BUDDLE FINDLAY

Legal update on litigation and dispute resolution - December 2019

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Appropriate interest rate following breach of trustee duty

The English Court of Appeal in *Watson v Kea Investments Limited* [2019] EWCA Civ 1759 has given guidance on how interest is claimed and assessed in breach of trust cases. This is the latest case in the long-running litigation brought by Sir Owen Glenn against his former business partner Eric Watson.

The Court accepted that interest ought to be awarded at 6.5% as a proxy for profit, and upheld the equitable compensation award of £43.5m owing to Sir Owen's Kea Investments Limited. The rate of 6.5% represented approximately the return expected by trustees with a medium risk profile at the relevant time.

Mr Watson argued that the rate should have been fixed by reference to borrowing or deposit rates, which would have reduced the sum payable by as much as £20m. The Court rejected this: interest ought to represent the return that the trust fund should have received, in reality.

This case demonstrates the courts' discretion to make awards that align with a hypothetical total return with regard to economic realities over the time period in question.

In addition, the Court held that for awards of interest payments, the liability of a constructive trustee is the same as that of an express trustee. Therefore, higher interest rates based on objective evidence can be awarded in any case where the defendant is liable as a constructive trustee, including many fraud cases.

See the Court's decision here.

Anti-bartlett clauses deemed effective in much-awaited Hong Kong case

The efficacy of anti-Bartlett clauses that protect trustees from liability for loss-making trust investments has been upheld by Hong Kong's Final Court of Appeal in *Li v DBS Bank (Hong Kong) Limited* [2019] HKCFA 45.

DBS Trustee HK (Jersey) Limited (DBS) was the sole trustee of a trust holding shares in an investment company. The investment company suffered significant losses in the 2008 financial crisis, as a consequence of a number of risky investments made on the instructions of one of the settlors of the trust. The case concerned the liability of DBS for its failure to supervise the company's investments. DBS was protected by 'anti-Bartlett' clauses in the trust deed, which provided that the trustee was under no duty to supervise investments, nor to interfere in the business or management of the company. Despite this provision, DBS had been found liable in the lower courts for its failure to adhere to its "high-level supervisory duty" to monitor the business of the trust's company when it made the investments.

The Court of Final Appeal overturned this finding. It held that the high-level supervisory duty was inconsistent with, and expressly excluded by, the anti-Bartlett clause. To hold otherwise would "introduce an amorphous and ill-defined basis for undermining a legitimate arrangement consciously adopted by the parties, exposing the trustees to unanticipated risk of liability and sowing confusion as to the extent of their duties".

A similar conclusion would likely be reached in New Zealand, as the Trusts Act 2019 will only void an indemnity clause that seeks to exempt trustees from liability for dishonesty, wilful misconduct, or gross negligence.

See the Court's decision here.

UK Supreme Court discusses fraud and Quincecare duty

The UK Supreme Court recently held in *Singularis Holdings Limited v Daiwa Capital Markets Europe Limited* [2019] UKSC 50 that the fraudulent actions of a director are not attributable to a company, so as to protect a Bank from its *Quincecare* duty to its customers.

Singularis' sole shareholder was a fraudulent Mr Sanea, who was also the chairman, president and treasurer, and the only director involved in the management of the company. Singularis had a substantial surplus fund held on its behalf in by the defendant banking company, Daiwa. At a time when Singularis was already facing significant financial difficulties, Mr Sanea, in breach of his fiduciary duties, instructed Daiwa to pay that money to other entities for his own benefit, rather than to his company who needed it.

It was held 'incontrovertible' that Daiwa had breached their *Quincecare* duty – that is, the implied duty a bank owes its customer to use reasonable skill and care in exercising the customer's orders. This duty requires a bank who reasonably ought to know of a dishonest order not to act upon it.

Daiwa argued that despite this breach, they should not be liable for Singularis' loss because Mr Sanea's fraudulent actions, as those of the directing mind of the company, were attributable to Singularis. Therefore, it argued, Singularis' claim should fail as a company cannot bring a claim based on its own illegal activity.

The Supreme Court held that attributing the fraud of the company's director to the company itself would undermine the *Quincecare* duty in cases where it is needed most. Even if the fraud were attributable, it would not have succeeded as it was not Mr Sanea's dishonesty that caused the loss, but Daiwa's breach of duty by acting on his orders. The appeal was thus unanimously dismissed.

See the Court's decision here.

Water damage exclusion clause not to be interpreted in a vacuum

The Court of Appeal has rejected an application to strike out an indemnity claim made by Napier City Council in *Local Government Mutual Funds Trustee Limited v Napier City Council* [2019] NZCA 444.

In response to proceedings issued by property owners against Napier City Council in relation to compliance issues, the Council claimed an indemnity from Riskpool under an insurance policy. The proceedings in part were based on defects concerning water ingress, and the policy provided that "liability for Claims… in relation to leaks, water penetration, weatherproofing, moisture, or any water exit or control system" are wholly excluded. Accordingly, Riskpool applied for the indemnity proceedings to be struck out.

The central issue in the case was whether the exclusion clause excluded the claim in its entirety. The High Court responded in the negative, finding that the clause would only exclude a claim to the extent that it related to water damage, and not any other damage raised, and rejected the application.

The Court of Appeal dismissed the appeal, though it did not rule conclusively on the interpretation of the exclusion clause. The drafting of the policy contained "a number of curiosities" that made it difficult to determine the intended meaning of the clause in a vacuum. The Court allowed the parties to adduce further evidence, and returned the matter to the High Court for the clause's meaning to be determined at the substantive hearing.

See the Court's decision here.

Third-party costs orders against insurers

In *Travelers Insurance Company Ltd v XYZ* [2019] UKSC 48, the UK Supreme Court has confirmed that insurers will not be liable for third-party costs to non-insured claimants, where the insurers are justifiably involved in that litigation by reason of other, insured claimants.

623 claims were brought against Transform Medical Group (CS) Limited (Transform) for the supply of defective silicone breast implants. Transform had product liability insurance from Travelers Insurance Company Limited (Travelers), though most claims fell outside the insured period.

Travelers settled the claims that fell within the insured period. The uninsured claimants successfully sued Transform. However, Transform had been liquidated, leaving the legal costs of those claimants unpaid. Travelers had funded Transforms' defence and paid the insured claimants' portion of the total legal costs. The uninsured claimants applied for a third-party order that Travelers pay their costs as well.

The Supreme Court cited two approaches to deciding whether a third party should pay costs:

- Whether the third party took control of the litigation and became 'the real defendant'
- Whether the third party engaged in 'unjustified intermeddling'.

An insurer would become the real defendant if the insurer:

- Determined that the claim would be fought
- Funded the defence of the claim
- Controlled the conduct of the litigation
- Fought the claim exclusively to defend their interests
- The defence failed in its entirety.

The Court considered the 'real defendant' test inappropriate in the circumstances, as the claims were wholly uninsured.

Instead, the question was whether the insurer engaged in 'unjustified intermeddling' in litigation to which it was not a party. Such intermeddling would be justified where there was a close connection between the insured and the uninsured claims. The Court found that Travelers had done nothing to justify a costs order against it: an insurer who acts in good faith in relation to insured claims should not incur liability in costs.

See the Court's decision here.

Interim relief before service of proceedings

The Court of Appeal in *Commerce Commission v Viagogo AG* [2019] NZCA 472 has held that serving documents or hearing a protest to jurisdiction are not prerequisites to granting interim relief against an overseas defendant.

The Commerce Commission had sought an interim injunction against ticket seller Viagogo in the High Court to prevent the publication of allegedly false and misleading representations on Viagogo's website. As Viagogo had not been served with the proceedings in Switzerland (and thus the jurisdiction of the New Zealand court had not been tested), the Court considered it illogical to order an interim injunction before it decides whether it has jurisdiction to hear a claim. Accordingly, the application was denied.

The Court of Appeal disagreed, holding that while a court "cannot proceed to finally determine a claim against a defendant while any protest to jurisdiction is outstanding", the grant of an interim injunction "is not limited in the same way" as it does not have the same finality as a finding on the merits. The fact that a defendant is yet to be served or raises a protest are factors relevant to determining the overall justice when considering an interim injunction application, but they do not preclude relief.

In support of its finding, the Court stated that it "is not deprived of the ability to make orders that are required to enable it to do effective justice between the parties in the future, in the event that the substantive claim is heard by a New Zealand court, simply because a defendant is to be served overseas or has objected to the jurisdiction of the New Zealand court". The Commission must now decide whether it proceeds with its application for an injunction.

See the Court's decision here.

Privilege survives dissolution of company

The UK Court of Appeal has held that legal privilege outlasts the dissolution of a company in *Addlesee v Dentons Europe LLP* [2019] EWCA Civ 1600.

Legal advice privilege applies to communications between a client and its lawyers. The general rule is that those communications cannot be disclosed to third parties unless and until the client waives the privilege.

In this case, the plaintiffs (Addlesee and others) were investors in a property development company that had been dissolved and removed from the register. They believed the company's development scheme had been fraudulent, and took claims against its lawyers, Dentons Europe LLP, for deceit and negligence. The investors wanted to access company documents held by Dentons, but the firm refused to disclose them on the basis that they were protected by legal privilege.

The Court held that legal privilege should be applied in a way that was consistent with its underlying policy rationale: that what a client tells its lawyer should never be revealed without the client's consent. This is a fundamental principle of the administration of justice. The existence and scope of legal advice privilege depends on the nature and purpose of the communication and the circumstances under which it was made. Once privilege is established, it remains unless it is waived.

In this case, while Dentons' client was no longer in existence to consent to waive privilege, no one with appropriate authority had waived the privilege, so it remained.

See the Court's decision here.

What does 'reasonable endeavours' mean?

In *Focus Construction Interiors Limited v Spaceworks Design Group* [2019] NZHC 2211, the High Court considered the extent of a party's liability to fulfil a 'reasonable endeavours' obligation.

Following a breakdown in the parties' relationship, a settlement agreement between Focus Construction Interiors Limited and Spaceworks Design Group was executed which included a clause stating that Spaceworks would make reasonable endeavours to refer $3m of work to Focus within four years of the agreement date. Four years later, Spaceworks had only referred $512,824 worth of work.

The Court found that the clause was enforceable, as the objective of referring $3m of work was sufficiently certain. However, no breach was found, as Spaceworks was found to have acted reasonably in the circumstances.

The Court noted that a 'reasonable endeavours' obligation will not usually require the obligor to sacrifice its own commercial interests, unless the contract requires that certain steps have to be taken. The Court distinguished 'reasonable endeavours' terms with 'all reasonable endeavours' or 'best endeavours' terms. Where several reasonable courses of action are available to achieve the desired outcome, a 'reasonable endeavours' obligation only requires the obligor take one of those reasonable courses. A 'reasonable endeavours' obligation is less stringent than a 'best endeavours' obligation.

See the Court's decision here.

Objective test for rectification rectified in England

The English Court of Appeal in *FSHC Group Holdings Limited v GLAS Trust Corporation Limited* [2019] EWCA Civ 1361 has revised the test of rectification, finding that an objective assessment of the circumstances will only be relevant where there is a prior concluded contract between the parties.

Previously, the test for rectification (as provided in obiter by Lord Hoffman in *Chartbrook Limited v Persimmon Homes Limited* [2009] UKHL 38) in all cases was objective, requiring assessment of 'what a reasonable observer would have understood the intentions of the parties to be'.

The Court considered this test appropriate in circumstances where the parties had entered into a prior agreement that conflicts with the agreement at issue. The parties' intentions should be assessed objectively by reference to the prior agreement, and rectification may be appropriate where those intentions are not reflected in the contested written contract.

However, where no prior agreement exists, the Court found that a subjective test is more appropriate to meet the threshold for rectification. The subjective test requires that:

- The parties shared a subjective intention in relation to a part of the agreement
- An 'outward expression of accord' existed, so that the parties knew they shared this intention
- The intention was shared at the time of execution
- The terms of the agreement did not reflect that intention.

This approach is derived from the equitable principle of good faith, which prevents a party from enforcing the terms of a contract that are inconsistent with the parties' common intentions at the time of execution.

The case brings the English position on rectification into line with that of New Zealand and much of the Commonwealth. The test employed by the Court of Appeal has been settled law in New Zealand since 1987.

See the Court's decision here.

When can you drive too hard a bargain? Economic duress in contractual negotiations

The English Court of Appeal in *Times Travel (UK) Limited v Pakistan International Airlines Corpn* [2019] EWCA Civ 828 has set a high bar for parties seeking to establish lawful act economic duress to get out of bad contracts.

Times Travel operated a business that almost entirely depended on selling tickets for Pakistan International Airlines (PIA). During a dispute over historical commissions payment, PIA lawfully terminated its contract with Times Travel and offered a new contract which included a requirement that Times Travel waive its commissions claim. Times Travel signed the contract but argued that it did so under economic duress.

The Court noted that while economic duress can be established for unlawful acts (eg fraudulent statements), a threat to carry out a lawful act only goes too far when it is made 'illegitimately'. Further, duress will not extend to the use of lawful pressure to achieve a result to which the person exercising pressure subjectively believes, in good faith, it is entitled. To maintain certainty in commercial negotiations, deliberate use of a lawful act in bad faith is required to establish economic duress.

Here, it was common ground that PIA was entitled to terminate the old contract and reduce Times Travel's ticket allocation, and no bad faith was found on the part of PIA.

See the Court's decision here.

High Court considers enforceability of an agreement to agree

The High Court in *Pure Elite Holdings Limited v Bodco Limited* [2019] NZHC 2191 considered the enforceability of an agreement to agree in relation to the capitalisation of an infant milk formula plant.

Danpac (NZ) Limited was a company that had been formed with the intention of building an infant milk formula plant. Pure Elite Holdings Limited (PEH) was interested in acquiring such a plant. To this end, the parties (amongst others) entered into 'heads of agreement', indicating an intention to collaborate, particularly regarding the capitalisation of Danpac. Though some steps were taken in accordance with the heads of agreement, the relationship ultimately fell through, and no funding was provided by PEH.

The Court found that heads of agreement indicated that the parties intended to create a binding legal relationship. However, there were matters that had been left to further agreement that went to the heart of the bargain: the relative capital contributions, the timing of those contributions, and what the relevant shareholdings would be. The purported contract provided no objective means of agreement, and there were no machinery or reference points from which the Court could ascertain the scope of the obligations the parties intended to assume. This meant that, at least to the extent of the capitalisation of Danpac, the purported contract was no more than an 'aspirational declaration of mutual intent'. It did not give rise to an enforceable agreement.

Despite this, the Court held that the parties had, in a broad sense, entered into a joint venture by working towards a common end. However, this did not in itself give rise to a fiduciary relationship, and there was nothing that indicated that the parties were entitled to repose or did repose trust and confidence in each other. In capitalising Danpac, each party was entitled to consider its own interests. This was confirmed by the fact that the purported contract entitled each party to get its own legal and tax advice.

See the Court's decision here.

A licence to grant relief – UK Supreme Court expands scope of relief from forfeiture remedy

The UK Supreme Court in *The Manchester Ship Canal Company Limited v Vauxhall Motors Limited* [2019] UKSC 46 has unanimously rejected the argument that, in the context of land, equitable relief is only available for forfeiture of property rights, as opposed to a right to possession under a contract (such as via a licence to discharge or extract).

Vauxhall Motors Ltd (Vauxhall) operated a large plant on the banks of the Manchester Ship Canal. Vauxhall built the plant in the early 1960s and entered into a contract (Licence) with the Manchester Ship Canal Company (MSCC). The Licence permitted Vauxhall to build various pipes across MSCC's land (Spillway) and drain surface water and treated industrial effluent into the Canal. Vauxhall agreed to pay £50 per year to MSCC in exchange for these rights. Clause 5 of the Licence allowed MSCC to terminate the Licence if (among other things) Vauxhall did not pay its annual rent within 28 days of a demand. Vauxhall was inadvertently late in making a payment, and MSCC served a termination notice. The effect was that Vauxhall would have to negotiate a new licence at a significantly higher rate per year (expected to be in the hundreds of thousands of pounds). The Court granted relief from forfeiture, effectively reinstating the Licence on the condition that Vauxhall paid its arrears and certain other costs.

The decision aligns with the treatment of forfeiture elsewhere. Relief from forfeiture is an equitable remedy, developed by common law rather than a specific statute. A number of historic cases had already established that relief from forfeiture may be granted by the court in respect of chattels and other personal property, provided that the party seeking relief had proprietary or possessory rights in the relevant items. This decision brings land-related cases in line with those authorities.

Key takeaways from the decision on a practical level are to:

- Avoid drafting licence termination clauses that are overly similar to a traditional forfeiture clause
- Include a way to review any licence fee, particularly for renewable, long-term or perpetual licences. For example, Vauxhall only had to make an annual payment of £50, and this was unable to be reviewed on the terms of the licence
- Avoid granting any possessory or proprietary rights if possible (potentially even for short-term licences, given Lord Briggs JSC's

comments at [51] of the decision). For example, Vauxhall gained virtually exclusive possession of the licensed Spillway and a high degree of control over it in perpetuity. As a result, Vauxhall was entitled to ask the court for relief from forfeiture of those rights.

See the Court's decision here.

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