quinn emanuel urquhart & sullivan uk llp

LONDON DIGEST | AUTUMN 2011

Unfair Prejudice: An Abuse of Process?

It has long been established that where a majority shareholder in a company offers to purchase a minority shareholding at a fair value (as determined by a competent expert) any petition alleging unfair prejudice will be negated and will be liable to be struck out as an abuse of process (*O'Neill v Phillips (1999)1 WLR 1092)*. The High Court in *Harbourne Road Nominees Ltd v (1) John Greenway Karvaski (2) Sitewatch Fire & Surveillance Ltd [2011] EWHC 2214 (Ch),* however, has now held that the *O'Neill* principle does not apply in the case of equal shareholders. Rather, in such cases, the determinative issue was whether the shareholder had been offered a sale on terms that gave him all the advantages he could reasonably expect to achieve from issuing an unfair prejudice petition: only then would it be an abuse to continue those proceedings in the face of such an offer.

Background Facts

Sitewatch was incorporated in 2001 as a joint-venture company by Mr Morris and Mr Karvaski to provide the services which their respective companies had previously provided independently of one another. The shares in Sitewatch were held by Harbourne, as nominee, for Messrs

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On 21 June 2011 Quinn Emanuel was crowned "International Law Firm of the Year" at the annual Lawyer Awards in London. This prestigious award is a testament to the London office's prodigious growth and achievements in the last three years: *The Lawyer* magazine wrote that "The success of the firm's London office, its first fully fledged international outpost, was key to it winning the prize and beating the likes of Latham & Watkins, Sullivan & Cromwell and Debevoise & Plimpton in the process". In its follow-up profile, *The Lawyer* magazine noted our "meteoric rise to prominence", and that we have now "hit top gear". With our recent expansion of capacity and expertise, and our willingness to take on the tough cases that other firms won't touch, there has never been a better time to get in touch with Quinn Emanuel. Q

Financial Litigation Breakfast Series

Quinn Emanuel invites you to the first of two presentations on current topics in financial litigation and looks ahead to the issues in 2012.

Topics:

- Hostile restructurings: Schemes, inter-creditors & the scope for tactical litigation (Richard East & Rob Hickmott)
- The transatlantic view: UK/US financial litigation – choosing the right forum & key trends for litigants (Sue Prevezer QC)

Date: Tuesday, November 8th
(A second presentation focused on mis-selling and sovereign debt will be held on Tuesday, December 6th.)

Time: 8:45 am to 10:00 am

Place:
Shooting Gallery
Haymarket Hotel
1 Suffolk Place
London SW1Y 4HX

Why attend?

- Complex financial litigation is no place for amateurs.
- Coffee and breakfast (including bacon sandwiches!) will be served.

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Karvaski and Morris in a 50/50 split. Pursuant to the joint venture arrangement, Mr Karvaski became a director of Sitewatch and drew a salary. It was agreed, however, that both he and Mr Morris would operate Sitewatch jointly and, as shareholders, each would receive dividends.

Over time, Sitewatch received little return business from Mr Morris' company. In November 2010, therefore, Mr Karvaski sought to take control of Sitewatch. He informed Mr Morris that (i) Sitewatch would no longer utilise his company's services; (ii) it was unlikely to declare any dividends in the current or next financial year; and (iii) it would be in Sitewatch's best interests if Mr Morris no longer remained a shareholder and if he was excluded from participating in the management of Sitewatch. Mr Karvaski offered to purchase Mr Morris' 50% shareholding but the parties were unable to agree on a price. Mr Morris proposed, therefore, that an accountant be appointed to value Sitewatch's assets and determine its share price.

Mr Morris had previously conveyed his concern that Mr Karvaski's threatened actions would unfairly prejudice his interests as a shareholder. In response, Mr Karvaski contended that, where an offer was made by the majority shareholder in the format set out in *O'Neill* – i.e. there was an offer to purchase shares at a fair value which, if not agreed, should be determined by a competent expert – that would negate any claim for unfair prejudice. Consequently, Mr Karvaski asserted that any unfair prejudice petition Mr Morris presented would be liable to be struck out or stayed, with Mr Morris suffering the associated cost consequences.

Offers and counter-offers, expressed to be made in the *O'Neill* format, ensued but no agreement was reached. In April 2011 Mr Morris, through Harbourne, therefore proceeded to issue a petition alleging unfair prejudice affecting his shareholding in Sitewatch. In response, Mr Karvaski and Sitewatch contended that Mr Morris' refusal to accept Mr Karvaski's offers was unreasonable and that, in accordance with the principles established in *O'Neill*, the continued prosecution of the petition was either an abuse or was bound to fail.

Decision

The Court held that the key issue to be determined was whether, in all the circumstances of this particular case, Mr Karvaski and Sitewatch had satisfied the conditions required to have the petition struck out, or summary judgment awarded in their favour, i.e. that the continued prosecution of the petition after the making of the offer amounted to an abuse of process, or was bound to fail. That issue was highly fact sensitive; consideration of the nature and terms of any offer made could only ever be an intermediate step in that process.

In that context, the Court noted that the parties had appeared to approach this issue as if what had to be considered was simply the extent to which any offer made complied with the *O'Neill* guidelines, and that if a sufficient degree of compliance was achieved, Mr Karvaski would inevitably be protected from any petition issued by Mr Morris. The Court considered that to be "*a cardinal error*".

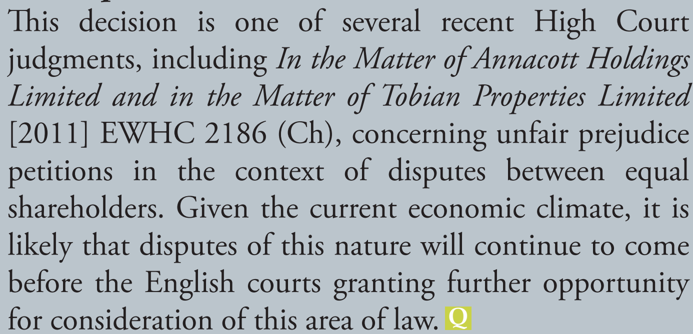
The Court noted that the reasoning in *O'Neill* expressly concerned cases where there was a majority shareholder. Mr Morris, however, was not a minority shareholder but an equal 50% shareholder and in such cases it was by no means obvious which of two equal shareholders should sell to the other. Further, in the case of equal shareholders, particularly, as in this case, where they were effectively quasi partners, the Court considered that there was a clear potential for injustice if one shareholder was able to seize de facto control of the company and force the other either to accept his offer to buy or be forever excluded from the participation that he bargained for and, in addition, be barred from any remedy in respect of what would be a continuing breach of the quasi partnership arrangement originally made.

The Court therefore distinguished *O'Neill*. Instead, the Court held that the real question in this case was whether Mr Morris had been offered a sale on terms that gave him all the advantages he could reasonably expect to achieve from the petition proceedings: if so, it would then be an abuse to continue those proceedings in the face of such an offer. In all the circumstances, however, the Court was not satisfied that such requirement had been met since Mr Morris might well obtain a Court order via his petition which was more advantageous to him in material respects than the offers made by Mr Karvaski.

Comment

Whilst it remains to be seen whether the appellants will seek permission to appeal this decision, the judgment will nevertheless be of particular interest to parties who have an equal stake in a joint venture and subsequently find themselves in dispute with each other, whether following a decision to part company or otherwise. The decision makes it clear that any party seeking to buy out their joint venture partner in such circumstances cannot simply rely on the guidelines in the *O'Neill* case. It is also apparent from the judgment, however, that such a party might face considerable uncertainty demonstrating to the Court that any buy-out offer is materially more advantageous than any remedy a Court might order following a petition alleging unfair prejudice. A party may

be able to mitigate that risk by ensuring that the nature and terms of any expert valuation underpinning the buy-out offer are sufficiently clear such that, reasonably, there can be no ambiguity as regards the material worth of the offer relative to any Court ordered remedy. That, however, may be far from straightforward.



Postscript

This decision is one of several recent High Court judgments, including *In the Matter of Annacott Holdings Limited and in the Matter of Tobian Properties Limited* [2011] EWHC 2186 (Ch), concerning unfair prejudice petitions in the context of disputes between equal shareholders. Given the current economic climate, it is likely that disputes of this nature will continue to come before the English courts granting further opportunity for consideration of this area of law. Q

Recent ISDA Cases

The ISDA Master Agreement 1992 (***ISDA 92***) is one of the most widely used standard-form commercial agreements in the world. Judicial decisions as to its proper construction have potentially very far-reaching consequences. Recent cases in the Commercial Court have engaged in the contentious debates regarding two important issues:

1. the operation of the netting provisions of ISDA 92 where a party is in Default (the ***Netting Issue***); and
2. the consequences of an Event of Default on future obligations to pay, and the calculation of Loss following Early Termination (the ***Once-and-For-All Issue***).

The cases present contrasting views that cry out for clarification by the Court of Appeal.

Starting Point: Marine Trade

The decision of Flaux J in *Marine Trade SA v Pioneer Freight Futures Co Ltd BVI* [2009] EWHC 2656 (***Marine Trade***) staked out the battleground of the debates. Very briefly, the claimant and the first defendant were parties to 14 Forward Freight Agreements (***FFAs***), which constituted Transactions governed by an ISDA 92 between the parties (as supplemented and amended by Forward Freight Agreement Brokers Association (***FFABA***) 2007 terms).

In January 2009, Pioneer was affected by an Event of Default. Neither party terminated the agreements. The Settlement Sums for that month were, approximately, US$7 million in favour of Marine Trade, and US$12.1 million in favour of Pioneer. The question arose whether those sums should be netted under s 2(c) of the ISDA 92.

Flaux J held that the netting provision did *not* apply. The Judge's reasoning focused on the wording of s 2(c), which provided that "amounts [which] would otherwise be payable" could be netted. Pioneer was in Default; therefore it did not satisfy the condition precedent in s 2(a)(iii); therefore the Settlement Sums otherwise due to it were not 'payable', in the sense that they were not due and owing for immediate payment; and therefore those sums were not eligible for netting under s 2(c). Flaux J could "quite see the commercial sense of being able to insist on 'gross' payment by a Defaulting Party".

The conclusion that a Settlement Sum was not 'payable', where a party was in default on the relevant date, had further consequences. Where a party does not satisfy the condition precedent in s 2(a)(iii) at the relevant date, the obligation of its counterparty to make payment does not arise at all: it is not merely suspended, and therefore cannot be 'revived' should the default be cured.

Both of Flaux J's conclusions have striking commercial consequences: using the facts of the case as an illustration, Pioneer would be required to pay the $7million sum it owed Marine Trade in full, without netting it off against the much larger sum owed to it in return. And it could never recover that much larger sum, even should it cure its default. (Flaux J did not discuss the scenario of an Early Termination, which has been addressed in subsequent cases.)

The case was not appealed.

Subsequent Debate of the Once-and-For-All Issue

The most recent edition of Firth's *Derivatives: Law and Practice* suggests that Flaux J's decision on this issue would lead to "extremely uncommercial result[s] … which … cannot have been intended" and "paradoxical result[s]". For example, a party might be forever deprived of a payment in circumstances where it bears no responsibility for a default – as in the case of the presentation of a winding up petition by a vexatious litigant. Other market commentary echoed those concerns.

In *Lomas v JFB Firth Rixson* [2010] EWHC 3372 (Ch) (***Lomas***), Briggs J took the opportunity to consider the Once-and-For-All issue. Briggs J was sympathetic to Flaux J's reasoning – acknowledging that it was "more consistent with the language of s 2(a)", simple and certain. Ultimately, however, he reached the opposite conclusion.

Briggs J focused on the commercial effects of the alternative constructions. He considered that to hold that the payment obligation does not arise at all would produce "a pointlessly draconian outcome" where the

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default was minor and fleeting; and particularly where there is only a Potential Event of Default (which is sufficient to render the condition precedent un-met). He also found it relevant that, on Early Termination, all Unpaid Amounts (including those which would have been payable but for an earlier Default) became owing. If the effect of s 2(a)(iii) truly was to prevent a payment obligation from arising in the event of default, it seems counter-intuitive for the obligation to spring up on Early Termination.

Briggs J reaffirmed his conclusion on the Once-and-For-All issue in *Lehman Brothers Special Financing Inc v Carlton Communications Ltd* [2011] EWHC 718 (Ch) (***Carlton***).

The Once-and-For-All Issue was next substantively discussed by Gloster J in *Pioneer Freight Futures Company Ltd (in liq) v TMT Asia Ltd* [2011] EWHC 778 (Comm) (***TMT Asia No 1***). Very briefly, Pioneer and TMT Asia had entered into a number of FFAs, governed by ISDA 92 and, variously, the provisions of FFABA 2005 and 2007. Pioneer – as we have seen – found itself unable to meet its obligations in late 2008/early 2009; and then the market turned in its favour. Gloster J was posed several preliminary questions including, relevantly, what sums should be included in the calculation of Loss following Automatic Early Termination.

TMT argued that, because Pioneer was in Default and therefore did not meet the condition precedent in s 2(a)(iii), any obligation on its part to pay Pioneer never arose. It argued that the phrase "any payment … required to be made (assuming satisfaction of each applicable condition precedent)" in the definition of Loss only applied to payments *actually* required to be made where in fact the conditions precedent were met; it did not deem those conditions to have been satisfied when in reality that were not. Therefore any such sums should not be included in a calculation of Loss.

Gloster J began her analysis by concluding that the language used could not sensibly be interpreted in the way proposed by TMT: the words "assuming satisfaction" clearly required an analysis of an artificial hypothesis. They were not linked to what had actually happened between the parties. If it were, in most cases a Non-defaulting Party would never owe anything to a Defaulting Party following Automatic Early Termination, because it would be able to argue that the Defaulting Party did not meet the condition precedent at the relevant times. This would render a choice of the Second Method and Loss next to worthless.

The commercial purpose of s 2(a)(iii), according to Gloster J, is to "mitigate counterparty credit risk during the currency of what may be numerous swap transactions under the umbrella of ISDA 92 and while they remain open." It fulfills this purpose by suspending the *payment obligation* (where the Defaulting Party may not be able to meet its own payments). It does *not* suspend the *debt obligation* (or prevent it from arising). Instead, it substitutes an accounting procedure – where respective debts are totted up on paper – while suspending any obligation to make payment.

Upon Early Termination, that ongoing counterparty credit risk disappears: the ongoing relationship between the parties is at an end. The calculation of Loss, therefore, would naturally include all of those debts accrued on paper – to be reconciled in the 'wash out'. According to Gloster J, "Commercially, this all makes sense."

Gloster J turned to the decision in *Marine Trade*: she reasoned that the Judgment failed to recognise that there were two separate obligations, and that the condition precedent in s 2(a)(iii) was only applicable to the payment obligation: it did not prevent the debt obligation from accruing. The "natural reading of [s 2(a)(iii)] envisages that once a condition precedent is fulfilled, the obligation to pay revives". The debt obligation is not revived: it was there all the time. Gloster J also agreed with Briggs J's reasoning in *Lomas*.

Subsequent Debate of the Netting Issue

Marine Trade met with intense criticism on this point. In the second edition of *Henderson on Derivatives*, its conclusion on the Netting Issue is floridly described as "astonishing", "arbitrary" and "bizarre". The core of Henderson's analysis is that Flaux J did not acknowledge that the obligation in s 2(a)(i) (and the conditions precedent to that obligation, in s 2(a)(iii)) is expressly said to be "subject to the other provisions of this Agreement" – including the netting provisions. Henderson argued that there was no justification for Flaux J giving 'primacy' to s 2(a)(iii).

In both *Lomas* and *Carlton*, Briggs J did not follow *Marine Trade* on the Netting Issue, on the invitation of all the parties.

Although the Netting Issue did not arise directly in *Pioneer Freight Futures Company Ltd v Cosco Bulk Carrier Company Ltd* [2011] EWHC 1692 (Comm) (***Cosco***), Flaux J seized the opportunity to reinforce the views he set out in *Marine Trade*. His Honour analysed other usages of the word "payable" in ISDA 92, and again concluded that only sums which were "immediately enforceable obligation[s] to pay" could be netted pursuant to s 2(c).

Following delivery of the judgment in *TMT Asia (No 1)*, TMT sought to amend its defence to raise the Netting Issue (on its case, following Flaux J's conclusion on the issue would reduce the sum it was required to pay Pioneer by some $10 million). After the new point was fully argued, the parties settled. Nonetheless,

Gloster J chose to deliver her judgment on the issue, characterising it as "in effect … an advisory opinion": see *Pioneer Freight Futures Company Ltd (in liq) v TMT Asia Ltd* [2011] EWHC 1888 (***TMT Asia (No 2)***). The Judge's reason for adopting this unusual course included the uncertainty in the market caused by the *Marine Trade* decision, and that she had "firmly reached the opposite conclusion" to Flaux J.

Gloster J began by considering the 'landscape' of ISDA 92 and the other agreements as a whole:

> "One does not have to approach the canvas of the relevant FFABA 2007 terms and ISDA 92 very closely to see that the broad commercial scheme of the instruments … is that aggregate or gross amounts in respect of all Transactions between the parties subject to the Master Agreement are to be netted off against each other … the scheme was intended to be a cohesive one, governing the entire period of the relationship of the parties."

The Judge referred to the commercial purpose of s 2(a)(iii) – as elucidated in *TMT Asia (No 1)* – and held that that purpose would be 'wholly undermine[d]' if a non-defaulting party could insist on payment on a gross basis. Such an interpretation would be "wholly contrary to the ethos of ISDA 92" and would "emasculate[] the netting provisions … in the very circumstances where they may be most needed."

Further, there was no utility in focusing on the word 'payable' where that word "can mean many different things in many different contexts"; it certainly did not require the interpretation given to the clause by Flaux J. Gloster J also picked up Henderson's point that the payment obligation in s 2(a)(i) is expressly subject to the other provisions of ISDA 92 – including the netting provisions. There was no reason, therefore, for the condition precedent in s 2(a)(iii) to limit the scope of which sums could be netted pursuant to s 2(c).

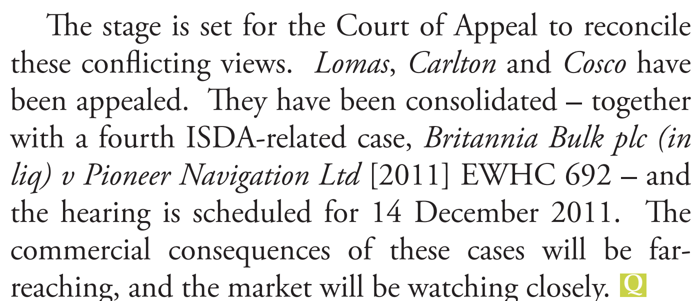
Conclusion

In *Marine Trade*, Flaux J concluded that:

1. Where a Defaulting Party did not meet the condition precedent in s 2(a)(iii), its counterparty never comes under an obligation to make payment; and
2. Sums nominally owed to a Defaulting Party are not available to be netted pursuant to s 2(c).

Both of these conclusions proved controversial – academic commentators and, more importantly, subsequent judicial decisions, have fundamentally disagreed with them. Nonetheless, Flaux J reinforced his decision on the Netting Issue in the very recent case of *Cosco*.

The stage is set for the Court of Appeal to reconcile these conflicting views. *Lomas*, *Carlton* and *Cosco* have been appealed. They have been consolidated – together with a fourth ISDA-related case, *Britannia Bulk plc (in liq) v Pioneer Navigation Ltd* [2011] EWHC 692 – and the hearing is scheduled for 14 December 2011. The commercial consequences of these cases will be far-reaching, and the market will be watching closely.



Working Towards Implementation: Jackson and the CJC

Background

The Ministry of Justice (MoJ) consulted in November 2010 on the implementation of a package of measures recommended in Lord Justice Jackson's Review of Civil Litigation Costs. Following the consultation the Government's response paper (published on 29 March 2011) set out the measures the Government intended to take forward. The response indicated that the MoJ intended to work with stakeholders to develop the detail of the proposals.

Objective

A Civil Justice Council (CJC) expert working party has now been set up to help develop practical proposals to assist with the implementation of secondary legislation (regulations, court rules) in the following areas:

1. Qualified one way costs shifting – atypical cases and behavioural aspects.
2. Introduction of an additional sanction/reward under Part 36.
3. The detail of the proportionality test – content of a Practice Direction – examples of when the test should not be applied.

Issues Considered

The working party will consider the key options and issues raised by respondents to the consultation and identified in the response paper and any additional issues identified as a result of members' own experience.

The working party will not revisit the policy objectives set out in the Government response but will focus on the practical measures which may be required to give effect to the proposals. The detailed drafting of any secondary legislation will be a matter for the Civil Procedure Rule Committee and/or Government lawyers and is outside the working party's remit.

The working party will develop and prepare papers setting out realistic optional solutions in each of the three areas and advice on the pros and cons of each option by the end of September 2011.

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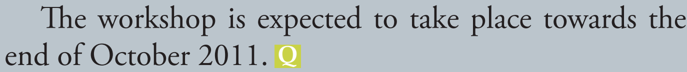
Forward Plan of Work

It is envisaged that the CJC will convene a workshop to be attended by a range of experienced practitioners. The purpose of the workshop will be to provide feedback on MoJ/CJC developed proposals for secondary legislation on qualified one way costs shifting, Part 36, proportionality and possibly other areas.

The workshop is expected to take place towards the end of October 2011. Q



Supreme Court Clarifies the Anti-Deprivation Rule

The Supreme Court has recently provided clarification on the limits of the anti-deprivation rule in insolvency law, in *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38. The anti-deprivation rule permits the Court to invalidate a transaction which a party provides that, upon its bankruptcy, its property is to pass to someone other than its insolvent estate.

Facts

Using subscription monies provided by noteholders, an SPV issuer purchased certain bonds as collateral. The collateral was vested in a corporate trustee.

The issuer entered into a credit default swap with Lehman Brothers Special Financing Inc ("LBSF") pursuant to which LBSF paid the issuer the amounts owed by the issuer to the noteholders, and the issuer paid to LBSF the interest received on the collateral held by the trustee. The swap was linked to a number of reference entities. The performance of the notes issued by the issuer was linked to the performance of the reference entities – the amount payable by LBSF to the issuer was correspondingly reduced if credit events occurred among the reference entities: LBSF was therefore gambling that enough credit events would occur for LBSF to be required to pay an amount less than the noteholders had invested. Conversely, the noteholders were gambling that the reference portfolio was safe, and accordingly that LBSF would always keep the issuer in funds. Upon the maturity of the notes, the noteholders would receive their principal in full, and LBSF would receive the value of the collateral.

The collateral secured the performance by the issuer of its obligations to the noteholders and to LBSF. The documents imposed a priority regime with respect to the collateral. This priority regime contained what is known as a "flip". In the usual course, LBSF had priority to the collateral. However, if there were an "event of default" under the swap agreement, which included the insolvency or bankruptcy of LBSF or its parent company LBHI, the noteholders would enjoy priority to the collateral.

Decision: An Emphasis on Good Faith

Following LBSF's insolvency, the appellants in the Supreme Court (LBSF and the trustee) argued, as they had previously (and unsuccessfully) in the Chancery Division and the Court of Appeal, that the "priority flip" upon LBSF's/LBHI's insolvency breached the anti-deprivation rule, because its purpose was to withdraw assets (the collateral) from LBSF's liquidation, thereby reducing the value of LBSF's insolvent estate to the detriment of its creditors. The Supreme Court rejected this argument.

Lord Collins delivered the leading judgment. He approved the distinction between, on the one hand, an owner of property contracting to the effect that the interest of a recipient of the property qualified in the event of the recipient's bankruptcy (for example, a protective trust where the beneficiary's interest expires on its bankruptcy), and on the other hand, the owner qualifying *his* own interest in the event of *his own* bankruptcy. Lord Collins said that the purpose of the anti-deprivation rule was to prevent parties defrauding their bankruptcy creditors. The rule was directed to "intentional or inevitable evasion" of the principle that the debtor's property is part of the insolvent estate – as such, the rule is to be applied "in a commercially sensitive matter". While Lord Collins accepted that a subjective intention to defeat the insolvency rules was not required to trigger the anti-deprivation rule, he suggested that in borderline cases a "commercially sensible transaction entered into in good faith" would not infringe the rule. Lord Collins's conclusion was that the "flip" in issue was part of a complex commercial transaction negotiated and entered into in good faith by sophisticated parties. The Court should be slow to invalidate their bargain and the anti-deprivation rule did not apply.

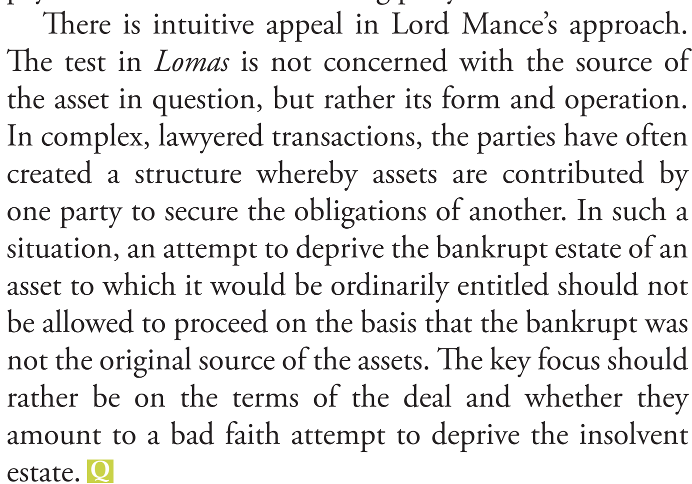
The Source of the Asset

Importantly, Lord Collins was persuaded of this in no small part because the collateral was essentially the proceeds from the noteholders' subscription payments for the notes. Accordingly, the property priority to which was in dispute was not LBSF's. Lord Collins said that if the assets in question belonged to someone other than the bankrupt, this could be an important, and in some cases decisive, factor in a conclusion that the transaction was commercial, entered into in good faith, and therefore outside the scope of the anti-deprivation rule.

Although four members of the Court agreed with Lord Collins without comment (Lords Phillips, Hope and Clarke, and Lady Hale), Lord Walker gave a short, separate judgment in which he endorsed the "own asset"

test. In support of this, he referred to *Lomas v JFB Firth Rixson Inc* [2010] EWHC 3372 (Ch) (summarised above), in which Briggs J drew a distinction between assets which were rights in action representing a quid pro quo for something already done, sold, or delivered before the insolvency, and those which represented a quid pro quo for services yet to be rendered or something still to be supplied by the insolvent party. In the former case, the anti-deprivation rule would more readily apply. This seems sensible, for commercial contracts often feature provisions mandating that performance may be withheld in the case of the other party's insolvency. A rule invalidating such provisions would have to be enacted by the legislature – as it has been in the United States under the Bankruptcy Code – rather than imposed on the commercial community by the courts.

Lord Mance, writing separately, agreed Briggs J's test from *Lomas*, but disagreed with the "own asset" rule, (i.e. with Lord Walker as to the thinking behind *Lomas*). Lord Mance thought the flaw in Lord Collins's analysis was that it implied that the noteholders had an inherent right to contractual priority to the collateral, or to the collateral itself. Lord Mance thought, rather, that the noteholders' rights depended upon the terms of the documentation, as did LBSF's. Nothing was to be gained, said Lord Mance, by enquiring into the source of the collateral – for what if rather than the "flip" clause, there were no collateral and simply a provision depriving LBSF of the right to payment if it was the defaulting party?

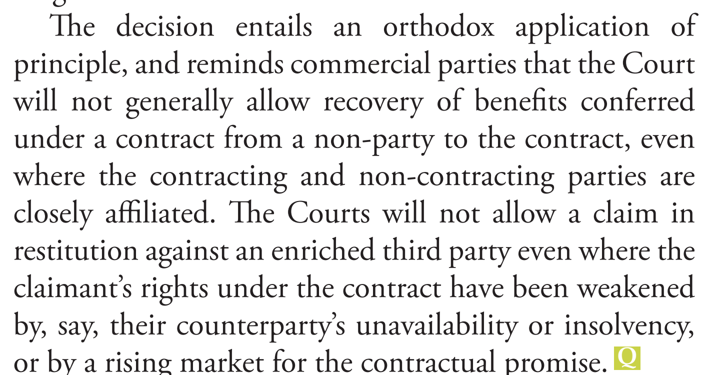


There is intuitive appeal in Lord Mance's approach. The test in *Lomas* is not concerned with the source of the asset in question, but rather its form and operation. In complex, lawyered transactions, the parties have often created a structure whereby assets are contributed by one party to secure the obligations of another. In such a situation, an attempt to deprive the bankrupt estate of an asset to which it would be ordinarily entitled should not be allowed to proceed on the basis that the bankrupt was not the original source of the assets. The key focus should rather be on the terms of the deal and whether they amount to a bad faith attempt to deprive the insolvent estate.

Contractual and Restitutionary Remedies: The Courts Stick to the Bargain

Victims of breaches of contract frequently seek to recover their losses from third parties associated with the parties in breach, usually because the parties in breach are not worth pursuing. The Court of Appeal has recently reiterated the law's hostility to such claims. In *Costello v MacDonald* [2011] EWCA Civ 930, the Costellos approached MacDonald to do building work on the Costellos' land. They informed MacDonald that for tax reasons, MacDonald would be paid by the Costellos' company, Oakwood. Oakwood and MacDonald therefore entered into a contract for the work. Later, the parties fell out and MacDonald sued the Costellos for the value of services performed for Oakwood. The Court of Appeal declined MacDonald's claim.

Delivering the Court's judgment, Etherton LJ's starting point was that the contract in question was between MacDonald and Oakwood, not between MacDonald and the Costellos. While the Court accepted that in causative terms, the Costellos had derived a benefit from MacDonald's provision of services to Oakwood, the Court also said that those services were provided solely because of and pursuant to MacDonald's contract with Oakwood. The Court said that a claim by MacDonald against the Costellos in unjust enrichment (i.e. in respect of gains accruing to the Costellos as a result of MacDonald's services) would *"undermine the contractual arrangements between the parties"*, subverting their chosen allocation of risk and potentially having the effect of transforming MacDonald into a secured creditor in Oakwood's insolvency (given the leap-frog claim against the Costellos would allow MacDonald to bypass Oakwood's other creditors). The Court also cautioned that if MacDonald's claim were allowed, MacDonald could elect between contractual damages against Oakwood (calculated by reference to the amounts due to MacDonald under the contract) and restitutionary damages against the Costellos (calculated by reference to the market value of MacDonald's services – i.e. the amount the Costellos would hypothetically owe MacDonald had they contracted with MacDonald). This meant that compensation in restitution could be more favourable than compensation in contract, thereby allowing MacDonald to possibly improve upon a bad bargain.



The decision entails an orthodox application of principle, and reminds commercial parties that the Court will not generally allow recovery of benefits conferred under a contract from a non-party to the contract, even where the contracting and non-contracting parties are closely affiliated. The Courts will not allow a claim in restitution against an enriched third party even where the claimant's rights under the contract have been weakened by, say, their counterparty's unavailability or insolvency, or by a rising market for the contractual promise.

Rubenstein v. HSBC Bank Plc. [2011] EWHC 2304 (QB)

A recent decision in the High Court illustrates the challenges facing Claimants in financial products mis-selling cases in the English Court.

The Claimant complained that he had received negligent advice from HSBC regarding an investment in an AIG Premier Access Bond (the "Bond"). The Claimant sought an investment which would protect his capital. Following the collapse of Lehman Brothers in September 2008 and the subsequent turmoil in the markets AIG suspended withdrawals from the Bond in which the Claimant had invested. When the Claimant was able to cash in his investment, he had suffered loss of capital.

The Court was asked to consider, among other issues, whether the transaction was an "execution only" transaction or an advisory one. The Court distinguished this case on the facts from recent judgments including, *JP Morgan Chase Bank v. Springwell Navigation Corporation* [2008] EWHC 1186 and *Wilson v. MF Global UK Limited* [2011] EWHC 13. The Court held that if a client asks for a recommendation, any response is likely to be regarded as advice unless there is an express disclaimer to the effect that advice is not being given. The question is whether an impartial observer, having due regard to the regulatory regime and guidance, and to what passed between the parties, would conclude that advice had been given. On this basis, the Court found that, on this occasion, advice had been given.

The Court went on to conclude that the advice given by HSBC was negligent. The Court found, however, that the negligent advice did not cause the loss suffered by the Claimant. It was not sufficient for the Claimant to establish that but for the negligent advice, he would not have invested in the Bond (*Andrews v. Barnett Waddington LLP* [2006] EWCA Civ 93). The Claimant had to demonstrate that the events of September 2008 were foreseeable when the investment was made in 2005. The Court concluded that what happened in September 2008 was wholly outside the contemplation of the bank at the time of the transaction. Consequently, the loss was not caused by the negligence of the bank; was not reasonably foreseeable and was too remote in law to be recoverable as damages for breach of contract or in tort.

Frequently, Claimants in mis-selling cases lose because the Court finds as a matter of fact, or because of the contracts between the parties, that no advice was given. Here, despite the Claimant overcoming that hurdle, the claim still failed. Whilst the English Court has been a barren hunting ground for Claimants in mis-selling cases during the economic downturn, the cases that have been decided assist future Claimants in understanding what is needed to articulate a successful case. Q

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