BUDDLE FINDLAY

Legal update on litigation and dispute resolution - October 2014

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Warning to litigation funders - backing "hopeless claims" may result in indemnity costs

The UK High Court in *Excalibur Ventures LLC v Texas Keystone Inc & Ors* [2014] EWHC 3436 has condemned a group of litigation funders who provided financial backing for a claim described by the Court as "*replete with defects, illogicalities and inherent probabilities*" by holding the funders joint and severally liable for £23 million of indemnity costs. The Court was highly critical of the manner in which Clifford Chance had brought the claim on behalf of its client Excalibur Ventures, which related to rights to oilfields in Iraqi Kurdistan. The £1.6 billion claim against Texas Keystone and Gulf Keystone was thrown out by the High Court in September 2013 after a protracted hearing.

The award of indemnity costs was in spite of Lord Justice Clarke recognising that, in the case of one of the funders, the funder had been misled as to the merits of the case and was unaware of the "*legal sinkhole which underlay Excalibur's case".* Lord Justice Clarke held this was irrelevant because the funder stood to gain substantially from the outcome of the litigation (almost 1500% return) and with that risk came responsibility. Even though Clifford Chance had ultimate control of the litigation, this did not excuse the funders from financial responsibility if the claim failed. According to Lord Justice Clarke "*The pursuit of objectively hopeless claims which required much time, labour and expense to refute is itself a ground for indemnity costs against both the litigant and his funder*".

Lord Justice Clarke expanded the precedent set in *Arkin v Borchard* [2005] 1 WLR 3055 that litigation funders could be liable for an opposing party's costs if the claim failed (up to the total amount of funding provided) by holding that it will be appropriate in certain circumstances for the funder's liability to be assessed on an indemnity basis.

This case serves as a warning to litigation funders to obtain proper legal advice to ensure that a prospective claim has a sound legal basis before agreeing to fund lengthy and expensive litigation, for the cost of which the funder might ultimately be held liable.

No regard to the "extremely stupid", the "fanciful" or the "gullible": misleading headline representations

Consumers are often faced with offers or representations (known as headlines) that upon closer inspection are not as good as they were first led to believe, but are instead subject to strict terms and conditions (often referred to as qualifiers). In many cases, these representations are in breach of the provisions of the Fair Trading Act 1986. In *Godfrey Hirst NZ Limited v Cavalier Bremworth Limited* [2014] NZCA 418, the Court of Appeal considered what is to be expected of consumers targeted by allegedly false or misleading headline representations and qualifiers.

The Court held that where headlines and qualifiers in advertising target a large group of consumers, it is not appropriate to apply the Fair Trading Act to a "hypothetical individual". Rather, "the consumer" comprises all the consumers targeted by the allegedly misleading representations, except the outliers. The "outliers" encompass consumers who are unusually stupid or ill-equipped, or those whose reactions are extreme or fanciful.

The Court also confirmed that consumers must exercise a degree of care which is reasonable having regard to all the circumstances including the characteristics of the target group of consumer (such as the consumers' level of knowledge, acumen, ability and the like). Again, the "outliers" are to be disregarded; it is not the lack of care which would be shown by "extremely stupid", "fanciful" or "perhaps gullible" consumers, but rather the standard of care to be expected of reasonably careful consumers.

Turning to whether the particular headline representations made by Cavalier were in breach of the Fair Trading Act 1986, the Court confirmed that:

- It is the overall impression (ie the dominant message) of the advertisement that is of crucial importance
- It is wrong only to analyse the separate effect of each representation (if there is more than one)
- Whether headline representations are misleading or deceptive depends on whether the qualifying information is sufficiently prominent
- Where there is glaring disparity between the representation and the information qualifying it, it is necessary to draw to the consumers' attention the true position in the clearest possible way
- The question for the Court is whether the advertisement viewed as a whole has a tendency to entice consumers into the "marketing web" by an erroneous belief engendered by the advertiser, even if the consumer may come to appreciate the true position before a transaction is completed.

Apportionment of liability not possible in instances of breach of a strict contractual duty

The recent case of *ANZ Bank NZ Ltd v Frost & Sutcliffe* [2014] NZHC 1640 serves as a reminder that the right to apportion liability in cases of contributory negligence under section 3(1) of the Contributory Negligence Act 1947 does not apply in cases of a breach of a strict contractual duty.

The plaintiff bank (Bank) agreed to forward discharge of mortgage documents to Frost & Sutcliffe solicitors (solicitors) on the basis that the solicitors would not release the mortgage discharge documents until a replacement mortgage had been executed. The replacement mortgage was never executed and the solicitors discharged the registered mortgage to allow a property transfer to take place. The Bank advanced funds on an unsecured basis. Shortly thereafter, the borrower was placed into liquidation. Searching for recourse, the Bank brought a claim against the solicitors for breach of their undertaking and for breach of contract.

The solicitors accepted that they were in breach of contract in failing to obtain the requisite authority from the Bank. However, they argued that the retainer did not impose a strict obligation, but rather a contractual duty to exercise the care of a prudent and competent solicitor, and that as a consequence any loss that flowed from their breach of contract was subject to a deduction for contributory negligence by the Bank.

The Court disagreed and concluded that, where a contracting party has placed an explicit and strict obligation on a professional adviser to carry out particular tasks, that strict contractual obligation cannot be compromised by the Contributory Negligence Act 1947 or by any analogous apportionment. Accordingly, contributory negligence was not available to the solicitors as a defence.

Failing to lodge against the Lodge: time barred

A frequent point of difficulty for plaintiffs in negligence actions is establishing that their loss occurred less than six years before they filed their claim. If they cannot establish that, their claim will generally languish under the provisions of the Limitation Acts of 1950 or 2010. This was the decisive point against the plaintiffs in *Shaw v Macalister Todd Phillips* [2014] NZHC 1948.

The case involved a contractual licence, granted personally to the plaintiffs in 2001 by the then owners of Matakauri Lodge. It permitted them seven days full board at no charge per annum at the Lodge. The Lodge changed hands and subsequent owners refused to recognise the licence.

The Shaws argued that the defendant solicitors were negligent as their rights under the licence should have been registered against the title. The solicitors argued that the claim was time barred.

The Court agreed with the solicitors, holding that the plaintiffs suffered actual loss in 2001 as they received a "damaged asset" rather than a contingent liability. Citing Elias CJ in *Davys Burton v Thom* [2008] NZSC 65, [2009] 1 NZLR 437, the Court held that the claim could not be contingent since, at the time the licence was entered into, the costs of remedial work and registration against the title would have been recoverable against the solicitors.

Accordingly, summary judgment was awarded against the plaintiffs.

This case was decided under the Limitation Act 1950. That Act is now replaced by the Limitation Act 2010, which applies to all causes of action arising after 1 January 2011. A point of difference between the two Acts is the provision in the 2010 Act that the limitation period may be extended in certain circumstances where the plaintiff only obtains knowledge of the facts material to the claim at a date later than when the claim arose. It is a moot point whether this late knowledge provision would have assisted the plaintiffs in this particular case. However, it is worth noting that one ground for applying the late knowledge extension is where the plaintiff was induced by a mistaken belief. Although that may have been the case here (ie the plaintiffs were mistaken as to the legal effect of the contractual licence), given the absence of the late knowledge extension in the 1950 Act, the claim was not argued that way.

Rigorous restraint remedied

The High Court in *BYOF Holdings Pty Ltd v Bencho Ltd* [2014] NZHC 156 exercised its power to modify a contract to make a restraint of trade reasonable. The case highlights the importance of restricting a restraint of trade to what is reasonably necessary to protect the interests of the party seeking to enforce it.

In 2008, Bencho bought BYOF's shares in PONZ, a New Zealand distributor of sunglasses. Bencho's restraint of trade clause extended to a wide number of people and was unlimited as to time. When BYOF challenged the restraint, Gilbert J held it was unreasonable and accordingly void at common law.

The Court exercised its discretion under the Illegal Contracts Act to modify the restraint to make it reasonable. Gilbert J restricted the clause to those who reasonably needed to be restrained to protect Bencho's interests as purchaser. The restraint's duration was reframed as six years - while Bencho had paid a significant amount for the restraint to protect PONZ's goodwill, the market in which PONZ operated meant only a limited restraint period was needed. The market was not technical; there were few barriers to entry and it had been a smooth transition for Bencho as PONZ's sale manager had continued in his role.

"Without prejudice": no dispute as to liability, no privilege

The decision of the English High Court in *Avonwick Holdings Limited v Webinvest Ltd* [2014] EWHC 332 (Ch) is a reminder that labelling correspondence "without prejudice" will not necessarily invoke the protection of privilege. It is the substance of the document rather than the label applied to it which is material. The correspondence must be prepared for the purpose of settling a genuine dispute.

Webinvest owed Avonwick a significant sum of money and the parties had entered into discussions as to the restructuring of the payment of that debt. Those discussions did not result in agreement and Avonwick sought to put Webinvest into liquidation. Webinvest applied to set aside the statutory demand served on it and to restrain Avonwick from presenting a winding up petition. There was no evidence that Webinvest disputed that it owed the money to Avonwick. Rather, Webinvest alleged that during the course of their payment negotiations, the parties had agreed to a "pay when paid" arrangement. Avonwick disputed this and in support of its opposition sought to put in evidence correspondence from its solicitor to Webinvest solicitor, which was marked "without prejudice". Webinvest opposed the production of this correspondence on the grounds that it was privileged.

The Court considered that while the express marking of documents as "without prejudice" is a highly material factor in determining their status, it is not conclusive. For a document to be inadmissible on the grounds that it is "without prejudice", it must form part of a genuine attempt to resolve a genuine dispute, and both elements of this test must be satisfied. If, as was the case here, there is no dispute as to liability, but only a negotiation as to how and when liability should be discharged, the negotiations, and any documents produced in the course of them, are not covered by the "without prejudice" exception to the admissibility of relevant evidence.

Interpreting written contracts: the importance of the factual matrix

In the recent decision in *Blakeman v General Distributors Limited* [2014] NZHC 2169, the High Court affirmed the application of the general principles of interpretation of written contracts and the importance of the factual matrix to interpreting a sublease (as discussed by the Supreme Court in *Vector Gas*; subsequent to *Blakeman* the principles have been considered by the Supreme Court in *Firm PI 1 Limited v Zurich Australian Insurance Limited* [2014] NZSC 147).

The Blakeman Trust (Trust) took a lease of land in Paihia in 1994 to build a supermarket. The Trust's lease will expire on 6 December 2014, and under the lease the Trust has the option to purchase the improvements or take a new lease. In 2003, the Trust gave a 10 year sublease to General Distributors Limited (GDL) to operate a supermarket on the site with a final expiry date of 1 August 2014.

GDL wanted to continue to operate the supermarket beyond the final expiry date and claimed that clause 2.4 of the sublease entitled it to a right of first refusal of the land or a new lease if the Trust bought the land. Clause 2.4 provides that if the Trust purchases the freehold or takes a new lease or renewal (a trigger event), then provided GDL is not in breach of the sublease and gives six months' notice the Trust will offer GDL a new sublease. GDL gave the required notice in time but the Trust argued that the notice was invalid as there had been no trigger event as required by clause 2.4.

The Court held clause 2.4 required that a trigger event occur before GDL could issue notice, an interpretation the Court considered consistent with the commercial reality of the situation. The Court found the sublease was a significant commercial transaction. The parties gave particular attention to setting the final expiry date and knew that the expiry date of the head lease

made no provision for GDL to continue in occupation after 1 August 2014. An important part of the factual matrix was that the parties knew GDL took the lease to operate a supermarket on the premises. The Court considered it unlikely that anyone running such a business would enter into a lease which might require it to vacate the premises on one months' notice, as GDL argued.

GDL's attempt to imply a term into the sublease allowing it to hold the sublease over until December was rejected by the Court because the proposed implied term did not accord with the intention of the parties. The Court declared GDL had not validly exercised any rights under clause 2.4, and the Trust was entitled to immediate vacant possession.

Negligent failure to detect defects does not preclude recovery under indemnity

The issue for the English Court of Appeal in *Greenwich Millenium v Essex Services* [2014] EWCA Civ 960 was whether the respondent (the contractor) could rely on an indemnity for workmanship defects where it had itself negligently failed to detect those defects.

The indemnity in question provided that a labour-only sub-contractor would indemnify the contractor against any liability arising by virtue of a breach or breaches of the subcontract or by act, default or negligence of the sub-contractor.

The Court confirmed that absent express wording to the contrary, there is a presumption (known as the *Canada Steamship* principle) that a party is unlikely to have intended to be liable under an indemnity for another party's negligence. Although the *Canada Steamship* principle is of general application, it is based on the presumed intention of the parties and in applying that rule the Court must have regard to the commercial context of the particular contract under consideration.

In the case of a construction contract, a failure by the indemnified party to identify defects caused by its contractor or sub-contractor will not (in the ordinary course) defeat the operation of an indemnity clause, even if that clause does not expressly encompass damage caused by the negligence of the indemnified party. In this particular case, it could not be presumed that the parties had intended to confine the indemnity to workmanship breaches which were invisible upon reasonable inspection.

Accordingly, the contractor was entitled to recover against the sub-contractor.

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