MACFARLANES

2014: AN OVERVIEW OF IMPORTANT CASES AND DEVELOPMENTS

LITIGATION AND DISPUTE RESOLUTION

MITCHELL REVISITED

In *Denton v TH White Ltd and another* [2014] EWCA Civ 906, the Court of Appeal "restated" the test to be applied to applications for relief from sanctions imposed when a party breaches a rule or court order. In so doing it commented that the guidance previously given in *Andrew Mitchell MP v News Group Newspapers Limited* [2013] EWCA Civ 1526 had been "misunderstood" and "misapplied" and that this had led to some decisions which were "manifestly unjust and disproportionate".

Under the revised test, the court will consider:

1. whether the relevant breach was "serious or significant";
2. the reason why the default or failure occurred; and
3. all the circumstances of the case, so as to enable the court to deal justly with the application.

Since *Denton,* the flood of satellite litigation that followed *Mitchell* has subsided. This is partly because the courts are adopting a less draconian approach but is probably also a result of the Court of Appeal's statement, in *Denton*, that "heavy costs sanctions" will be imposed on parties who "opportunistically and unreasonably" oppose applications for relief from sanctions, or who refuse reasonable requests for extensions of time. There is now less to gain, and more to lose, from trying to take advantage of the other side's procedural failings.

Nevertheless, the Court of Appeal made it clear that the decision should not be taken as heralding a return to the pre-Jackson culture of tolerance of non-compliance with rules. Compliance remains more important than it was before April 2013. If a deadline is approaching and the other side will not agree to extend it (or the rules do not permit this), it is important that an application for an extension of time is made before the deadline has passed to avoid the rules on relief from sanctions coming into play.

COSTS BUDGETING REGIME EXTENDED TO ALL CLAIMS UNDER £10M

The new rules on costs budgeting were seen by many as the most significant of the Jackson reforms. In broad terms, the rules require parties to prepare detailed budgets for the cost of taking a dispute to trial and to adhere to those budgets.

Initially the rules did not apply to claims of £2m or more, or to any claims in the Commercial Court, which limited their impact on medium and large scale commercial litigation. That changed, however, on 22 April 2014 when the threshold was increased so that the rules now apply to all claims (issued after 22 April) under £10m in all courts.

Furthermore, the court has a discretion to apply the costs management rules to claims which exceed the £10m threshold. In *CIP Properties (AIPT) Ltd v Galliford Try Infrastructure Ltd and others* [2014] EWHC 3546 (TCC) (a case where the £2m threshold still applied) the rules were applied to a claim worth £18m.

OBLIGATION TO RESOLVE DISPUTES BY "FRIENDLY DISCUSSION" HELD TO BE ENFORCEABLE

In *Emirates Trading Agency LLC v Prime Mineral Exports Private Limited* [2014] EWHC (Comm), the High Court upheld a (time limited) contractual provision requiring the parties to seek to resolve a dispute by "friendly discussion". The judge held that the agreement was not incomplete as no term was missing. Nor was it uncertain as an obligation to seek to resolve a dispute by friendly discussions in good faith had an identifiable standard; namely, fair, honest and genuine discussions aimed at resolving a dispute. Difficulty of proving a breach in some cases should not be confused with a suggestion that the clause lacked certainty.

The judge also said that it was in the public interest to enforce such an agreement because commercial men expect the court to enforce obligations which they have freely undertaken and because the purpose of the agreement was to avoid what might otherwise be an expensive and time consuming arbitration.

The greatest impact of this case will be felt in the context of "tiered" arbitration clauses. Where (as in this case) the holding of negotiations is a condition precedent to commencing arbitration, the tribunal will not have jurisdiction to hear a dispute unless and until the parties have done this. This may cause problems if a limitation period is expiring. Claimants will need to ensure that they commence discussions early enough to allow sufficient time for negotiations to take place before a deadline passes.

In practice, it may be difficult to identify the steps that a party must take in order to comply with an agreement to negotiate. This uncertainty may bring an increased risk of satellite litigation and create opportunities for parties to use such obligations as an excuse to delay matters.

Prior to this decision, it was not unusual for contracting parties to include agreements to negotiate as a demonstration of commercial goodwill, without expecting to create a legally enforceable obligation. That expectation may now need to be revisited.

Parties who wish to include enforceable agreements to negotiate in their contracts should ensure that a time limit is placed on the negotiations. Obligations to negotiate for an unlimited or unspecified period of time are still likely to be unenforceable.

SUPREME COURT DECISION ON BRIBES AND SECRET COMMISSIONS

In *FHR European Ventures LLP and others v Cedar Capital Partners LLC,* the Supreme Court has ruled that a bribe or secret commission received by an agent is held by the agent on trust for his principal. As well as ending a line of 200 years of inconsistent judicial decisions and academic controversy, the decision also has important practical consequences. In essence the decision means that the principal will have a proprietary interest in any bribe or secret commission received by its agent and will, therefore:

- in the event of an insolvency, have priority over the agent's unsecured creditors; and
- have the right to trace the bribe or commission, potentially into the hands of knowing recipients or into other assets purchased by the agent using the bribe or commission.

FAILURE TO PAY ON TIME DID NOT GO TO THE ROOT OF A CONTRACT

The case of *Valilas v Januzaj* [2014] EWCA Civ 436 concerned two dentists, Mr Valilas (V) and Mr Januzaj (J). J ran a dental practice and V practiced there under an oral agreement (the facilities contract) whereby V could use the premises in return for 50 per cent of his receipts each month. The relationship broke down and V informed J that he would stop making monthly payments but offered (in broad terms) to pay sums due at a later date. J subsequently told V that he could no longer work at the practice and excluded him from the premises.

The Court of Appeal held (by a majority of two to one) that V's failure to pay sums due was not a repudiatory breach of the facilities contract such that J was entitled to bring the contract to an end. This meant that J was himself in repudiatory breach by excluding V from the premises and was liable in damages to V for the resultant loss of business. In reaching this decision, the Court of Appeal made the following points:

- Unless the parties agree otherwise, time of payment is not generally of the essence in a commercial contract. Therefore, the obligation to make the monthly payments on the due date was not a condition of the facilities agreement, breach of which would automatically entitle J to terminate the contract.
- Rather, the obligation to pay on time was an "innominate" term. Case law contains a number of formulations of the test for when breaches of an innominate term will be repudiatory, such as where they "go to the root of the contract" or where a breach would "evince an intention no longer to be bound by the terms of the contract" or deprive the innocent party of "substantially the whole benefit" of the contract. While a declared intention by a party to perform a contract in a manner substantially inconsistent with his obligations may amount to a renunciation, the breach involved must be analysed to see whether it has any of these consequences.
- In this case, J would receive everything he was entitled to, albeit that some of it would be late. Withholding payment was different from a refusal to pay at all. J had not established that there would be serious consequences for him and his practice from the late payment.

EXCLUDING LIABILITY "OPENS THE DOOR" TO THE GRANT OF AN INJUNCTION

In *AB v CD* [EWCA] Civ 229, the claimant sought an interim injunction restraining the defendant from terminating a licence to use an internet based marketing platform. The claimant argued that damages would not be an adequate remedy if it was subsequently decided (at an arbitration) that the defendant had wrongfully terminated the licence, because an exclusion clause in the licensing agreement prevented the claimant from recovering damages for all of its losses.

The defendant, on the other hand, argued that the parties had agreed in their contract what damages would be recoverable and a finding that the contractually agreed level of damages was an inadequate remedy would fail to give effect to the parties' commercial expectations.

The Court of Appeal agreed with the claimant. A limitation clause (or a liquidated damages clause, provided that it is not a penalty) will be determinative in a claim to recover damages. However, such a clause does not constitute an agreed price (or an excuse) for a party to refuse to perform its primary contractual obligations and the Court can still use other remedies, such as an injunction, to force a party to perform those obligations.

The mere existence of an exclusion or limitation clause will not automatically entitle a party seeking an interim injunction to claim that damages are an inadequate remedy. However, where a party is able to show that it will suffer loss, which the relevant clause prevents it from recovering, this "opens the door" to the exercise of the Court's discretion to grant an injunction.

Laws LJ put the point as follows:

"*Where a party to a contract stipulates that if he breaches his obligations his liability will be limited or the damages he must pay will be capped, that is a circumstance which in justice tends to favour the grant of an injunction to prohibit the breach in the first place.*"

It is important, therefore, to be aware that inserting an exclusion clause into a contract may have unintended consequences. Whilst this may reduce a party's exposure to a damages claim, it may also increase the chances of the court granting an injunction requiring that party to continue to comply with the terms of a contract against its will. The same principles would apply to a limitation clause or a liquidated damages clause. In some situations, the benefits of using these types of clause may be outweighed by the disadvantages.

MORE CASES ON IMPLIED TERMS OF GOOD FAITH

Following on from the 2013 case of *Yam Seng PTE Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QBD), where the claimant successfully argued that a duty to act in good faith should be implied into an agreement for the distribution of certain "Manchester United" branded products, it was held, in *Bristol Groundschool Ltd v Intelligent Data Capture Ltd and others* [2014] EWHC 2145 (Ch), 2 July 2014, that there was an implied duty of good faith in a contract relating to the development of computer-based pilot training materials. The judge also gave some guidance on the test to be applied when considering whether a party has complied with an obligation to act in good faith, namely whether the conduct would be regarded as "commercially unacceptable" by reasonable and honest people in the particular context involved.

However, in *Greenclose Limited v National Westminster Bank plc* [2014] EWHC 1156 (Ch), the judge declined to follow Yam Seng, saying that:

"*there is no general doctrine of good faith in English contract law and such a term is unlikely to arise by way of necessary implication in a contract between two sophisticated commercial parties negotiating at arms' length. Leggatt J's judgment in Yam Seng…is not to be regarded as laying down any general principle applicable to all commercial contracts.*"

This is a developing area but the current position is as follows:

1. There is no general duty of good faith in English law.

2. However, an obligation to act in good faith may be implied into a contract using the normal rules for implying terms into a contract in fact as described by Lord Hoffman in *Attorney General of Belize and others v Belize Telecom Ltd* [2009] UKPC 10.

3. The courts will be more ready to imply obligations to act in good faith into "relational contacts" (i.e. long-term contracts which might require a high degree of communication and co-operation such as joint venture, franchise and long-term distribution agreements).

4. Where a contract confers an express right on a party, an obligation to act in good faith is unlikely to restrict that right. For example a party is unlikely to be required to exercise a right to terminate "in good faith".

NOT SO PRIVILEGED

In *Rawlinson and Hunter Trustees SA v Akers* [2014] EWCA Civ 136, it was held that five accountants' reports, which had been prepared for a financial institution which had provided funding to a group of BVI companies, were not covered by litigation privilege.

For litigation privilege to apply, a communication must have been created for the dominant purpose of litigation and the relevant litigation must be "reasonably in prospect" at the time the document was created. These tests have a high threshold and the burden of proof will be on the party seeking to claim privilege.

The court found that the reports either did not satisfy the dominant purpose test because they were prepared as much for summarising and assessing the financial condition of the companies as for litigation, or because they were prepared so long before litigation (as long as two and half years) that litigation could not be said to have been reasonably in prospect.

Although the court applied established principles, this case demonstrates the dangers of assuming that, because litigation is "in the air", a party will be able to rely on litigation privilege. It is important, at the time documents are commissioned/produced, to record the fact that a document is being/has been created for use in litigation on the face of the relevant document and in instructions to the persons responsible for producing the document. The litigation, in respect of which documents are being produced, should be identified with as much specificity as possible. If it is not possible to do these things, that is likely to be a good indicator that it will be difficult to substantiate a claim to litigation privilege in any future litigation. If that is the case, consideration should be given either to not recording the findings of the relevant investigation in writing or to involving internal and external counsel in a way which would result in the relevant document being covered by legal advice privilege.

VARIATION OF CONTRACTS CONTAINING LIQUIDATED DAMAGES CLAUSES

The general rule is that the question of whether a clause is a penalty or not must be viewed as at the date of the contract. In *Unaoil Ltd v Leighton Offshore Pte Ltd* [2014] EWHC 2965 (Comm), it was held that if a contract is varied, the relevant date will be the date of the variation. The effect in this case was that a clause, which "was or at least may have been a genuine pre-estimate of loss" at the time the relevant contract was entered into became an unenforceable penalty when the contract was amended (to provide for a lower contract price). The judge said that he was unaware of any previous authority on this issue but held that this approach was consistent with general principle.

Although a short point, it is significant because the effect is that contracting parties will need to revisit any liquidated damages clauses when making amendments to their contracts (particularly if the amendments involve significant changes to the parties' obligations or sums payable under the contract).

APPOINTMENT OF A RECEIVER OVER A DEFENDANT'S SHAREHOLDING IN FOREIGN COMPANIES

In *Cruz City 1 Mauritius Holdings v Unitech Limited* and others [2014] EWHC 3131 (Comm), the claimant had won an LCIA arbitration against the defendant and obtained an award for almost $300m. Notwithstanding the fact that it had sufficient assets to do so, the first defendant refused to pay the sums due and made it clear "by words and conduct" that it would do whatever it could to avoid meeting its liabilities.

The claimant successfully applied for an order under s.37 Senior Courts Act 1981 appointing receivers over the first defendant's 100 per cent shareholding in four overseas companies. The court also made ancillary orders which required the defendant (a) not to impede the receivers from acting and (b) to appoint the receiver as their representative for the exercise of shareholder rights. This was with a view to enabling the receivers to exercise the defendant's rights as a shareholder, for example, to sell the shares, exercise voting powers, appoint directors and seek a winding up of subsidiary companies.

The more conventional way of enforcing a judgment against shares owned by a judgment debtor would be to obtain a charging order over the shares and then an order for sale. This method, however, may be of limited use where there is not a ready market for the shares, where an order for sale of the shares would not be the best way of realising their value or where, as in this case, the shares are in foreign companies and it would be impossible or difficult to obtain an order for sale of them in the local courts. Applying for the appointment of a receiver, who can then exercise the powers of a shareholder to realise sums to pay off the judgment debt, will in some cases be a much more effective method of enforcement. Although the judge said that this jurisdiction will only be exercised where there is some hindrance or difficulty in using the normal processes of enforcement, those are precisely the circumstances in which it will be useful.

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