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Contentious Commentary

Contract

The consequences of trouble

Termination for breach in accordance with an express contractual term does not necessarily give a right to loss of bargain damages.

Breach of a condition of a contract entitles the innocent party to terminate the contract and to claim loss of bargain damages (ie damages covering the outstanding term of the contract). Breach of a warranty only gives a right to damages caused by the breach, not a right to terminate the contract.

The parties may specify whether or not any particular clause is a condition or a warranty but, if this is not addressed expressly, a clause will normally be treated as an innominate term. This generally means that breach of the clause will only give a right to terminate and claim loss of bargain damages if the breach is sufficiently serious to be repudiatory.

Suppose then that a clause gives an express right to terminate for breach, but says nothing about damages or whether the clause is a condition. The innocent party can terminate the contract in accordance with its terms, but does the innocent party also have a right to loss of bargain damages following the exercise of that right?

This doesn't arise, in the main, for financial contracts (loan agreements, ISDA etc) because they generally set out in full the consequences of breach, including damages. It does matter in other forms of contract, which often don't do so. In particular, if exercise of a contractual right of termination may deprive the innocent party of loss of bargain damages, termination on that ground could be a lot less attractive. The ability to claim loss of bargain damages could then depend upon proving not only breach of the term in question, which may or may not be clear, but also that this breach was repudiatory. This double requirement would add an extra tier of uncertainty to what can be a nerve-racking process anyway.

In *The Astra* [2013] EWHC 865 (Comm), Flaux J expressed the view that since breach of condition gives a right to terminate, a clause that provides expressly for termination on breach must be a condition, bringing with it the tag-along right to loss of bargain damages if the contractual right of termination is exercised. This symmetrical approach would allow focus on whether there had in fact been a breach of contract, not on its severity. The issues still may not be easy, but they would be easier.

However, in *Grand China Logistics Holding (Group) Co Ltd v Spar Shipping AS* [2016] EWCA Civ 982, the Court of Appeal followed the first instance judge in reaching the opposite conclusion. Popplewell J reasoned that if a contractual clause expressly gives a right to terminate, the clause can't be a condition because there would be no need for the express right to terminate if it were - the right to terminate would follow as a matter of law without any need to say so. Whether this is consistent with the realities of commercial drafting and the quest for certainty is a different question.

Needless to say, as with most issues of contract law, it all depends upon the drafting of the individual contract, in this case an NYPE 1993 charterparty. But the general thrust of *Grand China Logistics* is that the days when contractual terms were either conditions or warranties are long gone. Absent clear indication to the contrary, the courts will interpret a term as innominate because they consider it inherently unlikely that the parties wish to confer on the innocent party a right of termination no matter how trivial the breach.

The Court of Appeal's view is that an innocent party can terminate under an express term, but doing so will in effect be treated as if termination were the exercise of an option to terminate, not termination for breach, unless the breach is also repudiatory at common law.

The lesson of *Grand China Logistics* is that, when terminating a contract

Contents

- Take care when terminating a contract
- The test for repudiatory breach of contact can be difficult
- Public authorities have confidentiality obligations
- GMRA default notices considered
- Rescission not available when innocent parties would be affected
- When is an exclusion clause not an exclusion clause?
- Partnership shares can be forfeit for breach
- The European Commission can be liable in tort for breach of fundamental rights
- Arbitration costs include litigation funder's fee

pursuant to its express terms, think carefully about the remedies available under the contract and at law. More particularly, when drafting a contract it might not be enough simply to include a right of termination for breach. The contract should also cover expressly what consequences will flow from termination, including as to damages.

Law without law

The application of the test for repudiatory breach may not be as strict as its wording suggests.

The facts of *Grand China Logistics* (above) were that the charterers entered into long-term (three and five years) charterparties, but were rapidly in financial difficulties and consistently late in making hire payments. The owner exercised its contractual right to withdraw the vessels for late/non-payment. There was no doubt as to the owner's right to withdraw the vessels, but the charterers' guarantors contested the owner's claim to loss of bargain damages, which came to $25m.

Having decided that the charterers were not in breach of a condition of the contract, the Court of Appeal had to decide whether the charterers were in renunciatory breach, ie an anticipatory breach of contract where the charterer makes clear that it is not going to perform the contract at all, that it is going to commit a breach of condition or that it is going to commit breach of an innominate term the consequences of which breach will be repudiatory. It now seems to be accepted that the exercise of a contractual right to terminate will also entitle the innocent party to loss of bargain damages if the breach relied on would, as a matter of general law, be repudiatory or renunciatory (at least unless the clause also offers remedies for breach, in addition to termination, that are inconsistent with loss of bargain damages). This led on to arguments as to the test for repudiatory breach of contract.

The Court of Appeal decided that the time for payment under a commercial contract is not in the main of the essence (ie punctuality is not a condition). The test favoured by the Court of Appeal for repudiatory breach was that the breach must deprive the innocent party of substantially the whole of the benefit which it was the intention of the parties that the innocent party should obtain from further performance of the contractual undertakings.

This sounds a very strict test, but it is

Confidentiality

A chill wind

HMRC may not disclose taxpayers' information to the press, even off the record.

HMRC has had considerable success in defeating artificial tax avoidance schemes, including film finance schemes (see page 4), but its focus on such schemes does not justify its disclosing taxpayers' information to the press. It is subject to the same obligations of confidentiality as all public bodies, namely that if information of a personal or confidential nature is obtained or received in the exercise of a legal power or the furtherance of a public duty, the recipient will in general owe a duty to the person from whom the information was received or to whom it relates not to use it for other purposes, subject to the express terms of any statute (*Marcel v Commissioner of Police for the Metropolis* [1992] Ch 225). General words in section 18 of the Commissioners for Revenue and Customs Act 2005 are not sufficient to abrogate this duty.

This was the conclusion reached by the Supreme Court in a rather condemnatory judgment in *R (oao Ingenious Media Holdings plc) v Commissioners of Her Majesty's Revenue and Customs* [2016] UKSC 54. Dave Hartnett, then head of HMRC, had held an off the record briefing with journalists from *The Times* in which he was less than complimentary about the person behind C, asserting that he represented a "threat" and was a "big risk" to the tax gatherers. Rather more was published than, perhaps, Mr Hartnett intended (though even less flattering comments were omitted) despite his comments only being attributed to a "senior Revenue official".

Curiously, C started judicial review proceedings to complain about these disclosures, which led to the question of whether normal judicial review tests should be applied, ie C should only win if HMRC's decision to disclose was *Wednesbury* unreasonable. This got traction in the courts below, but was dismissed in the Supreme Court. Whether there has been breach of an obligation of confidentiality is a matter of law for the courts, not discretion for HMRC. So HMRC's disclosures were only justified if they were undertaken for the proper performance of HMRC's functions. The Supreme Court was again dismissive. Cultivating media contacts or publicising HMRC's views about tax avoidance schemes did not get near to a justification. And it made no difference that the briefing was off the record.

The decision was undoubtedly meant to send a warning shot across the bows of public officials who might consider media friendliness more important than confidentiality. The *Marcel* principle is of general application.

instructive to consider how the Court of Appeal applied its test in *Grand China Logistics*. The judges were looking for a renunciatory breach, ie a statement or conduct by the charterer that indicated that it would act in a way that would deprive the owner of substantially the whole of the benefit under the contract. The Court of Appeal focused on the nature of the contract. The charterparties required the owner to provide the ship, crew, bunkers etc, with the charterer merely directing the vessel to its destinations. The charterer was obliged to pay in advance, allowing the owner to meet the running costs from the hire payments. Despite punctual payment not being a condition, the Court of Appeal decided that it was "of the essence of the bargain… that the shipowner is entitled to regular, periodical payments of hire as stipulated, in advance".

A single late payment might not have been repudiatory, but the charterers' constant late payments, their indications of their financial problems and their suggestion that they would pay their bankers before the owner all supposedly went to the root of the contract, depriving the owners of substantially the whole of the benefit of the charterparties, and/or made the arrangement radically different. These were sufficient to evince an intention not to pay hire punctually in the future, "leaving owners obliged to accept this limping performance and attendant uncertainty". This was renunciatory breach. The Court of Appeal stressed that, even if a payer protests its desire to make the payments, if it indicated an inability to do so that would still be renunciatory.

The conclusion that the charterers' conduct entitled the owners to terminate the charterparties is realistic. Faced with their counterparties' constant dribbling defaults and drift towards insolvency (later entered), the owner must at some point have been entitled to call a halt and claim damages. The Court's approach indicates that in applying its test, a more subtle approach is required than simply counting the folding stuff.

Eight years and counting

Numerous questions are addressed on termination for breach under GMRA.

In *Lehman Brothers International (Europe) v Exxonmobil Financial Services BV* [2016] EWHC 2699, Blair J addressed numerous questions arising from the termination on 15 September 2008 of repos subject to a GMRA (2000 edition). Blair J's conclusions included:

- A Default Notice is required to "stat[e] that an event shall be treated as an Event of Default". This does not require the Notice to state which particular EoD is being relied on or what the event is. In any case, on 15 September 2008, LBIE, as recipient of the notice, could have been in no doubt that it was the appointment of administrators that was being relied on even though this was not stated expressly.
- Notices are permitted under a GMRA by "electronic messaging system". This includes email (cf *Greenclose Ltd v National Westminster Bank plc* [2014] EWHC 1156 (Ch), in which it was decided that email is not an electronic messaging system for the purposes of the ISDA Master Agreement).
- A Default Notice "shall be sent" to the fax number specified in the Annex to the GMRA. This is mandatory. A fax sent to another number, even if received, is not valid. But by failing for six and a half years to take the point that the fax was sent to the wrong fax number, LBIE had waived its right to rely on this point. This kind of point must be taken "promptly".
- A faxed notice is effective when received by a responsible employee, the burden of proof being on the sender. Blair J decided that it was so likely that people were working at LBIE at 6.02pm on 22 September 2008 (even though LBIE was by then in administration) that the burden of proof was satisfied. Further, 6.02pm was not shown to be after close of business on that day.
- A Default Valuation Notice must be served by "close of business in the Appropriate Market on the fifth dealing day after" the EoD, the "Appropriate Market" being "in relation to Securities of any description, the market which is the most appropriate market for Securities of that description, as determined by the non-Defaulting Party." Where a portfolio includes Japanese, European and US securities, there is no single Appropriate Market such that there is a single five day limit. A notice served at 6.02pm on 22 September 2008 was in time for US, UK and Irish securities, but out of time for Japanese securities. Close of business in the Appropriate Market does not mean close of business for dealing, but refers more generally to when banks are working.
- If a Default Valuation Notice is not given in time, the value defaults to the Net Value, ie the "amount which, in the reasonable opinion of the non-Defaulting Party, represents the fair market value". This does not require an objective assessment but gives a discretion to the non-Defaulting Party, which must be exercised in good faith and not capriciously or arbitrarily.

Tax and spend

A contract cannot be avoided for third party bribery.

HMRC has had considerable success in recent times in defeating artificial tax avoidance schemes (see page 2). Like Amazon and Starbucks, the judiciary has not failed to observe the movement in the zeitgeist in this regard. The ineffectiveness of tax schemes can result in parties being required to pay back-tax, as well as stringent penalties and interest, and it is therefore unsurprising that those who took part in such schemes should use the same energy to strive to find ways to avoid these charges.

One such attempt failed in *Chancery Client Partners Ltd v MRC 757 Ltd* [2016] EWHC 2147 (Ch). The taxpayers contended that the agent who introduced them to the schemes had been paid a secret commission - a bribe - with the result that they could rescind the arrangements ab initio. No arrangements, no tax.

If a contracting party secures your entry into a contract by payment of a bribe, you can rescind the contract. That much is trite law. The problem here was that the complexity of the arrangements required numerous parties to numerous contracts, and most of the numerous parties had nothing to do with either end of the bribes. The various transactions could not be rescinded as against all parties because of a bribe affecting only one party. All the parties could, if they so wished, terminate the agreements, but that would not (unlike rescission) mean that the agreements had never existed or extinguish the tax consequences of their previous existence.

The taxpayers could claim damages from the briber and the bribed, but could not in one bound escape the tax consequences of their acts.

Definitional exclusions

An exclusion clause will be construed narrowly unless it defines liability.

Judges traditionally approach exclusion clauses with brows deeply furrowed. But a standard academic conundrum is when is an exclusion clause not an exclusion clause but part of the definition of the obligation and therefore not to be viewed with such curial suspicion.

In *Impact Funding Solutions Ltd v AIG Europe Insurance Ltd* [2016] UKSC 57, the Supreme Court decided that a list in an insurance policy of matters not covered by the policy was not an exclusion clause but was purely definitional. As a result, it escaped any judicial predisposition to construe it narrowly. That kind of predisposition "applies not only where the words of exception remove a remedy for breach, but where they seek to prevent liability arising by removing, through a subsidiary provision, part of the benefit which it appears to have been the purpose of the contract to provide. The vice of a clause of that kind is that it can have a propensity to mislead, unless its language is sufficiently plain. All that said, words of exception may be simply a way of delineating the scope of the primary obligation."

Clarity may be all, but it isn't always commercial.

EU law

Don't bank on it

The EU is not liable for losses caused by the resolution of Cypriot banks.

Perhaps the most surprising thing

Equity

Unpartnering

Partnership payments can be forfeit.

In *Hosking v Marathon Asset Management LLP* [2016] EWHC 2418 (Ch), Newey J reached the perhaps surprising conclusion that a profit share paid to a partner in a limited liability partnership could be forfeit, to the extent that to do so was proportionate and equitable, if the partner committed serious breaches of fiduciary duty. This is in addition to any equitable or other compensation to which the partnership is entitled.

It is well-established that agents forfeit some or all of their fees if they act in serious breach of fiduciary duty. The underlying reason is that by failing to observe its duties, the agent has deprived the principal of at least part of what the principal was paying for - indeed, if the breach is sufficiently grave that there has effectively been no performance, the agent forfeits all. This carries a strong under-current of equitable punishment, ensuring that fiduciaries behave properly.

But this has never been applied to partnerships or limited liability partnerships even though partners are agents and fiduciaries. However, Newey J saw no reason why it should not apply, despite the detailed contractual provisions setting out the partners' entitlement to profits. The contract could oust the principle, but silence was not enough to do so. Rather close to re-writing the contractual deal?

about *Ledra Advertising v Commission and ECB* (Case C-8/15P) is that the case got as far as it did. The claimants lost resoundingly, but they gave the EU a respectable run for its money on the law. And the case might encourage others to engage in more interesting follow-on litigation against EU institutions.

The claim arose from the rescue of Bank of Cyprus and Cyprus Popular Bank, which involved uninsured deposits (>€100k) being converted into shares and other securities under Cypriot bank resolution laws. Depositors alleged that this occurred because the European Commission, acting for the European Stability Mechanism, negotiated with/forced upon Cyprus a deal that required this as the price for ESM advances. The conversion, the depositors said, was in breach of article 17 of the EU's Charter of Fundamental Rights (right to property) and the Commission should have ensured compliance with EU law.

The CJEU accepted that article 17 of the Treaty on European Union requires the Commission to ensure and oversee the application of EU law. The ESM's founding treaty requires the ESM to entrust to the Commission the tasks of working out what a supplicant requires by way of finance and of negotiating a memorandum of understanding. Just because the Commission is acting for the ESM, a non-EU institution, in negotiating and agreeing the MoU does not allow the Commission to disregard EU law. The Commission was created by EU law and must always comply with EU law. As a result, if the MoU brought about a deal that was in breach of EU law, including the Charter, there could be a non-contractual claim against the Commission under article 340 of the Treaty on the Functioning of the European Union even though the deal was entered into by someone else (here, the ESM).

But the CJEU decided resoundingly that there had been no breach of EU law. Article 17 of the Charter does not confer an absolute right. Restrictions on the right to property can be imposed if they genuinely meet objectives of general interest and do not constitute, in relation to the aim pursued, a disproportionate and intolerable interference with the property. Measures aimed at ensuring the stability of the banking system in Cyprus and the wider euro area, having regard to the risk of collapse of the two banks and the even larger losses the depositors would have suffered in that eventuality, were transparently neither disproportionate nor intolerable. The depositors therefore lost.

The intriguing aspect of *Ledra* is what other claims it might open up. If the Commission must at all times ensure compliance with EU law, including the Charter of Fundamental Rights, and if its fingerprints can be found on measures that infringe those rights, perhaps there is a tortious claim to be winkled out. Others may seek to explore how far this obligation can be stretched.

Arbitration

Hard cases

Sums owed to a litigation funder can be recovered in costs.

Sitting as an arbitrator, Sir Philip Otton (formerly a Lord Justice of Appeal) was highly critical of the losing defendant's conduct. The defendant set out to cripple the claimant financially; it flouted the agreement; it exerted commercial pressure before and throughout the arbitration process; and it made unjustifiable personal attacks. This, the arbitrator decided, drove the claimant into the arms of litigation funders in order to be able to pursue the arbitration.

The claimant obtained funding, on standard terms, that obliged it to pay the funder the higher of 300% of the funding and 35% of the recoveries. The claimant won the arbitration, as a result of which it was obliged to pay £1.94m to the funder. The question arose whether the claimant could recover this sum in costs from the defendant (in addition to indemnity costs on a more usual basis). Section 59(1)(c) of the Arbitration Act 1996 allows an arbitrator to award "legal or other costs": are success fees payable to a litigation funder "other costs" for these purposes?

The arbitrator decided that the success fee payable to a litigation funder was an "other cost" for these purposes, and made an order for its payment. In *Essar Oilfield Services Ltd v Norscot Rig Management Pvt Ltd* [2016] EWHC 2361 (Comm), the judge decided that the arbitrator's decision did not constitute a "serious irregularity" under section 68 of the Act, so the defendant had no recourse to the courts (the parties had excluded appeals). But, in any event, the judge agreed with the arbitrator.

The judge decided that the courts' power in this area was not relevant, and saw no reason to limit "other costs" by reference to "legal" or at all. The only question was whether the costs related to the arbitration and were incurred for the purposes of the arbitration. If they were, then the arbitrator had a discretion to include them in an award of costs, subject to the usual constraints on that discretion.

Difficult to know what to make of this decision. Few would have thought that "legal or other costs" included a success fee payable to a funder. Other costs are experts' fees, room hire, travel costs etc. But the judge took the view that if it is a cost and it

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is incurred for the purpose of the arbitration, it is covered by "other costs" and can therefore be awarded in costs. Arbitrators can expect wide submissions on this point in future. Time will tell whether the consensus is that success fees (or, indeed, bank interest, employee costs or other sums) can only be recovered when a party behaves seriously badly, as in *Essar*, or whether any (reasonable?) use of litigation funding, or reasonable incurring of other costs, is enough. And if it does become the norm, should arbitration clauses expressly exclude it?

Contentious Commentary is a review of legal developments for litigators

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