it set out to do with *Mitchell*, and parties will therefore

[7] *Denton & Ors v TH White Ltd & Ors* [2014] EWCA Civ 906

still need to ensure that they comply, as far as possible, with rules and deadlines, and where they are unable to do so, to do something about it as soon as they can.

COMMERCIAL

When will the court make a "no access order" under the Companies Act 2006?[8]

"THERE IS A STRONG PRESUMPTION IN FAVOUR OF SHAREHOLDER DEMOCRACY AND A POLICY OF UPHOLDING PRINCIPLES OF CORPORATE TRANSPARENCY AND GOOD CORPORATE GOVERNANCE…"

In general, companies are required to keep a register of their members showing various details, including member's name and address. Because persons other than the company may have a legitimate interest in accessing that register, if, for example, they wish to seek support from other members to requisition a general meeting, statute has conferred a right to inspect and take copies of it. However, there was evidence that some individuals were abusing this right and seeking information in order to harass members and accordingly, under section 117 Companies Act 2006, a company can now obtain a court order preventing access if the request fails a "proper purpose" test. In the recent case of *Burry & Knight Ltd & Anr v Knight* the Court of Appeal considered the application of that test for the first time.

Dr Knight was a former director of the applicant companies and continued to be a shareholder in both. He had various historic complaints about the conduct of the companies' businesses concerning events in the 1980s and 1990s, which he had been pursuing on and off since the 1990s, making numerous serious allegations about other directors. In 2012 he sought copies of the register of members. The companies obtained a "no access order" under the Companies Act and Dr Knight appealed.

The Court of Appeal considered that the words "proper purpose" should be given their "ordinary, natural meaning" and ought generally, in the case of a member, to relate to the member's interest in that capacity and/or to the exercise of shareholder rights. The Court held that the onus is on the applicant company to demonstrate that the request is for an improper purpose on the balance of probabilities, and so it is not enough that the purpose is capable of being, or may possibly be, an improper one. There is a strong presumption in favour of shareholder democracy and a policy of upholding principles of corporate transparency and good corporate governance, which point in favour of the court exercising its discretion to make a no access order "sparingly and with circumspection" where requests are made by shareholders to communicate with fellow shareholders.

However, in this case the Court of Appeal agreed that, in so far as Dr Knight sought access to the share registers in order to pursue his long standing allegations about conduct with other shareholders, his purpose was not a proper one. Although certain other "purposes" given by Dr Knight to justify his access to the register were not so improper, it was further held that, insofar as multiple "purposes" were put forward, the right approach was to make a no-access provision order if any one of the purposes was improper. The no access order

[8] *Burry & Knight Ltd & Anr v Knight* [2014] EWCA Civ 604

was thus upheld. However, Dr Knight was permitted to communicate indirectly with his fellow shareholders by the means of an agreed form of letter to be circulated by the companies.

Companies have just five working days to apply for a no access order following a request for access to the register. It is therefore important to ensure that appropriate steps are taken to identify whether a request is made for a proper purpose and, if the company considers it is not, to apply to the court as quickly as possible. However, as this case demonstrates, there is a strong presumption in favour of transparency and the court will not make such an order lightly.

Where is a company's place of "central administration"?[9]

The question of where to bring proceedings can often be a difficult issue, particularly in the context of complex corporate structures where subsidiaries and parent companies are located in different jurisdictions. Under the Brussels I Regulation (EC 44/2001) the general rule is that a party domiciled in an EU member state shall, regardless of their nationality, be sued in the courts of that member state. Article 60 of the Regulation provides that a company is domiciled at the place where it has its statutory seat, its central administration or its principal place of business. In the recent decision in *Young v Anglo American South Africa Ltd & Ors*, the Court of Appeal examined what was meant by "central administration".

"THE CLAIMANT CONTENDED THANT, EVEN THOUGH AASA'S REGISTERED OFFICE WAS IN JOHANNESBURG, THE NEGLISH COURT HAD JURISDICTION TO HEAR THE CLAIM…"

The dispute concerned a clinical negligence claim arising out of the alleged acts and omissions of doctors working at the Jwaneng Mine Hospital in Botswana when the claimant was born, for which it was accepted AASA was vicariously liable. The claimant contended that, even though AASA's registered office was in Johannesburg, the English court had jurisdiction to hear the claim as there was a good arguable case AASA's place of "central administration" was England, since its ultimate parent company was an English company with its head office in London.

The Court of Appeal considered it was clear that Article 60 was drafted so that a company may have three different locations of domicile for the purposes of the Regulation and that the three specified attributes were to be differentiated. The statutory seat is the domicile for the purpose of the internal laws of the state where the company is incorporated, and will usually be identified in its Memorandum and Articles of Association or equivalent; the principal place of business is the place where the company does its principal "business", which must be a question of fact in each case; and the central administration had to be different in kind from the other two, although its location may be the same as one or both. Applying the same meaning that has been given to the expression "central administration" in the Treaty on the Functioning of the European Union, the Court of Appeal concluded that the correct interpretation was the place where the company concerned, through its relevant organs according to its own constitutional provisions, takes the decisions that are essential for that company's operations, or where it conducts its entrepreneurial management.

It had thus been correct to concentrate on the factual position relating to AASA itself rather than its parent company and to search for the place where AASA itself made the decisions that were essential for its business. Once that point was appreciated the place of central administration was obvious, since none of the evidence indicated AASA carried out any function in England – it did all its

[9] *Young v Anglo American South Africa Ltd & Ors* [2014] EWCA Civ 604

business in South Africa. Although its parent company, based in London, plainly guided and even heavily influenced the decisions taken by AASA's board, that did not alter the position. The appeal was thus dismissed.

The Court of Appeal accepted that if, in a particular case, a holding company has usurped the functions of the organs of its subsidiary, it may be arguable that the central administration of the subsidiary is where the parent makes those decisions on the subsidiary's behalf. Nevertheless, in this case there was no suggestion that there had been such an usurpation and the case demonstrates that, save in extreme circumstances, it is unlikely that a foreign subsidiary will be at risk of English proceedings merely because its parent is domiciled here.

Should credit be given for a benefit obtained following a breach of contract?[10]

"…THE SEARCH FOR A SINGLE GENERAL RULE WHICH DETERMINES WHEN A WRONGDOER OBTAINS CREDIT FOR A BENEFIT FOLLOWING BREACH OF CONTRACT IS ELUSIVE."

Contract damages are intended to put the innocent party in the same financial position as if the contract had been performed. However, a party can sometimes end up better off as a result of a breach than they would have otherwise been, and in these circumstances the English court has held that it may be necessary to give credit for such benefit against the recoverable loss. The recent decision in *Fulton Shipping Inc of Panama v Globalia Business Travel SAU (formerly Travelplan SAU) of Spain* considered this issue in the context of a repudiated charterparty.

The claimant was the owner of a small cruise ship which was chartered to the defendant. However, shortly before the redelivery date in 2007 a dispute arose as to whether the parties had reached an agreement to extend the charterparty for a further two years. The defendant insisted that no agreement had been made and so the vessel was redelivered in 2007 and sold on by the claimant, which then brought a claim for loss of profits. In arbitration it was held that an agreement had been reached but that the claimant had to give credit for the difference between the amount for which the vessel had been sold in 2007, and the significantly lower value of the vessel in 2009, when she would have been redelivered if the defendant had not been in breach. This was more than the claimant's loss of profit claim, and meant that no damages were recovered. The claimant brought an appeal under section 69 Arbitration Act 1996.

The High Court noted that the search for a single general rule which determines when a wrongdoer obtains credit for a benefit following breach of contract is elusive. However, whether approaching the question as one of mitigation of loss or measure of damage, it will generally be necessary to show that the benefit was caused by the breach, rather than merely providing the occasion or context for the innocent party to obtain the benefit. Thus benefits flowing from a step taken in reasonable mitigation of loss will only be taken into account if and to the extent that they were caused by the breach and where the benefit arises from a transaction which the innocent party would have been able to undertake irrespective of the breach, that is suggestive that the breach was not sufficiently causative of the benefit. The Court added that, whether a benefit is caused by a breach is a question of fact and degree which must be answered by considering all the relevant circumstances and although causation between breach and benefit is generally a necessary requirement, considerations of justice, fairness and public policy may also have a role to play. In particular, the Court considered that even when benefits are caused by a breach they will not fall to be taken into account where it would be contrary to fairness and justice for the wrongdoer to be allowed to appropriate them for his benefit.

In this case the Court considered that the claimants were not required to give credit for any benefit in realising the capital value of the vessel in 2007 by

[10] *Fulton Shipping Inc of Panama v Globalia Business Travel SAU (formerly Travelplan SAU) of Spain* [2014] EWHC 1547 (Comm)

reference to its capital value in 2009. The difference in the value of the vessel was not caused by the defendant's breach of the charter but rather by the fall in the market flowing from the financial crisis, which occurred irrespective of the breach. At the moment of breach, the claimants had a choice whether or not to sell the vessel, as they had at any stage over the unexpired period of the charterparty. The breach merely provided the context or occasion for the claimants to realise the capital value of the vessel, they were not obliged to do so, either as a matter of fact or law.

As the High Court recognised, the question of whether a benefit is caused by a breach is a question which must ultimately be answered by considering all the relevant circumstances. Nevertheless, the Court's guidance on the factors to be considered when determining whether the benefit could reduce the measure of damages is helpful and should assuage the concerns of innocent parties looking to mitigate their losses upon a breach of contract.

FINANCIAL

What is a debenture?[11]

The term "debenture" is commonly used, particularly in a finance context, to describe a document executed in favour of a creditor which provides a charge over the debtor's assets by way of security. However, it has been accepted that the term can apply more broadly to a document which either creates a debt or is an acknowledgment of indebtedness. In the recent case of *Fons Hf v Corporal Ltd & Anr* the Court of Appeal went one step further in holding that a loan agreement was itself a debenture.

"…WHILST THERE IS NO HARD AND FAST DEFINITION TO BE ATTACHED TO THE WORD DEBENTURE, AS A MATTER OF LANGUAGE THE TERM CAN APPLY TO ANY DOCUMENT WHICH CREATES OR ACKNOWLEDGES A DEBT."

Fons had lent monies to Corporal under the terms of two shareholder loan agreements (SLAs). Subsequently Fons entered into a legal charge with Kaupthing Bank under which it agreed to charge in favour of the lender "shares" defined as "all shares … and also all other stocks, shares, debentures, bonds, warrants, coupons or other securities now or in the future owned by the Chargor in Corporal from time to time or any in which it has an interest." Both Kaupthing and Fons went into liquidation and the benefit of the charge came to vest in Pillar Securitisation Sarl, which contended that the definition of shares, and in particular the words "debentures" and "other securities", encompassed the rights of Fons under the SLAs.

The Court of Appeal noted that, whilst there is no hard and fast definition to be attached to the word debenture, as a matter of language the term can apply to any document which creates or acknowledges a debt. On this basis the Court noted that the SLAs would be debentures as they comprised, in each case, a written instrument which created and thereby acknowledged the relevant debts owed by Corporal. However, the fact that such an unsecured loan agreement may fall within a possible meaning of the word "debenture" did not necessarily mean it was an available meaning, still less the correct meaning, in the specific instance. It would rather lead the informed observer to ask whether there was anything in the charge or the relevant background which required the loan agreement to be given a narrower meaning.

The Court therefore turned to consider whether the words "other securities" limited the meaning of "debentures". In this case the parties accepted that the

[11] *Fons HF v Corporal Ltd & Anr* [2014] EWCA Civ 304

word "security" could mean both a debt or claim, the payment of which is secured by a charge or guarantee, and a more general term for describing investments. The Court also noted that the word can also be used to describe an instrument which merely indicates or acknowledges a debt. In this case the Court considered that there was no reason why the reasonable observer should regard the reference to "other securities" as limiting "debentures" to a meaning which would exclude the SLAs. Once it was clear from a reading of the charge that they did not have to include a charge over Corporal's assets, the reasonable observer would, in the Court's view, have read "debentures" as having its ordinary meaning of an acknowledgement of debt recorded in a written document.

In finding that the loan agreements in this case were debentures and thus covered by the charge entered into by Fons, the Court of Appeal took a robust approach which some have found surprising and which may potentially have significant and unintended implications for the regulation of entities involved in lending under the Financial Services and Markets Act 2000. Although some commentators have highlighted the fact that the circumstances of the loans in this case differed from those of a typical banking loan, and that the Financial Conduct Authority has stated that it does not consider the Court of Appeal's judgment has altered its interpretation of the relevant regulatory perimeters, the decision is nevertheless an important one which should be carefully considered.

How do you determine what should be paid following Early Termination under a 1992 ISDA Master Agreement?[12]

The 1992 ISDA Master Agreement sets out two different mechanisms which the parties can specify should be used in the event of Early Termination to determine the sum to be paid on close out. Parties can either opt to use "market quotation", which, in the event of an Event of Default, requires the non-defaulting party to obtain quotations for replacement transactions on the Early Termination Date; or to use the "loss" method, which requires the non-defaulting party to determine total losses and costs or gains in connection with the agreement reasonably and in good faith. In *Lehman Brothers Finance SA (in liquidation) v Sal Oppenheim Jr. & Cie. KGAA*, in which WFW acted for the successful claimant, the Commercial Court examined the operation of these mechanisms.

"…THE COURT CONFIRMED THE MARKET VIEW THAT … MARKET QUOTATIONS MUST BE "LIVE" AND FIRM, RATHER THAN HISTORIC OR RETROSPECTIVE."

The parties had entered into a series of put and call options by reference to the Nikkei 225 Stock Average Index which were governed by an English law 1992 ISDA Master Agreement. The options were automatically terminated early as a result of the claimant's parent company, Lehman Brothers Holdings Inc, filing for Chapter 11 bankruptcy protection in the United States. The parties had elected to use the market quotation measure under the agreement to determine what would be payable in such circumstances. However, in this case the Japanese stock markets were closed for a national holiday on 15 September 2008 (the Early Termination Date) and did not reopen until the next day. The defendant, as the non-defaulting party under the agreement, determined the amount to be paid following Early Termination, but the claimant contended that the figure was wrongly calculated, and that the "quotations" the defendant had purportedly obtained were no more than valuations of the transactions as at 12 September.

The Commercial Court held that in such circumstances the market quotation should be determined by obtaining quotations on the next available date, rather than looking to valuations of the options prior to the early termination date. In reaching this decision the Court confirmed the market view that such market quotations must be "live" and firm, rather than historic or retrospective. Notably, the Court also rejected attempts to extend the "value clean" principle by

[12] *Lehman Brothers Finance SA (in liquidation) v Sal Oppenheim Jr & Cie. KGAA* [2014] EWHC 2627 (Comm)

disregarding the effect on the market of the event of default and termination in valuing the options, holding that there was no purpose in extending the principle since, whether the market goes up or down after an event of default, the non-defaulting party will pay or receive a sum which equals the gain or cost of entering into the replacement transactions.

The Commercial Court also dismissed the defendant's attempts to argue that the loss measure should operate instead of the market quotation measure, holding that the evidence indicated a market quotation could have been determined on 16 September and there was no evidence that market quotation would not produce a commercially reasonable result. However, even if loss applied it was plain that a reasonable good faith determination of loss did not extend to a determination of loss prior to the Early Termination Date but only to that date or a date as soon as reasonably practicable thereafter.

The Commercial Court's decision in this case confirms the market view on the operation of these mechanisms but is nevertheless significant in providing clear guidance on the steps that the non-defaulting party must take in calculating close out amounts under the 1992 ISDA Master Agreement.

In what circumstances can a bank be restrained from making payment under a letter of credit?[13]

The vital importance of letters of credit to international trade has consistently been recognised by the courts. So much so that, provided documents presented to the paying bank conform to the formal requirements of the letter of credit, the court will not normally intervene to stop payment, irrespective of any commercial disputes between the parties to the underlying transaction. However, there is an exception to this principle where fraud is involved. The nature of the fraud exception was recently considered by the Privy Council in the case of *Alternative Power Solution Ltd v Central Electricity Board & Anr*.

"…AN INJUNCTION SHOULD ONLY BE GRANTED TO RESTRAIN A BANK FROM PAYING UNDER A LETTER OF CREDIT WHERE THE FRAUD EXCEPTION APPLIES AND THE BANK IS AWARE OF THE FRAUD."

APS had successfully tendered to supply light bulbs to CEB and an irrevocable letter of credit was issued by Standard Bank as the means of payment. Although the contract provided for CEB to inspect the bulbs prior to shipping no inspection took place, and CEB sought injunctions restraining Standard Bank from making payment. CEB contended that APS had acted fraudulently and should not be entitled to claim payment as it had not supplied the goods as agreed, had not allowed CEB to inspect the goods at the place of manufacture, and had also breached undertakings to the court.

The Privy Council noted that an injunction should only be granted to restrain a bank from paying under a letter of credit where the fraud exception applies and the bank is aware of the fraud. Although the usual test on an application for an interlocutory injunction is to establish an arguable case and that the balance of convenience justifies the grant of an injunction, the Privy Council considered that this was not the test in the case of an injunction to restrain payment under a letter of credit. Instead, the applicant must go further and satisfy the significantly more stringent test of showing that it is seriously arguable that, on the material available, the only realistic inference is that the beneficiary could not honestly have believed in the validity of its demands under the letter of credit, and that the bank was aware of that fact. In this case there was no suggestion that any of the documents presented to Standard Bank were forgeries or that any of them contained, to the knowledge of APS, any material misrepresentation. CEB's allegations as to the nature of the goods and their inspection were allegations of

[13] *Alternative Power Solution Ltd v Central Electricity Board & Anr* [2014] UKPC 31

breach of contract and were irrelevant to the bank's liability under the letter of credit, and even if there were force in the suggestion that APS had breached undertakings to the court, that was of no assistance in relation to the claim under the letter of credit unless Standard Bank had agreed a relevant variation or knew APS was acting fraudulently.

In any event, the Privy Council commented that the balance of convenience will almost always militate against the grant of an injunction, and that it is almost never possible to establish the test for fraud as opposed to a mere possibility of fraud. In this judgment the Privy Council has thus reinforced the inviolate nature of the letter of credit and indicated that, save in the most clear cases of fraud, significant obstacles lie in the way of an injunction to restrain payment.

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