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Commercial Law Update

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Topics

Interpreting Exclusion Clauses Between Commercial Parties

James Dawson

Executive Summary

1. In Transocean Drilling UK v Providence Resources PLC[1] the Court of Appeal has maintained the emerging trend in the interpretation of exclusion clauses, namely that primacy is to be given to the language used by the parties when construing terms, rather than to cannons of construction traditionally used.

Introduction

2. Lawyers are well familiar with the cannons of construction traditionally used in the interpretation of exclusion clauses;

    a. the *contra proferentem* rule,

    b. the *eiusdem generis* principle,

    c. that an exemption clause will not relieve a party from liability for negligence unless it does so expressly or by necessary implication,

    d. that neither party intends to abandon any remedies for breach by the other arising by operation of law, and clear words must be used in order to rebut that presumption

    e. that a Court will not interpret an exemption clause so as to deprive the contractual undertakings of one party of all effect,

    and

    f. the rules on what amounts to consequential loss

    to name but a few.

[1] [2016] EWCA Civ 372

3. In recent cases there has been a gradual rowing back from the traditional judicial hostility to exemption causes, often exemplified in the application of the cannons of construction, and a greater willingness to allow commercial parties to agree the terms they wish.

4. That principle has come of age in Transocean Drilling and analysis of the first instance and Court of Appeal decisions is helpful, both in revising the traditional cannons of construction and identifying where the law now is.

The facts of Transocean

5. Transocean hired a semi-submersible drilling rig, GSF Arctic III, to Providence. The rate was around US $230,000 a day depending on the use to which it was being put.

6. Due, largely, to misalignment of part of a blowout preventer, the rig was inoperable between the 18th December 2011 and the 2nd February 2012. Providence withheld payment of the hire charges to Transocean for those dates and, when Transocean brought an action for the hire, sought to set off against the claim losses, including US $10,000,000 paid for goods and services which were wasted as a result of the inactivity (the spread costs).

7. At first instance Popplewell J held that the rig had not been in good working condition on delivery, because there had been a build-up of debris in part of the blow out preventer. The Judge found there was a breach of clause 4 of the hire agreement, namely that Transocean must supply the vessel in good working condition. That breach caused the loss of time in respect of operation.

8. The contract had various clauses which relevant to the claims before the Court.

9. Clause 13, set out different payment rates according to the use the rig was being put to, including when it was inactive.

10. Clause 18, contained a complex series of indemnities by which it allocated losses arising out of the performance of the contract between the two parties, regardless of cause.

11. Clause 19, required Providence to maintain insurance for the benefit of both parties.

12. Clause 20, identified consequential loss as meaning

    (i) any indirect or consequential loss or damages under English law, and/or

(ii) to the extent not covered by (i) above, loss or deferment of production, loss of product, loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided by contractors or subcontractors of every tier or by third parties)...

It went on to provide that Providence would indemnify, defend and hold harmless Transocean from Providence's own consequential loss and Transocean would indemnify, defend and hold harmless Providence from Transocean's own consequential loss.

The Decision of the High Court

13. It is interesting to note a remark by Popplewell J early in his judgment that "*Providence is a small company*…" One is left with a lingering suspicion that in approaching the relevant clauses he was influenced by the fact that Providence is a small company whereas Transocean is not, but that may be unfair, and in fact the judgment is a closely reasoned and compelling one.

14. The approach taken by Popplewell J was to start with the application of cannons of construction.

15. Thus, in construing the payment clause (13) he states; "*The starting point is to consider three well known lines of authority on the approach to construction which afford helpful guidance in the present case.*"

16. Popplewell J then set out the first three cannons of construction he was to apply.

    a. "*Unless a contract contains clear language to the contrary, it will not be construed as enabling a party to take advantage of his own breach of contract …"*

    b. "*Where an exemption clause is capable of applying to negligent and non-negligent breaches, which are not fanciful, one should approach the clause on the basis that it was not intended to exclude liability for negligence unless the clause makes such an intention clear.*"

    c. "*One starts with the presumption that neither party intends to abandon any remedies for its breach arising by operation of law, and clear express words must be used in order to rebut this presumption.*"[2]

[2] Paragraph 39 of the judgment, latterly quoting Gilbert-Ash v Modern Engineering [1974] AC 689.

17. Applying those principles, Popplewell J held that Transocean could not recover hire charges for the period when the rig was idle because of its breach of contract.

18. Later in his judgment Popplewell J, in considering clause 20 of the contract, asserted it was to be construed *contra proferentem* against Transocean on the grounds that, as he had said earlier, "*One starts with the presumption that neither party intends to abandon any remedies for breach by the other arising by operation of law, and clear words must be used in order to rebut that presumption.*"[3]

19. Transocean argued that clause 20 required Providence to hold it harmless against money that it had paid for goods and services which were wasted as a result of the inactivity (the spread costs) and therefore the same were not recoverable against it.

20. Having so stated, he then noted that clause 20 of the contract contained a specifically defined incursion into the territory of the first limb of Hadley v Baxendale. It might be worth pausing to remind ourselves that the first limb is loss which arises in the ordinary course of things, and the second limb is loss which does not arise in the ordinary course of things but it was within the reasonable contemplation of the parties. Consequential loss is usually understood to mean loss within the second limb[4].

21. The parties agreed that the spread costs would fall within first limb, and were not, therefore, within the usual definition of consequential loss.

22. Since the parties agreed that consequential loss as defined in clause 20 included losses of the first type identified in Hadley v Baxendale and not simply losses of the second type, he held that the clause in respect of consequential loss must be construed narrowly rather than widely.

23. Having started with those propositions the Judge then went on to decide that "*loss of use*" is more naturally to be read as connoting the loss of expected profit or benefit to be derived from the use of equipment, rather than the costs which have been paid for equipment which cannot be used.

24. He then applied the *eiusdem generis* principle in order to apply a narrow construction to clause 20. The other losses within clause 20 were mostly losses of income or benefit. The reference to loss of use had to be interpreted in the same light. Providence did not lose the use of the equipment to which the spread costs related, it remained available to it.

[3] Paragraph 162.
[4] Croudace Construction (1978) 8 BLR 20 and Deepak Fertilisers v ICI [1999] Lloyds Rep 387

25. For good measure the Judge went on to hold that if the clause were to be construed as Transocean contended, the exclusion would cover all losses which Providence might conceivably suffer by way of damages for which Transocean would otherwise be liable and that breached the principle that a Court will not interpret a clause so as to render the primary performance obligations in the contract devoid of contractual content because there is no sanction for non-performance.

26. In those circumstances the Judge held that consequential loss, in the terms as drafted, did not include sums paid for materials and services which could no longer be used during the period of delay, notwithstanding the wording in clause 20 that loss of use included, without limitation, "*loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided by contractors or sub-contractors …*"

The Court of Appeal

27. Transocean appealed in respect of the finding on Spread Costs.

28. When the matter reached the Court of Appeal it started by stating that the appeal "*Raises some interesting questions about the freedom of two commercial parties to determine the terms on which they wish to do business*".

29. Having stated that, in distinction to Popplewell J's starting point, the Court of Appeal's starting point was that the task is first to ascertain the natural meaning of the language used[5]. It also noted, however, the relevance of the fact that the parties were of equal bargaining power.

30. The Court of Appeal went back to Photo Production v Securicor [1980] AC 827 and noted that it was held there that artificial approaches to the construction of commercial contracts are to be avoided in favour of giving the words used by the parties their ordinary and natural meaning.

31. The Court of Appeal also referred to "*the principle that the court should give the language used by the parties the meaning which it would be given by a reasonable person in their position furnished with the knowledge of the background to the transaction common to them*". In that context it referred to Arnold v Britton [2015] AC 1619 in support of the principle that particular importance must be given to the language chosen by the parties to express their intentions.

[5] Paragraph 14

32. Arnold v Britton was not a case about exclusion clauses but general contractual interpretation. In the context of the case the Supreme Court held "*it [interprets the clause] by focusing on the meaning of the relevant words, ... in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions"*.

33. In referring to those cases, the Court of Appeal began dispensing with the various cannons of construction applied by Mr Justice Popplewell stating "*The Courts have recognised that artificial approaches to the construction of commercial contracts are to be avoided in favour of giving the words used by the parties their ordinary and natural meaning.*"[6]

34. The Court then referred to clause 20 and held *""Loss of use" naturally refers to the loss of the ability to make use of some kind of property or equipment owned or under the control of the contractor or the company, as the case may be, but in this case the parties have made it clear by the words in brackets that follow that its scope is intended to be wider than that*." This is the ratio of the judgment.

35. Dealing with the Judge's reference to *contra proferentem*, the Court of Appeal acknowledged it as an available cannon of construction but held "*It is an approach to construction to which resort may properly be had when the language chosen by the parties is one sided and genuinely ambiguous, that is equally capable of bearing two distinct meanings*". It was only in those cases where the Court could choose the meaning which was less favourable to the party who had introduced the clause[7].

36. The Court of Appeal also went out of its way to state this was a separate principle to the principle that there is a presumption that neither party intends to abandon any remedies for its breach in the absence of clear words.

37. In referring to the principle that neither party intends to abandon remedies in the absence of clear words, the Court of Appeal made clear that the parties could abandon remedies if they wished to do so, the principle amounts to no more than a requirement that their intention must be apparent from the language they have used, fairly construed. In the present case it was clear that the parties did intend to give up some of their rights and the clause should be construed accordingly.

[6] Paragraph 14
[7] Paragraph 20

38. In relation to the Judge's point re Hadley v Baxendale the Court of Appeal held, firstly, that it was not clear why the nature of the clause called for a narrow construction in order to limit its scope and then reiterated that the Court's task is not to reshape the contract but to ascertain the parties intention giving the words they have used their ordinary and natural meaning.

39. The same point was made in relation to the *eiusdem generis* principle and the Court of Appeal pointed out that meaning is shaped by its context and the Judge failed to have sufficient regard to the words in brackets that followed the expressed "*loss of use*" or to recognise that the purpose of providing specific examples was to flesh out its meaning.

40. Finally the Court of Appeal did not deny the principle that a clause should not readily be construed as to have the effect of rendering the performance obligations devoid of contractual content where there is no sanction for non-performance, but stated that the principle was one of last resort and did not arise on the facts. Somewhat curiously, however, the Court of Appeal then went on to state "*If, as a result of incorporating several different provisions of that kind, the parties have effectively agreed to exclude any liability for damages for any breaches, it is difficult to see why the Court should not give effect to their agreement*".

41. Thus consequential loss was held to include the wasted expenditure.

Other cases

42. In Nobahar-Cookson v The Hut Group [2016] EWCA Civ 128, a month before Transocean, a different division of the Court of Appeal had considered the question of when the *contra proferentem* principle would be applied in relation to exclusion clauses. The leading judgment given by Briggs LJ who was also part of the court in Transocean.

43. In considering when the *contra proferentem* rule applies in that case, Briggs LJ drew a distinction between construction of commercial contracts generally (in which case the *contra proferentem* rule is of limited use) and cases involving the interpretation of exclusion clauses where "*recent decisions...have continued to affirm the utility of the principle"*

44. He then went on to explain the use of the *contra proferentem* rule by stating "*The parties are not lightly to be taken to have intended to cut down the remedies which the law provides for breach of important contractual obligations without using clear words having that effect.*" At face value that

appears to be a contradiction to the approach in Transocean referred to at paragraph 26 above, although the court in Transocean did not see it that way.

45. Having said all of the Briggs LJ then went on to hold "*This approach to exclusion clauses is not now regarded as a presumption, still less as a special rule justifying the giving of a strange meaning to a provision merely because it is an exclusion clause. Commercial parties are entitled to allocate between them the risks of something going wrong in their contractual relationship in any way they choose … the Court must still use all its tools of linguistic, contextual, purposive and common sense analysis to discern what the clause really means.*"[8]

46. In Nobahar-Cookson the Court of Appeal drew a distinction between a purposive construction and the use of cannons of construction in concluding "*In this perhaps unusual case, a thoroughly modern recourse to purposive construction happily marches hand in hand with perhaps a more old fashioned recourse of rules or cannons of construction, which continue to assist the Court where all else fails.*"

47. It is right to say that there are still cases being decided which apply the traditional cannons of construction, so in Teoco v Aircom [2016] EWHC 1074, the High Court held "*A notification clause which imposes a contractual time limit on the bringing of claims is a species of exclusion clause. If necessary to resolve ambiguity, such a clause should be construed (like any other exclusion clause) narrowly. This is because parties are not lightly to be taken to have intended to cut down the remedies which the law provides for breach of important contractual obligations without using clear words having that effect*".

48. It may also be the case that the cannons of construction will still be useful when parties are not of equal bargaining power.

And Finally...Consequential loss

49. It is interesting to note a passing remark by the Court of Appeal in Transocean in respect of consequential loss clauses. Having referred to the well-known cases of Croudace Construction (1978) 8 BLR 20 and Deepak Fertilisers v ICI [1999] Lloyds Rep 387, the Court of Appeal stated that it was "*Questionable whether some of those cases would be decided in the same way today, when Courts are more willing to recognise that words take their meaning from their particular context and that the same word or phrases may mean different things in different documents.*"

[8] Paragraph 19.

50. Consequential loss clauses are always difficult to draft and difficult to interpret but, the lesson is that previous assumptions may no longer be valid and parties need to define all the more clearly by what is meant by indirect and consequential loss and to define precisely what is meant by direct loss or losses which are recoverable.

Conclusions

51. It is likely that the Courts will now, primarily, seek to ascertain what the parties meant when construing exclusion clauses in the same way that they do for any other provision of the agreement.

52. Cannons of construction will only be used as a matter of last resort and never to strain the language used by the parties.

53. The lessons for practitioners are, therefore, that parties are now likely to be able to agree to much more robust exclusion clauses than would have been upheld in the past. That is both an opportunity and a trap. Clients who have been advised to sign unfavourable exclusion clauses will no longer be able to try and escape from liability on the basis of the older cannons of construction. In the brave new world the parties must say what they mean and mean what they say.

JAMES DAWSON

13 October 2016

Affirmation:

White & Carter v McGregor (1962) AC 413

Oliver Isaacs

1. It is often stated that an innocent party has a choice – to accept a repudiatory breach or to affirm the contract. This was the broad principle enunciated in the House of Lords decision of **White & Carter v McGregor (1962) AC 413**. In White & Carter v McGregor, McGregor (M) engaged White & Carter (W) to display advertisements on litter bins for three years. M immediately sought to cancel the contract which had been made by his employee without specific authority. This was a repudiation of the contract. However, W did not accept the repudiation and proceeded to do what was required of them under the contract and sue M for the contractual sums due.

2. The majority in White & Carter v McGregor held that an innocent party who elects not to terminate the contract and can complete without the other's co-operation or involvement, is entitled to claim for the agreed price for the completed job or task. (Lord Reid, Hodson and Tucker). Lord Reid stated as follows:-

"*If it had been necessary for the defender to do or accept anything before the contract could be completed by the pursuers, the pursuers could not and the court would not have compelled the defendant to act, the contract would not have been completed and the pursuers' only remedy would have been damages.*"

"It might be but it never has been the law that a person is only entitled to enforce his contractual rights in a reasonable way, and that a court will not support an attempt to enforce them in an unreasonable way. One reason why that is not the law is, no doubt, because it was thought that it would create too much uncertainty to require the court to decide whether it is reasonable or equitable to allow a party to enforce his full rights under a contract."

3. Most contracts require there to be co-operation. For example, an employee requires an employer's co-operation to work thus making the application of this principle relatively rare.

4. Lord Reid eluded to the possibility that a person would need to show a legitimate interest in performing the contract rather than claiming damages. He stated as follows:-

"*It may well be that, if it can be shown that a person has* ***no legitimate interest****, financial or otherwise, in performing the contract rather than claiming damages, he ought not to be allowed to saddle the other party with an additional burden with no benefit to himself. If a party has no interest to enforce a stipulation, he cannot in general enforce it: so it might be said that, if a party has no interest to insist on a particular remedy, he ought not to be allowed to insist on it. And just as a party is not allowed to enforce a penalty, so he ought not to be allowed to penalise the other party by taking one course when another is equally advantageous to him."*

5. He gave an example of a consultant being engaged to go abroad and prepare a complex and expensive report and whose instruction was countermanded before he had begun to perform. In that example, he suggested that there *might* be no legitimate interest. However, he provided no further explanation as to what those words meant. What appears to be suggested by that authority is that there could be or might be some fetter on an innocent party's right to elect or some broader bar to recovery.

6. Neither Lord Hodson nor Lord Tucker endorsed these comments.

7. Lord Reid's observations gained some traction in a number of cases which will need to be considered before one looks at the most recent case looking into this issue:-

    a. In **Attica Sea Carriers Corporation v Ferrostaal Poseidon Bulk Reederei GmbH, The Puerto Buitrago [1976] 1 Lloyds' Reports 250** a charterparty provided that a ship should be repaired at the end of the hire period at the charterer's expense. The charterer attempted to return the ship without repairs. The cost of repair ($2 million) would exceed the ship's value ($1 million). The owners argued that the charterers were bound to repair it before redelivery, and that they were entitled to hire charges until it had been redelivered in a proper state of repair. Mocatta J accepted this proposition. The Court of Appeal held to the contrary, that if the vessel was out of repair when redelivered, the charterers were liable in damages, but that the redelivery was nevertheless valid. On that

basis the issue to which Lord Reid's comments were relevant did not arise. Nevertheless Lord Denning MR considered in an obiter passage whether, if the redelivery had been a repudiation of the contract, the owners would have been entitled to refuse to accept it and sue for hire thereafter. He said that the decision in White and Carter had no application "*in a case in which the plaintiff ought, in all reason, to accept the repudiation and sue for damages, provided that damages would provide an adequate remedy for any loss suffered by him*". Orr LJ agreed with Lord Denning on the principal point. As for the White and Carter point, he said that in the instant case, first, the owners could not perform the contract without the co-operation of the charterers and, secondly, the charterers had set out to prove that the owners had no legitimate interest in claiming the hire rather than damages. Browne LJ also agreed with Lord Denning on the principal point and with Orr LJ on the White and Carter point.

b. In **Gator Shipping Corporation v Trans-Asiatic Oil Ltd, The Odenfeld [1978] 2 Lloyd's Reports 357** charterers repudiated a charterparty, and the question arose whether the owners were obliged to accept that repudiation, or could disregard it and sue for the hire. The judge held that "*any fetter on the innocent party's right of election whether or not to accept a repudiation will only be applied in extreme cases, viz. where damage would be an adequate remedy and where an election to keep the contract alive would be wholly unreasonable*" (Per Kerr J) On the facts he held that the owners were entitled to refuse to accept the repudiation.

c. In **Clea Shipping Corp v Bulk International (The Alaskan Trader) (1984) 1 All ER 129** a vessel subject to a charterparty for 24 months suffered a major engine breakdown after nearly a year, such that the repairs would take several months. The charterers said they had no further use for the vessel but the owner proceeded with the repairs and then sought to hold the charterers liable for hire for the rest of the period of the charterparty, once the repairs had been completed — some seven months. On an arbitration, the award was that the owners had no legitimate interest in pursuing their claim for hire rather than asserting a claim for damages. Lloyd J dismissed an appeal against the award. He reviewed the cases set out above and held that: "*Whether one takes Lord Reid's language, which was adopted by Orr and Browne LJJ in The Puerto Buitrago , or Lord Denning MR's language in that case ("in all reason") or Kerr J's language in The Odenfeld ("wholly unreasonable. quite unrealistic, unreasonable and untenable"), there comes a point at which the court will cease, on general equitable principles to allow the innocent*

party to enforce his contract according to its strict legal terms. How one defines that point is obviously a matter of some difficulty, for it involves drawing a line between conduct which is merely unreasonable (see per Lord Reid in White and Carter at pages 429–430) and conduct which is wholly unreasonable (see per Kerr J in The Odenfeld at page 374). But however difficult it may be to define the point, that there is such a point seems to me to have been accepted both by the Court of Appeal in The Puerto Buitrago and by Kerr J in The Odenfeld." He went on:- *"this court is bound to hold that there is some fetter [on the innocent party's right to elect to disregard the repudiation], if only in extreme cases; and for want of a better way of describing that fetter it is safest for this court to use the language of Lord Reid, which, as I have already said, was adopted by a majority of the Court of Appeal in The Puerto Buitrago."* He also said that the correct analysis was that, the court, on equitable grounds, refused to allow the innocent party to enforce his full contractual rights.

d. In **Ocean Marine Navigation Ltd v Koch Carbon Inc ("The Dynamic") (2003) EWHC 1936** an arbitrator held in favour of the charterers that the owners were limited to damages and could not claim hire. On appeal from the award, Simon J held that the arbitrator had not applied the law correctly in rejecting the owners' claim to hire, and he remitted the award. He opined at para 23 that *"(1) The burden is on the contract-breaker to show that the innocent party has no legitimate interest in performing the contract rather than claiming damages. (2) This burden is not discharged merely by showing that the benefit to the [innocent party] is small in comparison to the loss to the contract breaker. (3) The exception to the general rule applies only in extreme cases: where damages would be an adequate remedy and where an election to keep the contract alive would be unreasonable*." [My emphasis]

e. In **Reichman v Beveridge (2006) EWCA Civ 1659** the Court of Appeal stated that there was a "*very limited category of cases where the court would not allow the innocent party to enforce its full contractual right to maintain the contract in force and sue for the contract price*" Lloyd LJ in a judgment with which the other Lords Justices agreed, stated that "*the characteristics of such cases are that an election to keep the contract alive would be wholly unreasonable and that damages would be an adequate remedy, or that the landlord ought have no legitimate interest in making such an election*" [My emphasis]

f. In **Isabella Shipowner SA v Shagang Shipping Co Ltd (The Acquafaith) (2012) EWHC 1077** Mr Justice Cooke stated that there will be no legitimate interest in maintaining the contract " *if damages are an adequate remedy and his insistence on maintaining the contract can be described as 'wholly unreasonable', 'extremely unreasonable' or, perhaps, in my words, 'perverse."*

8. Thus the authorities show that there may be occasions in which an innocent party's right to elect to affirm may be fettered. What the test is and the circumstances in which such a right may be fettered has been considered most recently in the case of **MSC v Cottonex (2016) EWCA Civ 789**.

MSC v Cottonex (2016) EWCA Civ 789 - The Facts

9. MSC contracted with Cottonex to carry containers of Cottonex's cotton to Bangladesh. The various bills of lading specified that if MSC's containers were not returned within 14 days of discharge from the vessel, demurrage (i.e. in this case liquidated damages for delayed return of the containers) became payable at a top rate of $24 per day per container. The running of demurrage was subject to no express time limit and could potentially run indefinitely.

10. Cottonex sold and shipped the cotton between April and June 2011, but the buyer failed to collect it from the discharge port. The port authorities in Bangladesh refused to allow Cottonex to remove the cotton from the containers without court permission. No court order was made and therefore the cotton remained at the port. Demurrage began to run 14 days after discharge.

11. On 27th September 2011 Cottonex notified MSC that it was unable to return the containers and thus perform its contractual obligations in terms of returning the containers, as it no longer possessed legal title to the cotton. On 2nd February 2012 MSC offered to sell the containers to Cottonex. However, the negotiations did not come to fruition, as Cottonex considered that the price offered was too high. MSC issued High Court proceedings to recover the demurrage which it said continued to accrue.

12. In the first-instance judgment, the Commercial Court ruled that Cottonex's notification on 27th September 2011 amounted to a statement that it would be unable to redeliver the containers within

the foreseeable future, if at all. By this time, the court held "*the delay had become so prolonged as to frustrate the commercial purpose of the adventure and that Cottonex was therefore in repudiatory breach of all contracts of carriage*". Leggatt J further held *"that the Carrier had no legitimate interest in keeping the contracts of carriage in force after that date in order to continue claiming demurrage. Its election to do so, and to go on doing so ever since, can in my view properly be described as wholly unreasonable. It is wholly unreasonable because the Carrier has not been keeping the contracts alive in order to invoke the demurrage clause for a proper purpose but in order, in effect, to seek to generate an unending stream of free income."* In coming to its conclusion, the court identified the *"increasing recognition in the common law world of the need for good faith in contractual dealings"*. In effect, *"a contractual discretion must be exercised in good faith for the purpose for which it was conferred, and must not be exercised arbitrarily, capriciously or unreasonably".*

13. The court ruled that MSC was entitled to recover the demurrage for the period between the expiry of the 14-day grace period and 27th September 2011, when notification was given to MSC. MSC appealed.

The Court of Appeal's Decision

14. The Court of Appeal disagreed with the analysis that the contract was repudiated on 27th September 2011. "*[I]n the absence of some special circumstances it is hard to see how such a relatively short delay can have been sufficient to frustrate the commercial purpose of the adventure. I can see a possibility that the uncertainty surrounding the future course of events and [Cottonex's] ability to redeliver the containers might lead to such a conclusion, but the judge did not base his decision on any assessment of that kind. With all respect to the judge, therefore, I do not think that his finding can stand*."
    Failing to return the containers within the stipulated time was no doubt a breach of contract, but it was not immediately a repudiatory breach.

15. It was common ground that the delay in returning the containers amounted to a repudiatory breach only when the delay was such as to *"render performance of the remaining obligations under the contract of carriage radically different from those which the parties had originally undertaken, or (where the delay was continuing) whether it would be regarded by a reasonable person in the position of the parties as being likely to last that long".*

16. The Court of Appeal did find that from 2nd February 2012 the contract was repudiated "*just as it would if [Cottonex] or those for whom it was responsible had caused the containers to be destroyed*." It was not that Cottonex would not return the containers, but rather that it could not. The court concluded that: "*as from 2 February 2012 the contract in its agreed form was not capable of performance – further performance in the changed circumstances brought about by the delay would be radically different from that agreed… In those circumstances, as it seems to me, the innocent party simply cannot treat the contract as subsisting because it is no longer capable of performance as agreed. There is no alternative to the conclusion that the contract has come to an end*." The court thus concluded that MSC was entitled to damages consisting of:- (i) demurrage on the containers up to 2nd February 2012; and (ii) a sum representing the value of the containers as at that date.

17. In reaching that conclusion, Moore Bick considered whether it would have been open to the Claimant to affirm the contract. He held that the option of affirming the contract did not remain open to the Claimant once the adventure had become frustrated and further performance was impossible. Moore-Bick LJ noted that the implications of Lord Reid's speech in White & Carter had not yet been fully explored and suggested that in an appropriate case, the Court would exercise its equitable jurisdiction to decline to grant an innocent party a remedy to which he would normally be entitled. The Court indicated in this case that the commercial purpose of the enterprise had been lost so that there was no legitimate interest in affirmation.

18. The effect of this is to potentially bring about an automatic repudiation of the contract - where the innocent party has no further obligations to perform or no obligations that require cooperation and the only unperformed obligations by the party in breach have become impossible/frustrated.

19. When the Court will exercise its inherent equitable jurisdiction is not clear. No guidance was given as to how such a principle will or should be applied in future cases and the precise point at which any automatic repudiation takes effect will be difficult to ascertain. Indeed, the test itself remains uncertain. Whilst Lord Reid has referred to the need to show a "legitimate interest," different Judges have used different formulations of the test. The one thing that is clear is that this issue is ripe for further litigation and exploration by the appellate Courts.

OLIVER ISAACS

17 October 2016

The 2016 changes to Insurance Law:

A litigator's perspective

Seb Oram

A. INTRODUCTION

1. The new legislation. August 2016 brings significant changes to insurance law. They have been effected in stages, under 4 Acts of Parliament as well as associated statutory instruments.[9] Once fully in force:

    1) the law governing rights to bring claims against the insurers of insolvent parties will be contained in the **Third Parties (Rights Against Insurers) Act 2010** (**"the 2010 Act"**); and

    2) in relation to substantive insurance law:

        (a) an insured's pre-contract disclosure obligations will be governed: (i) for *consumer* insurance contracts by the **Consumer Insurance (Disclosure and Representations) Act 2012** (**"the 2012 Act"**); and (ii) for *non-consumer* contracts, by the **Insurance Act 2015** (**"the 2015 Act"**); and

        (b) the effect of warranties and fraudulent insurance claims, the insurer's duty to satisfy insurance claims within a reasonable time, and miscellaneous further rules, will be governed by the 2015 Act.

2. The result may be untidy. That is particularly so because the Acts were not intended to codify the law, with the consequence that some important principles continue to be based on common law. Nonetheless, the reforms mark an important shift in the balance between insurers' and insured's rights, in favour of the insured.

3. For commercial litigators the 2010 Act is important, as it may provide a pool of assets lying outside a defendant's general assets in insolvency. Its utility depends on exercising rights to obtain timely information about any insurance policy. The 2015 Act is complementary, and equally important, since it limits the circumstances in which the insurer may reject a claim.

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[9] Changes to the substantive law of insurance are brought in by the **Insurance Act 2015**. It is amended by Part 5 of the **Enterprise Act 2016**, to introduce provisions about the late payment of insurance claims. The 2015 Act also itself amends the **Consumer Insurance (Disclosure and Representations) Act 2012**. Separately, the **Third Parties (Rights Against Insurers) Act 2010** will be brought into force. The 2010 Act is amended by the **Third Parties (Rights Against Insurers) Regulations 2016** (SI 2016/570).

B. PURSUING CLAIMS AGAINST THE INSURERS OF INSOLVENT PARTIES[10]

4. Introduction. Having sat on the statute books for 6 years, the **Third Parties (Rights Against Insurers) Act 2010** finally came into force on 1 August 2016.[11] It repeals the equivalent 1930 Act. The delay in implementation was caused by the need for amendments to expand the insolvency regimes to which it applies.[12]

5. Until the equivalent 1930 Act was passed, the benefits of an insurance claim would fall within the general assets of *D*'s insolvent estate, even if the policy was taken out to protect *Cl*'s interests. *Cl* would be treated as an unsecured creditor. The 1930 Act had the limited purpose of remedying that injustice, and did so by effecting a statutory transfer to *Cl* of *D*'s cause of action against *I* under the insurance contract.

6. The limitations of the 1930 Act. Critically, *Cl* acquires no better right against *I* than *D* had. The Act transfers "*[D's] rights against the insurer under the [insurance] contract*" (**1930 Act, s.1(1)**). That causes severe procedural problems because of the interaction of insurance law and insolvency law:

    1) If *D*'s contract is *liability* insurance, his right against the insurer is a right of *indemnity*. *Cl* therefore has to establish liability against *D* first, before the right to pursue the insurer will crystallise.[13] (That will often require him to obtain the court's permission under the Insolvency Act 1986 to institute proceedings, which is invariably granted.)

    2) If *D* has ceased to exist (through death or dissolution) *Cl* cannot sue him (or, in the case of a company, will need to restore it first) in order to establish his claim.

    3) Further, the 1930 Act regime had its own weaknesses in that *Cl*'s entitlement to ask for information about the policy was limited. Until Re OT Computers it was thought to arise only after *Cl* established liability against *D*. Insurers tended to use that tactically.

7. The 2010 Act addresses those problems:

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[10] The annotation in this section assumes that a claimant (*Cl*) has a claim against an insolvent defendant (*D*) and that *D* has the benefit of an insurance policy with his insurer (*I*), which extends to *Cl*'s claim.

[11] **Third Parties (Rights against Insurers) Act 2010 (Commencement) Order 2016** (SI 2016/550), **reg. 2**. The 2010 Act received royal assent in March 2010.

[12] Those amendments are made by Part 6 of the 2015 Act and by the **Third Parties (Rights Against Insurers) Regulations 2016** (SI 2016/570).

[13] Because a right of indemnity is dependent on an underlying liability: Bradley v. Eagle Star Insurance Co Ltd [1989] AC 957 (HL). However, that liability (to *Cl*) need not have been incurred before the insolvency. If it has not, *Cl* receives a statutory transfer of *D*'s *contingent* right to claim under the policy if and when the liability against him is made out: Re OT Computers (in administration) [2004] Ch 317 (CA) at [28].

1) As a matter of timing, *Cl* does not need to establish his claim against *D before* proceeding against *I* to enforce the rights under the insurance contract (but must establish it at some stage, both as to its existence and amount, before those rights are actually enforced): **2010 Act, s.1(3),(4)**.[14]

2) *D*'s liability can be "established" by a number of means (judgment, arbitration or agreement). There is also a new procedure for obtaining a declaration of both *D*'s and *I*'s liability towards *Cl*: **2010 Act, ss.1(4), 2**. (See below.)

3) The categories of "relevant person" (those subject to various insolvency regimes) include a corporate *D* who has been dissolved, and an individual *D* who has died insolvent. The categories of insolvency and dissolution are comprehensive. Note, however, that actual insolvency is not a requirement in all cases (so, for example, a company in members' voluntary liquidation or that has simply been struck off is still a relevant person).

4) *Cl*'s rights to obtain information about the insurance coverage are significantly enhanced (see below).

8. Combined party declaration procedure. The new procedure for obtaining a declaration of liability is in **section 2**. Declarations can be sought at the same time in respect of: (i) *D*'s liability towards *Cl*; and (ii) *I*'s potential liability under the insurance towards *Cl*. If the insurance contract requires arbitration, the declaration of *D*'s liability can also be sought in it: **2010 Act, s.2(7)**.

9. Note that where a declaration of *D*'s liability is sought, it is not *necessary* for *D* to be joined (although it will not be bound by the result if it is not: **2010 Act, s.2(9)-(10)**). In those proceedings *I* can rely on any defence that *D* had: **2010 Act, s.2(4)**. That raises a tactical question, is it better to bring an ordinary Part 7 claim and obtain default judgment?

10. What is transferred to *Cl*? The principle of statutory transfer remains: **2010 Act, s.1(2)**. Therefore, the 2010 Act does not *improve* the terms of the insurance policy,[15] except in two respects. First, a provision in the insurance contract that purports to alter the rights of the parties on the happening of the insolvency, is of no effect (mimicking the anti-deprivation principle of insolvency law): **2010**

[14] That may mitigate the effect of time bar clauses in the insurance contract (the Courts previously reached a similar result through a process of construction, *e.g.* William McIlroy (Swindon) Ltd v. Quinn Insurance Ltd [2012] 1 All ER (Comm) 241 (CA)).

[15] The 1930 Act was "*abundantly clear… that the legislature never intended… to put a third party in any better position as against an insurer than the insured himself*": Firma C-Trade SA v. Newcastle Protection and Indemnity Association (The Fanti) [1991] 2 AC 1 (HL), p.29; Law Society v. Shah [2009] Ch 223 (Ch) at [26].

Act, s.17. Secondly, certain claim pre-conditions in the policy (*e.g.* that *D* should provide information or assistance to the insurer) are overridden: **2010 Act, s.9(3)-(5)**.

11. As necessary incidents of the statutory transfer:

    1) *I* may rely on any defence available under the insurance policy to reject a claim (**2010 Act, s.2(3)**);

    2) if the new declaration procedure is brought against *I* seeking to establish *D*'s liability at the same time, *I* may rely on any defence to liability that *D* had (see above); and

    3) *I* can assert a right of set-off that would have existed against *D* (**2010 Act, s.10**).

12. Two further points are noteworthy. First, if the value of the insurance claim *exceeds* D's liability to *Cl*, that excess is not transferred (**2010 Act, s.8**). And similarly, if the insurance proceeds are *less* than the value of the claim then *Cl* may prove in the insolvency for the balance (**2010 Act, s.14(1)**). Secondly, the territorial scope of the Act is very wide and "*does not depend on whether there is a connection with a part of the United Kingdom*" (**2010 Act, s.18**). The only apparent limitation is that, in order to be a 'relevant person' *D* will need to have gone through a UK-based insolvency procedure or restructuring. That opens the possibility of territorial proceedings being established simply for the purpose of obtaining a transfer of insurance rights.

13. Information rights. *Cl*'s rights are significantly improved by **2010 Act, s.11; Sch. 1**. The new statutory rights are in addition to any other rights that *Cl* may have to seek information (**Sch. 1, para. 6**). There are broadly two circumstances in which information can be sought.

14. First, the narrower limb arises where *D* has been *dissolved* and *Cl* has *already started proceedings* against *I* (**Sch. 1, para. 3**). A notice may be served on previous officers, employees or insolvency officeholders requiring them to disclose "*any documents that are relevant to that liability*"; that operates as an obligation under CPR to provide standard disclosure: **Sch. 1, para. 3(1), 4(1)**. The right is constrained somewhat by the fact that proceedings against the insurer must have started, and *Cl* must send his Particulars of Claim in that action with his notice.

15. Secondly, there is a broader limb under which *Cl* is entitled to request information:

    1) from a person who *Cl* reasonably believes has incurred liability towards him and is a '*relevant person*' (*i.e.* subject to an insolvency regime): **Sch. 1, para. 1(1)**; or

2) if *Cl* reasonably believes that a liability has been incurred towards him and that rights of that person under a policy have been transferred to him, any "*person who [Cl reasonably believes] is able to provide*" the information set out below (**Sch. 1, para. 1(2)**).

16. *Cl* may request the following information from those persons (**Sch. 1, para. 1(3)**):

1) whether there is a contract of insurance that covers the supposed liability of D or might reasonably be regarded as covering it;

2) if there is such a contract: (i) who the insurer is; (ii) what the terms of the contract are; (iii) whether the insured has been informed that the insurer has claimed to reject liability; (iv) whether there are or have been any proceedings between the insurer and the insured in respect of the supposed liability and, if so, relevant details of those proceedings; (v) where the contract sets a limit on the fund available to meet claims in respect of the supposed liability and other liabilities, how much of it (if any) has been paid out in respect of other liabilities; (vi) whether there is a fixed charge to which any sums paid out under the contract in respect of the supposed liability would be subject.

17. Unless there is an entitlement to claim *legal professional* privilege, the recipient must respond within 28 days providing the information, or explaining why he is not able to (**Sch. 1, para. 2(1),(4)**). If the requested information is in a document that was once, but is no longer, in the recipient's control, he must provide *Cl* with whatever information he can about that information and the person to whom it was transferred (**Sch. 1, para. 2(2)**). All of these obligations are enforceable by court application (**Sch. 1, para. 2(3)**). *Cl*'s written notice must include particulars of the facts on which he relies as entitling him to give that notice (**Sch. 1, para. 1(6)**).

18. Whether the request is made under para. 1 or 3, a safeguard for the recipient is that he will only be taken to be "*able to provide information*" if he "*can obtain it without undue difficulty from a document that is in [his] control*" (**Sch. 1, para. 7**).

19. Transitional provisions. Under transitional provisions, the 1930 Act will continue to apply where *D* has *both* entered insolvency *and* has incurred liability towards *Cl* prior to 1 August 2016. The significance of those two events is that a statutory transfer under the old Act requires both of those events to have occurred.[16]

[16] See **2010 Act, s.20(2); Sch. 3, para. 3**. Case law under the 1930 Act had determined that the statutory transfer to *Cl* occurred on the later of: (i) *D*'s insolvency; or (ii) liability being incurred towards *Cl*: Re OT Computers (in administration) [2004] Ch 317 (CA) at [28]; Re T&N (No. 4) [2006] Lloyds Rep IR 817.

C. CHANGES TO SUBSTANTIVE INSURANCE LAW

20. Introduction. The recent reforms give effect to a number of Law Commission reports. They began in the **2012 Act**, which updated the law relating to pre-contractual disclosure and misrepresentation in the *consumer* field.[17] The **2015 Act** does the same for *non-consumer* insurance, and also implements wider changes (in both consumer and non-consumer cases) intended to redress the balance of fairness towards the insured.

21. Even before the Acts there was a disparity between strict insurance law applied by the courts, and the 'fair handling of claims' principles applied by the Financial Ombudsman Service (under the statutory force of the Financial Services and Markets Act 2000). Those able to invoke its jurisdiction could rely on ICOB r.8.1.1 requiring an insurer to handle claims fairly and not unreasonably reject a claim. The Law Commission remarked that, by contrast, the Courts were "*systematically forced to reach unfair decisions*" and that the law was out of step with other European member states.[18]

22. Summary of the 2015 Act. I shall focus in this talk on the changes to the law on warranties and fair presentation. Nonetheless, as an overview, the 2015 Act:

    1) replaces existing rules on (non-consumer) pre-contract disclosure and misrepresentation with a 'duty of fair presentation';

    2) restricts the insurer's remedies for breach of warranty and misrepresentation, making them more proportionate to the breach;

    3) consequentially limits the insured's duty of utmost good faith;

    4) introduces implied terms for the payment of claims within a reasonable time; and

    5) restricts the insurer's remedies for fraudulent insurance claims.

23. Extent / application of the Act. The 2015 Act extends to England and Wales, Scotland and Northern Ireland (**2015 Act, s.23(1)**). Its substantive provisions come into effect on 12 August 2016, subject to the following wrinkles:

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[17] The 2012 Act came into force on 6 April 2013 and applies to consumer insurance contracts entered into, and variations to consumer insurance contracts agreed, after that date.

[18] Joint report of the Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* (Law Com. No 319, Cm 7758; Dec 2009), para. 3.2.

1) The new 'duty of fair presentation' and the modifications to the good faith principle will apply: (i) to contracts of insurance entered into after 12 August 2016; and (ii) to variations, agreed after that date, to *all* contracts: **2015 Act, s.22(1)**.

2) The new rules on warranties, and on fraudulent claims will apply only to (i) contracts of insurance entered into after 12 August 2016; and (ii) variations to *those* contracts: **2015 Act, s.22(2)**.

3) The implied term for reasonable payment of claims will not come into force until 4 May 2017.[19]

24. Changes to the law on warranties. The distinction between a warranty and a misrepresentation is that the former is contractual. At common law, breach of a warranty in an insurance contract automatically discharges the insurer from liability (unless the breach is waived). The rule is particularly harsh because: any warranty must be strictly complied with; the warranty need not be material to the risk to have this effect, and the breach need not be connected to any loss suffered by the insurer; and the contract will be discharged even if the breach is remedied before the insured suffers the peril and makes a claim.[20] It is now clear that, if on its true construction the term is a warranty, the discharge is prospective only: Bank of Nova Scotia v. Hellenic Mutual War Risks [1992] 1 AC 233 (HL).[21]

25. The 2015 Act abolishes the rule of automatic discharge (**s.10(1)**). Instead, after a warranty has been breached:

1) the insurer will still be liable for losses occurring, or attributable to something happening, before the breach of warranty (**s.10(4)**);[22]

2) it will also be so liable after the breach is remedied (**s.10(4)**). Where the warranty requires something to be done by a particular time, it can still be remedied after if "*the risk to which*

[19] These provisions (ss. 13A and 16A) are introduced by amendment under the Enterprise Act 2016. They will come into force on 4 May 2017 and will apply only to contracts entered into after that date: **Enterprise Act 2016, ss.28(2), 44(3)**. A separate limitation period is introduced (Limitation Act 1980, s.5A), being 1 from ultimate payment of the claim.

[20] See, generally, *MacGillivray on Insurance Law* (13th ed., 2015), at para. 10-003.

[21] Prior to that decision there was a considerable body of opinion to the effect that the contract was discharged from inception. The House of Lords clarified that a promissory warranty is in the nature of a condition precedent to the insurer's liability.

[22] This distinction appears to reflect the common law principle that under an indemnity insurance policy the insurer is liable for the occurrence of insured perils during the risk period, even if damage from that risk only materialises after the end of the period: Wasa International Insurance Co Ltd v. Lexington Insurance Co [2010] 1 AC 180 (HL) at [38]-[39]

the warranty relates later becomes essentially the same as that originally contemplated by the parties" (**s.10(5)-(6)**);

3) the insurer is otherwise not liable during the period of breach *unless*: (i) "*because of a change of circumstances, the warranty ceases to be applicable to the circumstances of the contract*"; (ii) compliance with the warranty has become unlawful; or (iii) the insurer waives the breach.

26. There is therefore no change to the basic principle that a warranty must be strictly complied with but, in essence, a breach of warranty becomes suspensory. There are two important qualifications. The Act does not define "warranty", which is left to common law principles. If on its true construction the term is a condition precedent to liability, this provision will have no application. Further, however, basis of contract clauses can no longer be relied upon to turn representations in to warranties: **2015 Act, s.9(2)** (as for consumer contracts in **2012 Act, s.6(2)**).

27. **Section 11** is complementary, but potentially wider in scope as it is not limited to warranties. If a loss occurs and a term in the contract has not been complied with, the insurer may not repudiate cover if the insured "*shows that the non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred*". Its purpose is to prevent insurers from relying on non-causative breaches, *e.g.* a failure to have a fire alarm installed, if required by the policy, when the actual damage was flood damage.

28. These rules apply both to consumer and non-consumer contracts. In the former they cannot be excluded by agreement; in the latter they can, so long as the terms satisfy certain transparency requirements (**2015 Act, s.17**).

29. Changes to the law on representation and disclosure. It is helpful to contrast these against the existing law for consumers, because the regimes are similar.

1) **The duty.** Before entering into a *non-consumer* contract there is a positive obligation on the insured to "*make to the insurer a fair presentation of the risk*": **2015 Act, s.3(1)**. I consider this duty further below. By contrast, for a *consumer* contract the insured must simply take reasonable care not to make a misrepresentation: **2012 Act, s.2(2)**.[23]

2) **Effect of breach.** In both cases, the insurer only has a remedy for breach of those duties if it can show that, but for it, it would not have entered into the contract, or would have done so on different terms

[23] The consumer is (usually) judged by the standard of a reasonable consumer, and what amounts to reasonable care will depend on all the circumstances. Specific examples are: how clear, and how specific, the insurer's questions are; and whether or not an agent was acting for the consumer (**2012 Act, s.3**). A dishonest misrepresentation will always amount to a lack of reasonable care (**2012 Act, s.3(5)**).

(**2012 Act, s.4(1)(b)**; **2015 Act, s.8(1)**).[24] The Acts draw a further distinction between breaches that are '*deliberate or reckless*', or not (**2012 Act, s.5(1)**; **2015 Act, s.8(3)**).[25] In each case the burden is on the insurer to establish that.

(a) **Deliberate and reckless breaches.** The insurer may avoid the contract, refuse all claims and is not obliged to return the premiums paid (**2015 Act, Sch. 1, para. 2**). The position is the same for consumer contracts, except that the insurer must repay the premiums "*to the extent (if any) that it would be unfair to the consumer to retain them*" (**2012 Act, Sch.1, para. 2**)

(b) **Other breaches.** (For consumers these are termed "careless", but that simply reflects that there will be no breach unless the consumer fails to exercise reasonable care.) If:

i. the insurer would not have entered into the contract—it can avoid the contract and refuse all claims, but must return the premiums;

ii. the insurer would have entered into a contract on different terms—the contract is to be treated as being on those terms, if the insurer so requires. If a higher premium would have been payable, the insurer may reduce proportionately the amount to be paid on a claim.

Part 2 of Schedule 1 of each Act provides similar rules where the breach relates to a variation of an existing contract.

30. The new provisions do not expressly deal with composite policies (under which two or more persons are insured under one policy in respect of separate interests). The courts readily construed such policies as severable in respect of those separate interests, with the result that the avoidance of one part can occur without the other: *MacGillivray*, at para. 17-034.

31. The duty of fair presentation. The duty, which applies only to non-consumer contracts, is partly results-based (requiring specific information to be disclosed) and partly dependent on the quality of disclosure.[26]

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[24] That reflects the common law that any non-disclosure must have been the effective cause (but not the sole cause) of that contract being entered into: Pan Atlantic Insurance Co v. Pine Top Insurance Co Ltd [1995] AC 501 (HL). The test is not precisely the same, however, because it no longer refers to a reasonable insurer.

[25] The Act thus adopts the test in Derry v. Peek. Note a material difference between the consumer and non-consumer regimes: a consumer breach will not entitle the insurer to a remedy unless it is additionally shown that the consumer knew/was careless about the matter being *relevant* to the insurer.

[26] The Law Commission's reforms were designed to create an efficient and collaborative process, in particular: (i) to encourage active engagement in the disclosure process by the insurer; (ii) to prevent inefficient disclosure by 'data dumps'; (iii) to require a reasonable search by the insured for available information; and (iv) to reduce unnecessary disclosure of material already known or accessible to, or unnecessary for, the insurer.

1) **Results-based element.** The insured must provide (**2015 Act, s.3(4)**):

(a) disclosure of every material circumstance which the insured knows or ought to know, or

(b) failing that, disclosure which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances.

These two limbs are not alternatives that the insured may elect. Rather, the insured can probably only rely on the latter when he has attempted but failed to comply with his primary duty, but has disclosed enough to put the insurer on notice (as in Garnat Trading & Shipping (Singapore) Pte Ltd v. Baominh Insurance Corporation [2011] 2 Lloyds Rep 492 (CA); see *MacGillivray*, at para. 20-028).

A circumstance or matter is 'material' if it would influence the judgment of a prudent insurer in determining whether to take the risk and, if so, on what terms (**2015 Act, s.7(3)**). Unless requested, there is no need to disclose matters that the insurer already knows (or ought to know or is presumed to know), which reduce the risk or which the insurer has waived the right to know.

2) **Quality-based element. Section 3(3)** requires a presentation of the risk

(b) which makes that disclosure in a manner which would be reasonably clear and accessible to a prudent insurer, and

(c) in which every material representation as to a matter of fact is substantially correct, and every material representation as to a matter of expectation or belief is made in good faith.

The Law Commission proposals considered that a reckless presentation of the information (such as by 'data dump') could trigger the insurer's remedies. A material representation will be 'substantially correct' if a prudent insurer would not consider the difference material (2015 Act, s.7(5)).

32. A person's knowledge includes his wilful blindness: **2015 Act, s.6(1)**. The requirement for an insured to disclose what he "ought" to know looks peculiar, but is explained; he ought to know what should reasonably have been revealed by a reasonable search of information available to him: **2015 Act, s.4(6)**. Further, there are now detailed rules about whose knowledge is to be attributed to the insured (whether an individual or corporate entity).

33. What is a consumer contract? This becomes an obviously critical point. To avoid inconsistent regimes the 2015 Act adopts the definition of the **2012 Act, s.1** which provides:

> *"consumer insurance contract" means a contract of insurance between—*
>
> *(a) an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession, and*
>
> *(b) a person who carries on the business of insurance and who becomes a party to the contract by way of that business (whether or not in accordance with permission for the purposes of the Financial Services and Markets Act 2000)*

The Law Commission expressly borrowed from the EU Directive on Distance Marketing in order "to avoid any unnecessary differences between the definition" in various EU consumer statutes.[27]

34. Thus, a contract will be non-consumer if, first, the insured is not "an individual" or, secondly, the contract is entered into wholly or mainly for business purposes.[28] Micro-enterprises (which are non-consumer under the statute) may therefore still receive more favourable treatment if they can bring themselves within the jurisdiction of the Financial Ombudsman, although that might be short-lived if its claims handling rules are updated to come into tow with the Act.

35. What is left of the good faith principle? Its mischief was considered to be the disproportionate remedy (rescission of the contract) that it provided for. That is abolished, but the good faith principle is not entirely abrogated. On the contrary it is "*modified to the extent required by the provisions of this Act and the [2012 Act]*": **2015 Act, s.14(2)**.

36. That leaves some (admittedly narrow) scope for it, principally in the *post-formation* period of the contract. It has been held to apply: (i) when the insurance requires the insured to provide the insurer with information; and (ii) when a liability insurer exercises his right to conduct the insured's defence to a claim (see *MacGillivray*, para. 17-003). The Supreme Court has recently demonstrated a reluctance to extend its application to the making of claims: Versloot Dredging BV v. HDI Gerling Industrie Versicherung AG [2016] UKSC 45.[29]

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[27] Joint report of the Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* (Law Com. No 319, Cm 7758; Dec 2009), para. 5.15.

[28] Consequently, in mixed-purpose insurance contracts are specifically envisaged, and in those cases the main purpose of the insurance needs to be considered.

[29] Lord Sumption commented that "*once the contract is made, the content of the duty of good faith and the consequences of its breach must be accommodated within the general principles of the law of contract*", so that any right to avoid the contract to which its breach gives rise, ought to be prospective only (at [8]).

Can a false contractual warranty give rise to a claim

in Misrepresentation?

Christopher Edwards

1. The recent Commercial Court case of *Idemitsu Kosan Co Ltd v Sumitomo Corporation* [2016] EWHC 1909 (Comm) has reconsidered the issue as to whether a warranty given within a contract, or a draft copy of that warranty provided before the contract is entered into, can constitute a misrepresentation for a claim in common law or under the Misrepresentation Act 1967.

2. A claim in misrepresentation has potential benefits over a claim for breach of warranty for 2 reasons:

   a. The remedies to a claim in misrepresentation, being tortious remedies, are potentially preferable to those recoverable for breach of contract. In particular, the rules of remoteness are less strict in tortious claims. Further, an injured party in a misrepresentation claim may be able to have the contract rescinded by the court.

   b. A claim for breach of warranty may be capped by the contract, both in terms of damages recoverable and in terms of the period for bringing the claim. In *Idemitsu* for example, the contractually agreed 18 month time limit for bringing a claim for breach of warranty had expired.

3. Accordingly, parties that claim to have suffered a breach of warranty have, on occasion, sought to argue that such a breach also entitles them to bring a claim for misrepresentation.

PREVIOUS CASE LAW

Eurovideo Bildprogramm GMBH v Pulse Entertainment Limited [2002] EWCA Civ 1235

4. *Eurovideo* concerned a license agreement between Eurovideo Bildprogramm GMBH ('Eurovideo') and Pulse Entertainment Limited ('Pulse') whereby Pulse licensed videos of classic cartoons in German speaking parts of Europe to Eurovideo. The license agreement contained the following provisions:

   "Exclusive right for the first exploitation in the licensed media and language in the Territory, during the Term."

   "the exclusive right for the first exploitation and the license to manufacture, sell rent and advertise video devices, whether tape or disc or other contrivance, reproducing the Programmes for supply to the public for private home use by means of a playback device and to distribute same throughout the Territory and to grant sub-licenses to do the same …"

5. Most importantly, in clause 8, headed 'Representations and warranties', it stated:

"Licensor represents and warrants to Licensee as follows:
...
C That Licensor has not entered into any agreement which conflicts with the rights granted herein to Licensee. Licensee has the exclusive first exploitation right in the licensed territory."

6. In all 3 clauses, the wording 'exclusive right for the first exploitation' or similar was inserted during negotiations at the request of Eurovideo.

7. At first instance, the judge found that Pulse's acceptance of those amendments amounted to a representation of fact both in the exchange of letters and in the draft contract proffered by Pulse to Eurovideo for signature that corresponded with the wording set out in clause 8 above. Pulse appealed this element of his judgment, arguing that:

   a. Where language is proffered as to what is intended to become a term of the contract under negotiation it cannot be relied upon as a representation of fact. It can only be relied upon as a term of the contract in the form of a warranty such as can give rise to a breach of contract if the warranty is broken but which cannot give rise on such facts to a misrepresentation.

   b. The language used to negotiate in this case should not be considered to amount to representations.

8. Giving the unanimous judgment of the court, Rix LJ dismissed the appeal. He held that:

   a. '[L]anguage found in negotiations or in a draft contract can, depending upon the particular wording involved, amount to a representation of fact.' (para 30);

   b. When unpacked, the negotiations in this case contained representations of fact.

   c. In particular clause 8 contained misrepresentations of fact. It was not surprising that the clause was headed "Representation and Warranties". It was accurately so called, even though the label by itself could not be conclusive or determinative.

***Invertec v De Mol Holdings BV, Henricus Albertus de Mol* [2009] EWHC 2471 (Ch)**

9. Invertec purchased the entire share capital of Volante Public Transportation Interior Systems Limited ('Volante') from De Mol Holdings BV ('DMH'). It subsequently brought claims for fraudulent misrepresentation, under the Misrepresentation Act 1967 and negligent misstatement based on representations which became warranties in the Sale and Purchase Agreement ('SPA'). No claims were brought for breach of warranty..

10. The warranty provision stated:

> *5.1 Accuracy of warranties*
> *The Vendor warrants to the Purchase [sic] that, save as fairly disclosed by the Disclosure Letter, the Warranties are true and accurate in all material respects.*

11. The warranties, set out at paragraph 4 of the judgment, are fairly standard warranties for an SPA, warranting amongst other things:

> *3.7.1 [Volante's Management Accounts] have been prepared in [g]ood faith (good faith being regarded for these purposes as being with the intention of achieving a reasonably accurate and not misleading view of the financial and trading position of the Company) on bases and principles which are consistent with those used in the preparation of the unaudited management accounts of the Company for the financial year ended on the Company Balance Sheet Date [and] reflect with reasonable accuracy the financial and trading position of the Company for the period from the Company Balance Sheet Date to the Company Management Accounts Date.*
>
> *6.5.10 The Company is not unable to pay its debts with the meaning of s.123 Insolvency Act 1986*
>
> *9.1.2 The Company has discharged every Tax Liability of the Company falling due before Completion, due from the Company directly or indirectly in connection with any Event occurring on or before Completion and there is no Tax Liability of the Company or potential Tax Liability of the Company in respect of which the date for payment has been postponed by agreement with the relevant Tax Authority or by virtue of any right under any Tax Statute or the practice of any Tax Authority.*
>
> *9.1.4 Neither the Company nor any director or officer of the Company (in his capacity as such) has any liability for any interest, fine, penalty or surcharge in connection with any Tax Liability of the Company.*
> *...*
> *9.1.11 All Instalment Payments are up to date.*
> *9.1.12 The Disclosure Letter contains full details, by express reference to this paragraph 9.1, of ever subsisting formal or information arrangement or agreement (including without limitation any dispensation) entered into by the Company with any Tax Authority with regard to any of its Tax affairs.*

12. Arnold J found that the Defendant's had breached the above warranties. He also found that they were misrepresentations:

> *362 Counsel for the Defendants argued that, because Invertec's claims are all framed by reference to warranties in the SPA, Invertec cannot have any claim for misrepresentation, fraudulent or otherwise, but only a claim for breach of contract. I do not accept this argument for the following reasons. First, two of the claims (those relating to the July and August 2005 management accounts and its corporation tax liability) concern information which was supplied by DMH to Invertec during the negotiations prior to the SPA, albeit that its correctness was warranted in the SPA. In the case of the first of these Invertec's pleaded case has always clearly relied on the representations made prior to the SPA. As discussed below, the second was only pleaded by amendment at trial.*
>
> *363 Secondly and more fundamentally, the warranties in question also amount to representations of fact as to the state of Volante on 6 October 2005. The warranties were negotiated between Invertec and DMH over a considerable period prior to the execution of the SPA. As a result, Invertec knew prior to signing that the agreement it was about to enter into contained those warranties. In those circumstances I cannot see any reason in principle why Invertec cannot claim that it was induced to into the agreement by the representations made by those warranties so as to found a misrepresentation claim if they were false, particularly if they were fraudulently made.*

13. Whilst Eurovideo does not appear to have been cited to the judge, he clearly took the view that the warranties, making statements of fact about the state of Volante on the date of completion, could also be considered representations from the language used.

***Avrora Fine Arts Investment Ltd v Christie, Manson & Woods Ltd* [2012] EWHC 2198 (Ch)**

14. The issue arose in a slightly different context in the case of *Avrora*, which was a claim for breach of warranty and misrepresentation under common law and the Misrepresentation Act by the purchaser at auction of painting attributed to the Russian artist Boris Kustodiev by Christie's, the auction house. Newey J found that the painting was not painted by Kustodiev.

15. The relevant warranty stated:

Christie's warrant for a period of five years that any property described in headings printed in UPPER CASE TYPE is authentic and not a forgery.

16. The auction catalogue stated that where it gave the name of an artist without any qualification, that meant the work was in its opinion, a work by the artist.

17. Avrora argued that Christie's had made an implied representation that it had reasonable grounds for its opinion that the work was by Kustodiev. Christie's argued that the giving of the warranty mean that there was no need to imply such a representation. The judge agreed with Avrora.

133 It is plain, I think, that a person making a promise will not necessarily be expressing any opinion. Were I to warrant that it would snow next Christmas, that might not mean that I believed that that would happen, let alone that I had reasonable grounds for so believing. In effect, the warranty would represent a bet. On other occasions, a warranty might serve to allocate risk without any representation of opinion being made. If, on the other hand, the person giving a warranty is to be taken to have expressed an opinion on the relevant point, I do not see why the fact that he is also giving a warranty should preclude an implied representation that he has reasonable grounds for that opinion. The fact that he is prepared to back up his opinion with a warranty might be thought to reinforce the impression that he has a basis for it rather than to negate it.

***Sycamore Bidco Limited v Sean Breslin, Andrew Dawson* [2012] EWHC 3443 (Ch)**

18. The same issues in *Invertec* arose before Mann J in the case of *Sycamore Bidco*, another claim arising out of the purchase of shares in a company, Gissings Group Limited. This claim was brought as a claim for breach of warranty and as a claim for misrepresentation under the common law and the Misrepresentation Act on the basis that the warranties were representations. In this case, the Claimant only relied on the representations within the SPA; it did not rely on prior negotiations or draft contracts.

19. The warranty provision itself stated:

Seller Warranties

5.1 The Sellers severally warrant to the Buyer in the terms set out in Part B of Schedule 4, and the Warrantors severally warrant to the Buyer in the terms set out in Part C of Schedule 4, subject to the provisions of clause 8.

5.2 Each Warranty is to be construed as a separate and independent warranty and, save as expressly provided otherwise in this agreement, will not be limited by reference to or inference from any other Warranty or by any other provision of this agreement and subject to clause 8, the Buyer will have a separate claim for every breach of Warranty …".

20. The relevant warranties given were:

2.3 The Group has not committed any material breach of any express term of any agreement or arrangement to which it is a party and which is material in the context of the business of the Company and so far as the Warrantors are aware, no facts or circumstances exist which are likely to give rise to such a breach.

3.12 So far as the Warrantors are aware, there are no facts or circumstances which are likely to require any reversal or repayment of any material brokerage, commissions or fees already collected by a Group Company, or for which credit has been taken, other than in the normal course of business.

4.1 :The Accounts:
4.1.1 show a true and fair view of:
(a) the state of affairs;
(b) the assets and liabilities; and
(c) the profit or losses
of each Group Company to which they relate and the Group (on a consolidated basis) as at the Accounts Date;
4.1.2 have been prepared in accordance with relevant generally accepted accounting practice …

21. As can be seen, these were fairly standard warranties for an SPA, and did not differ greatly from those considered by Arnold J in *Invertec*. However, Mann J refused to follow the previous decision, on the basis that he did not agree with it in principle.

22. He found that the warranties were warranties only, and not representations, for 6 reasons (para 203):

    a. There is a clear distinction in law between representations and warranties, which would have been understood by the draftsmen of the SPA.

    b. The warranties are at all times described as warranties, and never as representations;

    c. The words of the warranty provision are words of warranty, not representation.

    d. The disclosure letter distinguishes between warranties and representations.

    e. The SPA contained limitations of liability for breach of warranty, but not for representations. If the warranties were capable of amounting to representations, this would remove the sellers' protection under the SPA.

f. There is a conceptual problem in having representations in a contract that are said to be relied upon – the timing does not work for inducement to enter into the contract.

23. He then went on to say at paragraph 209:

> *...I think that there is no satisfactory answer to be given by those claiming representations to have been made, to the question which has to be asked: Why have the warranty provisions been inserted in the contract? The answer is to be found in clause 5 in each case - they are there because they are warranted. There is nothing more to make them into representations.*

24. Again, Mann J does not appear to have *Eurovideo* placed before him when he gave judgment. There certainly appears to be a tension between the Court of Appeal's judgment that a warranty could be a representation if the language permitted and his judgment that a warranty is a different species of statement to a representation, and would not be a representation unless there was specific wording indicating that the party making the warranties represented them as well. This was a matter that would be before the court in *Idemitsu* .

***Idemitsu Kosan Co Ltd v Sumitomo Corporation* [2016] EWHC 1909**

25. *Idemitsu* was another claim arising out of breaches of warranty in an SPA. A claim was brought under the Misrepresentation Act as time had expired for a claim for breach of warranty. Sumitomo applied for summary judgment, and the application was heard by Andrew Baker QC sitting as a judge of the High Court.

26. The relevant warranty provision stated:

> *6.1.1 Each of the Sellers warrants to the Buyer in respect of itself and its Relevant Shares in the terms of the Warranties in paragraphs 1 and 2 of Schedule 4; and*
>
> *6.1.2 Sumitomo warrants to the Buyer in the terms of the Warranties in the remaining paragraphs of Schedule 4,*

27. Schedule 4 contained the following relevant warranties:

> *3.2.1 The Licence Interest Documents and any extensions thereto are in full force and effect and neither any Group Company nor, so far as Sumitomo is aware, any other party to the Licence Interest Documents is in breach of its material obligations under any of them in any material respect.*
>
> *3.2.3 The Licence Interest Documents in the form made available to the Buyer are, so far as Sumitomo is aware, in all material respects, complete and up-to-date copies of the material agreements relating to the Licence Interests to which any Group Company is a party, and no Group Company is under any legally binding obligation to enter into any further material agreement in relation to the Licence Interests.*
>
> *5.1.1 No Group Company is at the date of this Agreement subject to any outstanding order or judgment of any court or engaged in any civil, criminal or arbitration proceedings, nor have any such proceedings been threatened against the Company in writing and, so far as Sumitomo is aware, there are no material circumstances likely to give rise to any such proceeding.*

6. THE ACCOUNTS AND RECORDS

6.1 The Accounts
The Accounts:

(a) have been prepared in accordance with CA 1985 and CA 2006 (where applicable) and UK GAAP applicable to a company incorporated in the United Kingdom at the time they were audited;

(b) show a true and fair view of the assets and liabilities of the Group as at the Accounts Date and of the profits and losses of the Group for the accounting period ended on that date;

(c) are not affected by any unusual or non-recurring items that would make the financial position and results shown by the Accounts unusual or misleading in any material respect; and

(d) have been prepared on a basis consistent with the audited accounts of the Company for the two prior accounting periods without any change in accounting policies used.

9. MATERIAL CONTRACTS

9.1.1 The Material Contracts (and the Licence Interest Documents) comprise all of the material agreements to which any Group Company is a party. The Material Contracts are currently in full force and effect, are disclosed in the Data Room and are free from Encumbrances.

28. Again, the warranting provision and warranties are fairly standard for an SPA, and did not differ greatly from *Invertec* or *Sycamore Bidco*.

29. Idemitsu argued that both:

    a. the warranties in the completed SPA; and

    b. the warranties set out in Schedule 4 of the execution copy of the contract;

    were representations upon which a claim of misrepresentation could be made. In this, it advanced its case beyond that of Sycamore Bidco, which had relied only on the warranties in the completed contract.

30. The judge summarised Idemitsu's arguments as follows:

    a. The statements of fact in the Warranties were by nature capable of founding an action for misrepresentation.

    b. The designation of those statements as contractual warranties did not derogate from their inherent quality as representations.

    c. Mann J.'s conclusions in Sycamore Bidco, supra, were therefore wrong in principle; and Arnold J.'s view in Invertec Ltd, supra, is to be preferred, even if Arnold J. expressed himself more briefly or instinctually than Mann J. did in the later decision.

d. Nothing in the SPA - in particular none of the particular provisions relied on by Sumitomo - robbed the statements made in Schedule 4 to the SPA of their status as representations or excluded liability for misrepresentation, if there were otherwise a viable misrepresentation claim.

31. The judge disagreed with these arguments, stating that the 'propositions beg the real question in this case, because they assume that if "seller warrants X" is a term of a contract of sale, the seller thereby makes a statement, to the effect of X, to the buyer' (para 16).

32. He quoted Mann J, before commenting as follows: 'it seems to me its [Mann J's judgment's] basic underlying premise, I think a sound premise, is that the act of concluding a contract on terms that include contractual warranties does not amount to or involve the making by the warrantor to the counterparty of any relevant statement' (para 19).

33. In dealing with Idemitsu's argument of representations arising from the execution copy, the judge, referred to *Eurovideo*, accepted that '...language found in the communication of a negotiating position, or in draft wording for a contract, or in an entire draft contract, passing between the parties during the negotiation of a contract, might amount to or form the content of a pre-contractual representation...' (para 24).

34. However, he rejected the argument that the warranties in Schedule 4 of the execution copy were representations, stating that it was 'artificial and wrong in principle' to read Schedule 4 as if it had an independent existence of its function to provide content to the warranty provisions:

30... This is therefore a case in which Sumitomo's provision (etc.) of the Execution Copy communicated, so far as material, no more than a willingness to give a certain set of contractual warranties in a concluded contract and that distinguishes the case from Eurovideo Bildprogramm, supra...

31. Through the SPA as signed, Sumitomo made no representation to Idemitsu by Schedule 4, because Schedule 4 was not by nature a set of statements of fact made by Sumitomo to Idemitsu but was the agreed means by which the parties together chose to define the content of the Warranties, being certain of Sumitomo's contractual promises made under the SPA. In my judgment, Sumitomo's prior provision of, or offer to sign, or signature of, the Execution Copy, proffering such a Schedule 4, cannot give it (Schedule 4) a different character at that stage than it was to have, and in the event did have, when the SPA was duly concluded on the terms of the Execution Copy.

35. In other words, the difference between Eurovideo on the one hand and Idemitsu, Sycamore Bidco and Invertec was that the language in the former could be interpreted as giving rise to a representation, whereas the language in the latter could not, as it was purely the language of warranty.

ANALYSIS

36. Unfortunately, the analysis in *Idemitsu* is problematic in that it does not make clear how the facts in *Eurovideo* differ sufficiently to be distinguished. Is it that the main clause in *Eurovideo* had the Defendant 'representing and warranting' rather than simply warranting? If so, it is somewhat surprising that the Court of Appeal didn't simply say that in *Eurovideo*, choosing instead to focus on the language of the clause that was said to be a representation.

37. Schedule 4 contained, in a non-technical sense, statements of fact. Outside of a warranty clause, they would, in my view, be likely to be able to be used as the basis for a claim for misrepresentation. It would seem therefore, that Mann J and Andrew Baker QC have carved out a 'representation free zone' when it comes to warranty clauses, whereby statements of fact stop being statements of fact because they are warranties.

38. There are clear policy reasons for this, including preventing an aggrieved party trying to circumvent contractually agreed provisions for liability and damages. To that extent, the judgments are understandable, but they represent a step away from the use of plain language in contract law, in that warranting a state of affairs now does not mean making a statement about that state of affairs, but merely warranting it. The verb 'to warrant' has now, more than ever, taken on an artificial meaning that makes no sense beyond the world of contract law.

CONCLUSION

39. Whilst the law is not entirely certain at the moment, it would appear that:

    a. A warranty alone, either as part of a contract or in pre-contractual negotiations, is unlikely to be able to support a claim in misrepresentation (*Idemitsu*).

    b. However, a provision that 'warrants and represents' or similar and contains statements of facts, is likely to be able to support such a claim (*Eurovideo*). In order to prove inducement, it is likely that such a representation would need to be contained in pre-contract drafts or negotiations.

    c. The existence of a warranty does not preclude an implied representation, particularly where there is other documentation to support such a representation (*Avrora*).

CHRISTOPHER EDWARDS
12 October 2016

Recent Issues In
Contribution Claims Under the 1978 Act

Edward Ross

1. The Civil Liability (Contribution) Act 1978 ("the 1978 Act"). As the preamble states, an act to make provision:

"For contribution between persons who are jointly or severally, or both jointly and severally, liable for the same damage and in certain other similar cases where two or more persons have paid or may be required to pay compensation for the same damage; and to amend the law relating to proceedings against persons jointly liable for the same debt or jointly or severally, or both jointly and severally, liable for the same damage."

2. In a nutshell two Defendants[30], liable to the same Claimant can ask the Court to apportion the claim between them. In effect to decide what it is *fair* for each of them to pay. This is an apparently simple concept enshrined in s.1(1):

"...any person liable in respect of any damage suffered by another person may recover contribution from any other person liable in respect of the same damage (whether jointly with him or otherwise)"

3. This talk will examine three recent decisions that have involved the application of the 1978 Act: ***WH Newson Holdings Ltd v IMI Plc* [2016] EWCA Civ 773, *Cape Distribution Ltd v Cape Intermediate Holdings Plc* [2016] EWHC 1119 (QB)** and ***Cape Distribution Ltd v Cape Intermediate Holdings Plc* [2016] EWHC 1786 (QB).**

<u>WH Newson Holdings Ltd v IMI Plc</u>

4. *WH Newson* was an appeal from a first instance decision in the Chancery Division before Rose J. The claim was based upon a finding in 2006 by the European Commission that IMI Plc ("D1") and Delta Limited and Delta Engineering Holdings Limited (together 'Delta') ("D2") had participated in a price-fixing cartel in the copper and copper alloy fitting market between 1988 and 2001.

[30] It can be more than two but I shall keep it simple for the moment.

5. WH Newson and 22 others ("C") brought damages claims against D1 on the basis that the cartel had inflated prices and so caused them a substantial loss. D1 defended the claims, and included in its Defence a pleading that the actions were barred due to limitation.

6. In C's Reply it was argued that, pursuant to s.32 Limitation Act 1980, there had been *"deliberate concealment"* of facts by D1 and therefore limitation had not started to run until C could, with reasonable diligence, have discovered those facts.

7. In the meantime D1 had issued Part 20 claims against D2. One element of then Defence to the Part 20 proceedings was to assert a positive case that C were aware of or could, with reasonable diligence, have discovered, the facts relevant to their cause of action and so there was no concealment. Accordingly the limitation defence should succeed.

8. C and D1 reached settlements and by the time the matter came before the Court the only substantive live issue was the Part 20 action by D1 against D2. The case turned on the interpretation of s.1(4) of the 1978 Act:

Section 1

'1. – Entitlement to contribution

(1) Subject to the following provisions of this section, any person liable in respect of any damage suffered by another person may recover contribution from any other person liable in respect of the same damage (whether jointly with him or otherwise).

(2) A person shall be entitled to recover contribution by virtue of subsection (1) above notwithstanding that he has ceased to be liable in respect of the damage in question since the time when the damage occurred, provided that he was so liable immediately before he made or was ordered or agreed to make the payment in respect of which the contribution is sought.

(3) A person shall be liable to make contribution by virtue of subsection (1) notwithstanding that he has ceased to be liable in respect of the damage in question since the time when the damage occurred, unless he ceased to be liable by virtue of the expiry of a period of limitation or prescription which extinguished the right on which the claim against him in respect of the damage was based.

(4) A person who has made or agreed to make any payment in bona fide settlement or compromise of any claim made against him in respect of any damage (including a payment into court which has been accepted) shall be entitled to recover contribution in accordance with this section without regard to whether or not he himself is or ever was liable in respect of the damage, ***provided, however, that he would have been liable assuming that the factual basis of the claim against him could be established.'***
(emphasis added)

The Question

9. The Court had to grapple with the proviso at the conclusion of s.1(4) and more specifically what amounted to the "factual basis of the claim against [D1]". Could D2 rely on the time bar argument? If so then the contribution claim would fail.

The First Instance Decision

10. To assist with the question of interpretation Rose J. was taken to two previous, non-binding, authorities ***Arab Monetary Fund v Hashim and others,* 28 May 1993, unreported** and ***BRB (Residuary) Ltd v Connex South Eastern Ltd* [2008] EWHC 1172 (QB)** and the Law Commission Report which preceded the 1978 Act.

Law Commission Report on Contribution

11. Part of the paper discussed the proposed changes to allow a Defendant who had entered into a *"bona fide compromise"* with a Claimant to seek a contribution from another Defendant. It was seen as unsatisfactory to require the Defendant to prove his own liability, it was said that it would turn *"the usual convention of civil litigation upside down".*

12. The recommendation was that the 1978 Act should allow recovery when the settlement was *bona fide*, without any regard to liability as between the parties to the original claim. However, s.1(4) didn't go quite that far, due to the proviso.

Hashim

13. Chadwick J. held that when determining the *"factual basis"* it was necessary to have regard, at least principally, to *all* the pleadings. He then considered the different forms of Defence one might have regard to:

    13.1. The Defendant denies the claim and pleads facts that are inconsistent with the material facts in the Particulars of Claim. Under the proviso the assumption the Court makes is that those inconsistent facts would not have been established.

    13.2. The Defendant pleads a *"collateral defence",* for example limitation. This was defined as one that is not necessarily inconsistent with the Particulars of Claim but seeks to avoid liability by way of confession and avoidance. Where the Defendant pleads positive facts, the burden of proof may shift to the Defendant.

14. His conclusion, following this differentiation, was that it was open for a Defendant in a claim under the 1978 Act to ask to the Court to investigate whether the *"collateral defence"* would have succeeded. If so the contribution claim would fail.

BRB (Residuary) Ltd

15. Cranston J appeared to have reservations about the *Hashim* decision opining that if the matter had been a blank sheet he would have held that the proviso *"confined the inquiry to whether the facts as pleaded in the statement of claim grounded a cause of action"* [14]. In the circumstances he went no further and simply applied *Hashim.*

Conclusion at First Instance

16. D1 argued that the limitation defence was not a *"collateral defence"* because it did not depend upon facts which D1 was required to prove. It was not D1 who had raised the point as to whether C were entitled to rely on s.32 or not. It would have been for C to have established those facts. On that basis the proviso was satisfied and D1 were allowed to recover a contribution from D2.

The Appeal

17. Sir Colin Rimmer, with whom Gross and Hamblen LJJ agreed, upheld the appeal, although on different grounds. By doing so the Court provided a welcome simplification to what had seemingly become a complex and potentially unwieldy principle.

18. The Court of Appeal set out how s.1(1) is qualified by the later subsections. s.1(2) looks at the matter from the perspective of D1 and allows recovery after liability between C and D1 has ceased, it matters not that the contribution claim is brought after that point.

19. S.1(3) looks at the matter from the perspective of D2 and allows recovery unless D2 has ceased to be liable because the cause of action against him has been extinguished by limitation or prescription. In *WH Newson* C's claim may have been barred but it was not extinguished.

20. S.1(4) is aimed at the cases where there has been a settlement and therefore in turn qualifies ss.(1) and (2). It is the:

"*express negation of the probative burden that, had they stood alone, section 1(1) and (2) would have imposed on D1."* [52]

21. The qualification is not absolute, because of the proviso, but the Court of Appeal held that in *Hashim* Chadwick J had:

"focused too closely on the trees in the proviso without also standing back and noting the nature of the wood in which they had been planted. The result was that he wrongly allowed the tail of section 1(4) to wag the dog." [55]

22. The reasoning was as follows:
    22.1. The premise of s.1(4) is a *bona fide* settlement. So it is always open to D2 to say there has been collusion or dishonesty and so prove it was not *bona fide*.
    22.2. Litigation is vast and wide ranging, from simple claims and denials to complex defences with shifting burdens of proof.
    22.3. The central feature of s.1(4) is that where there has been a *bona fide* settlement then there will be no question as to whether D1 was liable to C, giving clear effect to the Law Commission recommendations.

22.4. The proviso shows that whilst D1 must prove *something* to ground the contribution claim it is not a high threshold and all that must be shown is that the factual basis of the claim discloses a reasonable cause of action again D1.

23. The Court respectfully held that Chadwick J's interpretation in *Hashim* was wrong. The proviso:

"cannot therefore fairly be read as impliedly qualifying [the] prohibition so as to let in an inquiry directed at showing that D1 was not actually liable". [61]

24. One can see that this reflects the concerns of Cranston J in *BRB (Residuary) Ltd* and settles the point in the neat manner he suggested but then rejected - look at the particulars of claim, do they demonstrate a reasonable cause of action, if yes then the contribution claim succeeds (subject then to any arguments on quantum).

25. The decision may generate further litigation on the meaning of a *"reasonable cause of action",* as this was left undefined by the Court of Appeal. It also doesn't assist directly in those cases that settle pre-issue. However, it is the author's opinion that it provides a more satisfactory starting position and it will now be an easier enquiry than the previous one involving potentially complex investigations into collateral defences.

Cape Distribution Ltd v Cape Intermediate Holdings Plc

26. Cape comprises two somewhat mammoth judgments of Picken J. They deal with a whole host of preliminary issues arising out of the landmark 2012 decision, which decided that the parent company was liable to the employees of a wholly owned subsidiary.

27. The very basic premise of the case was as follows. C, the subsidiary, produced asbestos related products. Following claims for asbestos related illnesses C settled the majority of claims with the assistance of an employers' liability insurance policy.

28. Aviva, the subsidiary's employers' liability insurer sought to bring a subrogated claim against the parent company, seeking an indemnity or in the alternative a contribution under the 1978 Act.

29. In 1964, the subsidiary and parent had entered into a Sale Agreement, the effect of which was that the subsidiary would cease to have any business of its own. One particular aspect of the Sale Agreement

was an indemnity in the subsidiary's favour. Some months later, an endorsement was added to the subsidiary's employers' liability policy which, it was argued, precluded the subrogated claim because the parent company had been added as an insured.

Cape (No.1)

30. In amongst the preliminary issues was a specific question in relation to the 1978 Act:

"If CIH is insured, does the Policy which indemnifies against "liability at law for damages" extend to CIH's liability to CDL to make a statutory contribution under the Civil Liability (Contribution) Act 1978 or to provide a contractual indemnity pursuant to the Sale Agreement?"

31. This question turned on an exception to the insurance Policy which stated:

"The Company shall not be liable in respect of … Liability which attaches by virtue of an agreement but which would not have attached in the absence of such agreement …"

32. Picken J was referred to previous authorities on the point and in the end dealt with the matter very shortly. He held that if, following the trial, the subsidiary was only liable under the Sale Agreement then the exception would apply, that was the clear wording and meaning of the stipulation. However, *"liability at law for damages"* included liability to make a statutory contribution under the 1978 Act.

Cape (No.2)

33. In the second *Cape* judgment a further issue, under the 1978 Act, that had not been dealt with during the first hearing, was explored. The argument concerned s.7(3):

"The right to recover contribution in accordance with section 1 above supersedes any right, other than an express contractual right, to recover contribution (as distinct from indemnity) otherwise than under this Act in corresponding circumstances,; but nothing in this Act shall affect -
(a) any express or implied contractual or other right to indemnity; or
(b) any express contractual provision regulating or excluding contribution;
which would be enforceable apart from this Act (or render enforceable any agreement for indemnity or contribution which would not be enforceable apart from this Act)."

34. The issue was whether, due to the preliminary finding that the parent company was entitled to contractual indemnities from the subsidiary under the Sale Agreement, s.7(3) precluded the subsidiary from bringing a counterclaim under the Act? Although in the end the issue was not contentious the Judge felt it was right to determine the point and so addressed the arguments within his judgment.

35. It was submitted that where a party has an enforceable right to indemnity from another party the effect of s.7(3) is to protect the entitled party by preventing the loss of part of that right by way of a set-off or counterclaim under the 1978 Act. The Judge agreed and, having also referred to previous authority, held that the effect of s.7(3)(b) was that any counterclaim would *"affect"* the indemnity and so an action under the 1978 Act could not be sustained.

36. Whilst there was agreement with this approach by Counsel representing the subsidiary it was on the basis that an application for permission to appeal some of the preliminary findings in *Cape (No.1)* was going to be made. If the underlying preliminary findings are altered the effect of s.7(3) on this particular case could similarly be altered. Watch this space (both judgments have been appealed but as yet all that is known is they *should* be heard by early 2018)…

37. Why is it important? Apportionment under the Act could lead to a very different result as between parties when compared with the the application of a specific contract between them. It demonstrates the significant weight placed on a contractual bargain above the statutory regime for deliberation of contribution under the 1978 Act.

EDWARD ROSS

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Illegality in the Supreme Court:
***Patel v Mirza* [2016] UKSC 42**

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Introduction

1. In July 2016 the Supreme Court had the long awaited opportunity to re-visit the law on illegality in ***Patel v Mirza***.

2. The law of illegality had become a mess: academics and judges alike had commented on the need for some clarity in the approach going forward. The leading decision of ***Tinsley v Milligan*** [1994] 1 AC 340, set out below, had received a lot of negative attention both at home and abroad. Both the Law Commission, the domestic courts and courts in America, Canada and Australia had suggested the approach taken by the House of Lords needed to be revisited.

3. This note sets out the decision in ***Patel v Mirza*** and the impact of this decision on the law of illegality.

Background

4. Illegality, or the legal doctrine of *ex turpi causa non oritur action*[31]. The starting point is the judgment of Lord Mansfield in the eighteenth century case of ***Holman v Johnson*** (1775) 1 Cowp 341, 343 in which it was stated:

> *"The objection, that a contract is immoral or illegal as between plaintiff and defendant, sounds at all times very ill in the mouth of the defendant. It is not for his sake, however, that the objection is ever allowed; but it is founded in general principles of policy, which the defendant has the advantage of, contrary to the real justice, as between him and the plaintiff, by accident, if I may so say. The principle of public policy is this; ex dolo malo non oritur actio.* ***No Court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act****. If, from the plaintiffs own stating or otherwise, the cause of action appears to arise ex turpi causa, or the transgression of a positive law of this country, there the Court says he has no right to be assisted. It is upon that ground the Court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. So if the plaintiff and defendant were to change sides, and the defendant was to*

[31] 'From a dishonourable cause an action does not arise.'

bring his action against the plaintiff, the latter would then have the advantage of it; for where both are equally in fault, potior est conditio defendentis."

5. The basic principle is that the court should not support criminal activity and that the law must be consistent: it would be unsatisfactory if the courts gave with one hand what they took away with the other. However, the courts have generally been keen to limit the doctrine's scope, in part because it deprives a claimant of their ordinary rights to claim damages and has the potentially unfortunate consequence of providing an accidental and undesirable windfall for the defendant.

The position pre *Patel v Mirza*

6. ***Tinsley v Milligan*:** The parties both contributed to the purchase of a home. However, it was vested solely in T's name with the mutual understanding that both T and M were joint beneficial owners. The reason for this strategy was to enable M to make false benefit claims from the Department of Social Security ("DSS"). M made fraudulent benefit claims over a number of years and this money helped to pay the parties' bills and a small amount went to the equity in the house. M confessed to the DSS about what she had done and reached an agreement with it. However, the parties fell out and T sought possession against M. M counterclaimed for a declaration that the property was held by T on trust for both parties.

7. The House of Lords found held that property could pass under an unlawful transaction; but held that the court would not assist an owner to recover the property if he had to rely upon on his own illegality to prove title. M was able to prove her title without relying on her illegality and accordingly could succeed. The criticism of the House of Lords' approach was that it could give different outcomes as a result of procedural technicalities.

The case: *Patel v Mirza*

8. **Facts of the case:** P transferred to M £620,000 for the purposes of betting on shares. This would involve the use of insider knowledge, and accordingly was contrary to s.52 of the Criminal Justice Act 1993. M was unable to perform the contract as the insider information was not forthcoming and P claimed for a return of the monies paid. M's defence was that P could not succeed in a claim as it was based on an illegal contract.

9. At first instance the court dismissed P's claim on the grounds that, in line with the House of Lords' authority ***Tinsley v Milligan***, P could not succeed in a claim which relied upon his illegal

conduct. Further, P was unable to bring himself within the exception of the doctrine known as 'locus poenitentiae' because he had not voluntarily withdrawn from the illegal activity.

10. P appealed and the majority of the Court of Appeal agreed that P's claim could not succeed as he needed to rely on the illegal contract. However, the Court of Appeal disagreed with the trial judge's conclusion in respect of 'locus poenitentiae' and held that it was enough that the scheme had not gone ahead. In her dissenting judgment, Gloster LJ agreed with the outcome suggested by the majority but took a different approach to it. Gloster LJ emphasised the difficulty in this area of law and suggested that P's claim did not go to the mischief that the offence of insider trading was aimed at.

11. M appealed to the Supreme Court. The appeal was heard by nine justices and the Supreme Court, like the Court of Appeal before it, was split. All nine justices were in agreement as to the outcome of the appeal, namely that it be dismissed, but were split in the route to this outcome.

12. The majority held that the correct approach was the 'range of factors approach'. Lord Toulson delivered the judgment of the majority (with which Lords Kerr, Hale, Wilson and Hodge agreed) and stated:

"The essential rationale of the illegality doctrine is that it would be contrary to the public interest to enforce a claim if to do so would be harmful to the integrity of the legal system (or, possibly, certain aspects of public morality, the boundaries of which have never been made entirely clear and which do not arise for consideration in this case). In assessing whether the public interest would be harmed in that way it is necessary (a) to consider the underlying purpose of the prohibition which has been transgressed and whether that purpose will be enhanced by denial of the claim, (b) to consider any other relevant public policy on which the denial of the claim may have an impact and (c) to consider whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts. Within that framework, various factors may be relevant, but it would be a mistake to suggest that the court is free to decide a case in an undisciplined way. The public interest is best served by a principled and transparent assessment of the considerations identified, rather by than the application of a formal approach capable of producing results which may appear arbitrary, unjust or disproportionate.

A claimant, such as Mr Patel, who satisfied the ordinary requirements of a claim for unjust enrichment, should not be debarred from enforcing his claim by reason only of the fact that the

money which he seeks to recover was paid for an unlawful purpose. There may be rare cases where for some particular reason the enforcement of such a claim might be regarded as undermining the integrity of the legal system, but there are no such circumstances in this case."[32]

13. The new test did away with the reliance test namely the rule that a party who has to rely on his own illegal conduct in order to establish his claim should not be able to enforce the claim.

14. Lord Sumption gave a robust dissenting judgment (with which Lord Clarke agreed), strongly and unsparingly disapproving of the range of factors approach and stated that it:

"is far too vague and potentially far too wide to serve as the basis on which a person may be denied his legal rights. It converts a legal principle into an exercise of judicial discretion, the process exhibiting all the vices of "complexity, uncertainty, arbitrariness and lack of transparency" which Lord Toulson JSC attributes to the present law. I would not deny that in the past the law of illegality has been a mess. The proper response of this court is not to leave the problem to case by case evaluation by the lower courts by reference to a potentially unlimited range of factors, but to address the problem by supplying a framework of principle which accommodates legitimate concerns about the present law. We would be doing no service to the coherent development of the law if we simply substituted a new mess for the old one."[33]

Lord Sumption also reiterated the benefits of the reliance rule[34].

15. Lord Neuberger stated that he agreed with the majority, albeit perhaps somewhat tentatively, and observed that the range of factors approach was *"not akin in practice to a discretion, and, in any event, is the best guidance that can sensibly be offered at the moment."* This is not an overly positive endorsement of the range of factors approach, however it reflects the intrinsic difficulty in applying any rule or approach to the issue of illegality.

The new approach

16. Courts considering issues of illegality will now do so by reference to the three 'P's:
    - Purpose
    - Policy
    - Proportionality

[32] at [120]-[121]
[33] at [265]
[34] at [239]

17. I now consider each of three elements of the range of factors approach.

18. **Purpose**: How specific does the court need to be in assessing the purpose? When considering the first limb of the approach it is unclear whether a court will need to evaluate the purpose of the prohibition of the specific contravention or whether it will be sufficient for the court to consider the type or category of the contravention.

19. For example, in ***Tinsley v Milligan*** would a court need to evaluate the specific purpose of DDS legislation or simply consider the purpose of that type of legislation, i.e. fraud. Hopefully, the courts will take a pragmatic and proportionate approach to avoid extensive arguments or discussion about minute details of policy.

20. **Policy**: there will be times where there may be other conflicting policy considerations which the court will need to take into account when deciding whether an illegality defence should succeed. The case of ***Hounga v Allen*** [2014] 1 WLR 2889 is a good example of different policy considerations. H was a 14 year old Nigerian girl who was hired by A to work as home help for them in the UK in exchange for schooling and £50 per month. H was never paid or allowed to go to school, and suffered significant abuse by A. After a period of time A forced H out of the home and H was taken in by social services. H brought claims against A which included a claim for discrimination. At first instance it was found that she had been dismissed because of her vulnerability which was a consequence of her immigration status and awarded her compensation for injury to feelings. The Court of Appeal set this order aside on the grounds that the claim was tainted by the illegal nature of her contract. The matter came before the Supreme Court which restored the first instance decision. Lord Wilson JSC observed the need to consider the purpose of the policy which related to the illegality but also to consider whether there were any other aspects of public policy which needed to be balanced. Lord Wilson JSC concluded that (a) the award of compensation for damage to H's feelings was not a form of profit from the illegal contract and (b) to allow a defence of illegality would be contrary to the public policy in preventing human trafficking and in favour of the protection of victims.

21. **Proportionality**: Lord Toulson made a number of references to the need for proportionality in his judgment and warned of the risk of "overkill" if the approach was not applied sensibly. The risk is that someone may be deprived of their rights for a minor breach[35]. An example of an earlier case which considered the issue of proportionality was ***ParkingEye Ltd v Somerfield Stores Ltd*** [2013] QB 840 where the Court of Appeal upheld ParkingEye's claim for damages arising from

[35] As discussed by Devlin J in ***St John Shipping Corpn v Joseph Rank Ltd*** [1957] 1 QB 267, 288-289.

Somerfield's repudiatory breach of contract. The performance of the contract included an intended use of deception, however the court held that it was unintentional and did not form part of the main performance. The court refused to allow Somerfield's defence of illegality in part because it would have led to a disproportionate result.

22. What is unclear is where the courts will or should draw the line and what will be considered a too minor transgression to cause a claim to fail on the grounds of illegality. In ***ParkingEye v Somerfield*** the issue of proportionality related to the fact that deceptive letter was only a small part of ParkingEye's performance and was not essential to its performance of the contract. It would appear that the Court of Appeal was also influenced by ParkingEye's lack of intention, namely the fact that it had not appreciated that the letter would be legally objectionable.

23. It remains to be seen how this new, or amended, approach to illegality will work in the future. The principles themselves are straightforward but as ever the concern will be how the courts apply these principles. The minority of the Supreme Court were concerned that the three stage approach proffered by Lord Toulson would allow courts too broad a discretion when deciding cases involving illegality, and the result of this would be continued or further uncertainty in the law. Unsurprisingly perhaps at the time of writing there were no reported decisions applying the new approach.

24. Future cases will demonstrate whether the minority's concern about certainty are justified. Lord Toulson suggested that certainty of the law was not an absolute, or at least those that engaged in illegal activities may not deserve the same certainties as those individuals behaving with the law? Lord Neuberger, who otherwise agreed with Lord Toulson's approach in broad terms, suggested this that may not be correct. This perhaps hints at the potential 'moral dimension' to claims on illegality.

Conclusion

25. As emphasised consistently throughout the judgments, this remains a complicated area of law. Although the new range of factors approach is straightforward to understand, it remains to be seen whether it will be straightforward for judges at first instance to apply it and whether it will lead to greater consistency.

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