BUDDLE FINDLAY

Legal update on litigation and dispute resolution - March 2014

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He who hesitates is lost

The harsh reality of statutory limitation periods was highlighted in the recent High Court decision of *James v McMahon* [2013] NZHC 3018. The defendants (a firm of solicitors) admitted that they had been negligent but successfully defended the claim on the basis that the limitation period had expired.

In 2005, the plaintiffs engaged the defendants to prepare (among other things) a guarantee that would be effective until 2015. However, the defendants negligently failed to ensure that the guarantee was effective until 2015 (instead, the guarantee terminated in 2006). Not only had the defendants failed to prepare an appropriate guarantee, on several occasions between 2005 and 2010 the plaintiffs sought and obtained from the defendants assurances that the guarantor remained liable under the guarantee.

In 2010, the plaintiffs called on the guarantor to honour its guarantee. At that time, the plaintiffs discovered that the guarantee had terminated and was unenforceable. What the plaintiffs did not know was that the time period within which they could bring a claim against the defendants had almost expired.

In 2012, the plaintiffs commenced a proceeding against the defendants. The defendants admitted that they had been negligent when preparing the guarantee but successfully defended the claim on the basis that the six year statutory limitation period had expired in 2011.

For a claim in negligence, the six year statutory limitation period usually commences on the date that the plaintiff first suffers a loss. At issue was whether the plaintiffs suffered a loss in 2005 (when the guarantee was executed) or in 2010 (when the guarantee had to be called upon). The Court also had to consider whether the defendants were negligent (so that a new six year limitation period commenced) each time they subsequently confirmed the liability of the guarantor.

The Court reached the following conclusions:

- The plaintiffs suffered a loss upon execution of the guarantee. It was irrelevant that the plaintiffs did not know of (and could not have reasonably discovered) the error in the guarantee
- The defendants were not negligent each time they (incorrectly) confirmed that the guarantor remained liable. A solicitor who has acted negligently does not have a continuing duty to take care to remind himself (or herself) of the negligence of which they are unaware.

While this result appears harsh, the limitation period had not expired at the time the plaintiffs discovered the error in the guarantee. However, it is a timely reminder that limitation periods can expire before a plaintiff is even aware of their claim. Fortunately, the new Limitation Act 2010 will apply to causes of action arising after 31 December 2010. The Limitation Act 2010 introduces the concept of "*late knowledge*", which addresses the existing potential for a plaintiff to become time barred before they even become aware that they have a claim.

"Inter City" - descriptive use or a breach of trade mark?

In our May 2013 update we reported on the decision of the High Court in *InterCity Group (NZ) Ltd v Nakedbus NZ Limited,* in which the Court declined InterCity Group's application for an interim injunction preventing Nakedbus from using the words "inter city" and variations thereof.

In its recently determined claim for substantive relief, InterCity Group alleged, amongst other things, that Nakedbus had breached InterCity Group's "INTERCITY" trade mark by:

- Purchasing the keyword "inter city" and variations thereof via the Google AdWords service and using them in such a manner as to be taken as use of the INTERCITY trade mark with the meaning of s 89(2) of the Trade Marks Act 2002

- Using the words "inter city" in Google advertisements and on its website

InterCity Group also alleged that Nakedbus was passing itself off in its advertisements as InterCity Group, and that this conduct was misleading and deceptive.

The Court held that use of the AdWords "inter city" did not constitute "*use in the course of trade"* in terms of s 89(1) of the Trade Marks Act 2002. Further, as the use of the keyword could not be seen by the consumer (or anyone other than Google and Nakedbus), it could not be "taken" as anything, let alone "*taken as being used as a trade mark*" in terms of s 89(2).

The words "inter city" can be used to describe "city to city" travel. Accordingly, the Court had to determine whether the use of such words by Nakedbus in its advertisements was merely descriptive use or a breach of the InterCity Group trade mark.

Unlike the Judge who determined the interim injunction application, the Court considered that consumers searching online for national bus services would be unlikely to use the words "inter city" in a descriptive way. Consumers would be more likely to key in the word "bus" and the names of the cities between which they wanted to travel. Therefore, any consumer using the search term "inter city" was likely looking for the InterCity Group brand. The Court also considered that Nakedbus was aware of the significant goodwill attached to the InterCity Group brand and this was the only explanation for its use of the words "inter city" in its advertising. Further, there was actual evidence of a deliberate use by Nakedbus of the INTERCITY trade mark.

The Court held that the use of the words "inter city" by Nakedbus was:

- Likely to be taken as use as a trade mark
- Identical to the "INTERCITY" (in terms of s 89(1)(a)), or, if not identical, similar in terms of s 89(1)(c)
- Likely to deceive or confuse a substantial number of persons.

The Court also held that Nakedbus was passing itself off as InterCity Group, and that its conduct was misleading and deceptive as it was intended to suggest to internet users that there was an association or affiliation between the Nakedbus network and the InterCity Group network.

Insurance proceeds - third party claim v the insured's legal costs

Section 9(1) of the Law Reform Act 1936 (Act) imposes a statutory charge on insurance money payable to an insured to indemnify the insured for damages or compensation payable to third party claimants. The nature and effect of this charge was recently considered by the Supreme Court in *BFSL 2007 Limited v Steigrad* [2013] NZSC 156 in the context of directors' liability insurance taken out on behalf of the directors of the Bridgecorp Group and Feltex Carpet Ltd for claims for losses from breaches of directors' duties and also the costs of defending any actions brought against the directors. The sum insured was one composite sum.

The Court had to consider whether the charge under the Act secures:

- Whatever is eventually held to be the full amount of the insured's liability to the third party claimant (subject to any insurance policy limit), with no payments under the policy able to be made that would deplete the insurance money available to meet the third party claim if it is established, or
- The insurance money that remains at the time of judgment on, or settlement of, the third party claim against the insured, allowing in the meantime the payment of other sums that fall due for payment under the policy, even if that depletes the sum available to meet the third party claim.

The charge arises "*on the happening of the event giving rise to the claim for damages or compensation*" and applies "*notwithstanding that the amount of such liability may not then have been determined."* The majority of the Supreme Court considered that it was common ground that:

- No charge arises with regard to defence costs as they are not a "*liability to pay any damages or compensation*"
- The charge arises at the time the event giving rise to the liability occurs and secures whatever the full amount of the liability (if any) to the third party ultimately turns out to be.

The majority of the Supreme Court concluded that the statutory charge protects the third party claimant and, since the indemnity for defence costs is not within the statutory charge, the payment of defence costs is at the risk of the insurer. The Court, however, preferred to leave open the question of whether an insurer would be entitled to refuse to pay defence costs where there was a risk that the policy limit may be exceeded. If an insurer was so entitled, the risk would then be with the insured who ultimately may have to fund his or her legal costs.

No adverse inference drawn from non-disclosure of draft expert reports

In *QBE Insurance (International) Limited v Steward Motorsports European Limited* [2013] NZHC 3457 the High Court confirmed that s 56 of the Evidence Act 2006 prohibits a judge from drawing an adverse inference from what is in effect a refusal to waive privilege. Asher J held that this prohibition extends to situations where an expert refuses to disclose his/her initial report.

At first instance, the District Court judge placed weight against accepting the evidence of one expert, relying on the fact that he had refused to disclose his initial report despite requests that he do so. In the High Court, Asher J held that this approach was unfair as the original report was privileged and that privilege is not waived by the disclosure of a final report.

Asher J considered that the District Court judge's ruling "strikes at the heart of privilege" and referred to the English decision of *Jackson v Marley Davenport Ltd* [2004] EWCA Civ 1225 where it was established that, if an expert makes a report for the purpose of a party's legal advisers being able to give legal advice to their client or for discussion in a conference of a party's legal advisers, such a report is the subject matter of litigation privilege at the time it is made. The Judge in *Jackson* went so far as to confirm that draft or initial expert reports are also privileged. Asher J considered the position to be the same in New Zealand.

Court orders rectification despite delay

In *Robb v James* [2014] NZCA 42 the Court of Appeal upheld the High Court's order for rectification of an agreement for sale and purchase. Rectification is an equitable doctrine which permits the Court, in appropriate circumstances, to alter the terms of a written document to accord with the intentions of the party or parties executing it. In this case, the Court of Appeal confirmed that the appellants and the respondent shared a common intention as to the subject matter of the contract up to and including when they all executed the Agreement for Sale and Purchase. There was no evidence put forward by the appellants that indicated that they appreciated at the time of signing the agreement that the first respondent had been misled about the extent of the land in the discussions that had occurred the previous day.

The appellants argued that the combination of the respondent completing settlement on 1 June 2007 without explicit protest over the extent of land conveyed, and the delay between the respondent learning of the omission of the lost land in April 2007 and the commencement of proceedings in December 2009, should disentitle the respondent to the relief sought on the basis of laches, acquiescence or delay. The first respondent's evidence was that he had settled the purchase without pursuing a formal claim for the lost land on the basis of legal advice that it was better to sort it out later and that he had made repeated protests at what was going on. Therefore the course of his conduct was inconsistent with acquiescence. The Court of Appeal held that the lapse in time up to the commencement of the proceedings was "explicable, if not entirely justified" in light of evidence that the respondent had changed solicitors in that time. The Court considered that to reverse the orders made by the High Court in relation to rectification would be to sanction the unconscionable outcome that occurred and the "impact of the delays in formally pursuing that rectification cannot alter that characterisation of the parties' respective positions".

London calling for declaratory relief - the narrow or wide approach

A recent decision of the English High Court in *Pavilion Property Trustees v Permira Advisers LLP* [2014] EWHC 145 (Ch) has articulated the considerations that are important when declaratory relief is sought. This decision may have some relevance for New Zealand, as it is not in line with the most recent reasoning of our courts on the issue.

In *Pavilion*, one of the parties sought a declaration that part of a guarantee was valid and enforceable and could be severed from the remainder of that guarantee. Both parties consented to the relief sought.

The position in New Zealand is that, where declaratory relief is sought, anyone whose conduct or rights depend on the effect or meaning of an instrument should be able to obtain a declaratory ruling from the courts. This position has been discussed in obiter by the Supreme Court in *Mandic v The Cornwell Park Trust Board (Inc)* [2011] NZSC 135. In this case the Supreme Court disagreed with the approach of the Court of Appeal, which purported to narrow the availability of declaratory relief to only include where there is an existing genuine dispute between parties that cannot be determined in another forum, such as by arbitration.

In *Pavilion* the English court opted for a narrow approach more in line with the approach of our Court of Appeal. Mr Justice Morgan refused to grant the declarations put forward by the claimants but held that it was appropriate to make declarations to give effect to the reasoning in the judgment. The court demonstrated caution in granting declaratory relief for three reasons:

- There was no issue between the parties as to the legal position
- The court would not ordinarily make a declaration as to the operation of a statute just because the parties consent to such a declaration
- The matter was argued by one side only. The court expected counsel acting for the represented party, even where the other party consents to the relief sought, to identify any possible rival arguments and explain why these rival arguments should be dismissed in order to persuade the court that the declaration was right.

Exclusion of liability clauses under the Sale of Goods Act 1908

The recent English High Court decision of *Glencore Energy UK Ltd v Cirrus Oil Services Ltd* [2014] EWHC 84 (Comm) highlights the importance of ensuring exclusion clauses are drafted so that they exclude all intended heads of loss under a contract.

This decision involved a contract of sale under which Glencore Energy UK Ltd (Glencore) would sell crude oil to Cirrus Oil Services Ltd (Cirrus). After the contract had been entered into, Cirrus refused to proceed with the agreement upon learning that the crude oil was blended (which had an impact on the quality of the oil). In response, Glencore repudiated the contract and sought damages against Cirrus under the Sale of Goods Act 1979 (UK). In accordance with s 50 of that Act, Glencore calculated damages as the difference between the contract price and the market price of the goods at the time of the refusal to accept. In response, Cirrus argued that this type of damage was essentially a claim for lost profits which was specifically excluded by a "consequential loss" exclusion clause in the sales agreement.

The High Court disagreed with Cirrus and found that damages calculated under s 50 were intended to compensate the seller for the "loss of a bargain" as opposed to lost profit. Given exclusion clauses are strictly construed, and the express terms of the exclusion clause did not exclude this particular type of liability, the Courts held that this exclusion clause did not apply and Glencore could recover these damages from Cirrus.

This decision is of particular relevance in New Zealand as the relevant provisions in the Sale of Goods Act 1979 (UK) are identical to those in the Sale of Goods Act 1908 (NZ). The case highlights the importance of ensuring exclusion clauses are specifically worded to exclude liability for "loss of a bargain".

Reflective loss examined in Malhotra v Malhotra

The principle of reflective loss has been given judicial attention in the recent English decision of *Malhorta v Malhorta* [2014] EWHC 113 (Comm) in the context of an application for an inquiry as to damages following the discharge of a wrongly obtained injunction.

In *Malhorta*, the claimant had given a cross-undertaking in damages in support of an injunction, which was later discharged. The defendants sought damages under the cross-undertaking and, in the present interim proceedings, applied for an order for an inquiry as to damages. The claimant resisted the application on the basis that any loss suffered by the defendants was merely reflective of a loss suffered by the company and, consequently, the loss was irrecoverable under the reflective damages principle.

According to the principle as to the non-recoverability of reflective loss, a shareholder is unable to recover damages merely because a company in which s/he is interested has suffered damage. Under this principle, loss, such as a diminution in the market value of shares (or equal to the diminution in dividend), is merely a 'reflection' of the loss suffered by the company. Although the Court conceded the strength of the claimant's argument, he was unable to meet the "high hurdle" of demonstrating that there was no reasonable doubt that the relevant loss would be non-recoverable under the reflective loss rule. Accordingly, the Court ordered an inquiry as to damages be undertaken in respect of the defendants' claimed loss.

Even though the Court suggested that the principle of reflective loss was potentially a "knock-out blow" for the claimant, it was unwilling to summarily decline the defendants' entitlement to damages. The case demonstrates the unwillingness of the Courts to deny an inquiry as to damages following the discharge of a wrongly obtained injunction. Accordingly, any claimant wishing to overcome this "high hurdle" ought to be mindful of bringing sufficient credible evidence to support its position.

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