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Finance Litigation Update – December 2022

In this issue:

Welcome to our latest finance litigation update, in which we summarise some of the most significant cases and other developments relevant to banks and other financial institutions over the last six months or so, as follows:

Why choose Stephenson Harwood?

Moving money: Bitar v Bank of Beirut and Manoukian v SGBL

Reservation of Rights Letters

Banca Intesa v Venezia: valid or void?

What should an ISDA notice of default include? Macquarie Bank v Phelan

When is an Event of Default no longer 'continuing' under the ISDA Master Agreement?

Litigation privilege: Credit Suisse v Loreley

MUR Shipping v RTI: Court of Appeal rules on interpretation of force majeure

UK sanctions: Russian-owned customers? Beware extended payment terms

Court of Appeal confirms reflective loss can't be recovered

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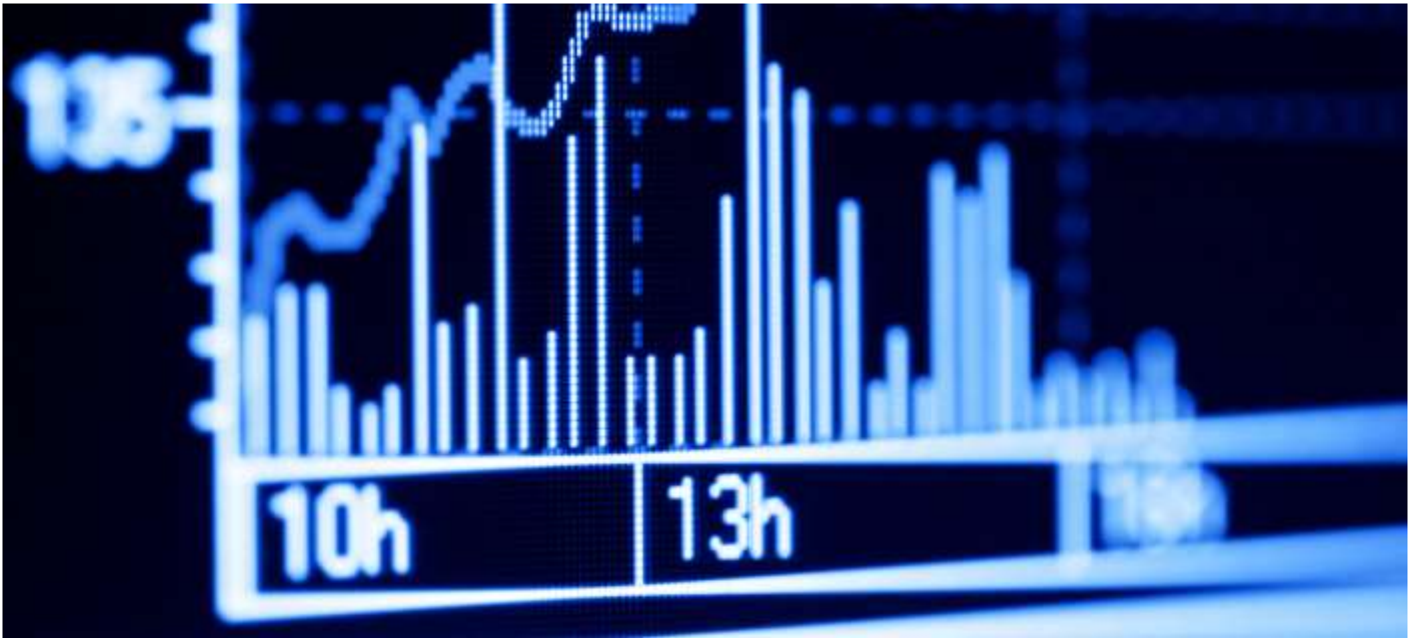
Moving money: Bitar v Bank of Beirut and Manoukian v SGBL



In **Bitar v Bank of Beirut S.A.L [2022] EWHC 2163 (QB)**, the High Court ordered the Bank of Beirut to effect an international transfer to its customer, Mr Bitar. This judgment is the third in a series of cases heard by the High Court arising from the refusal of Lebanese banks to make international transfers to their customers. The banks argue they were prevented from making the transfers as a result of restrictions imposed following the Lebanese financial crisis. While in *Khalifeh v Blom Bank SAL*[1] (considered in this *article*), the High Court agreed with the bank, this judgment closely follows the reasoning in **Manoukian v Societe Generale de Banque au Liban SAL & Another**, another recent case in which the court also ordered specific performance of an international transfer by two Lebanese banks to their customer.

Both decisions will be of significant assistance to customers of Lebanese banks seeking to transfer their funds out of Lebanon following the country's economic crisis. While the cases were heard under Lebanese law, the judgments give an insight into the English court's approach to dealing with issues of foreign law in the banking sphere. In particular, the judgment in *Bitar* provides useful insights into the court’s approach to expert evidence on foreign law.

Background

The background to both *Bitar* and *Manoukian* is similar. Both claimants were resident in England and had deposited money with Lebanese banks domiciled in Lebanon. Although Lebanese law applied in both cases under the terms of the banking mandates, the English courts accepted jurisdiction to hear the claims because Mr Bitar and Mr Manoukian were deemed to be ‘consumers’ for the purposes of the recast Brussels Regulation (1215/2012) (now sections 15A-15E of the Civil Jurisdiction and Judgments Act 1982). This provides that, subject to certain conditions, a consumer may bring proceedings in their country of domicile.

The banks considered that they were entitled to refuse to comply with the transfer requests in light of the restrictions imposed by the Lebanese Government on payments of foreign currency out of Lebanon. Instead, they argued that it was sufficient to tender payment in the form of banker's cheques (drawn on the Lebanese central bank, the Banque du Liban), to be deposited with a notary public in

[1] [2021] EWHC 3399 (QB)

Lebanon. This was unacceptable to the claimants, who argued that the financial crisis was not a legitimate reason for the banks to refuse to execute the transfers.

In the earlier case of *Khalifeh v Blom Bank SAL,* Foxton J held that Blom Bank had discharged its obligations by depositing cheques with a notary public in Lebanon. However, a key distinguishing feature of that case was that the claimant accepted that no international transfer right existed under Lebanese law.

In *Bitar* and *Manoukian*, the key issue to be determined was whether an international transfer right existed as a matter of contract and/or general Lebanese law.

Contractual Transfer Right

In *Manoukian,* Picken J analysed the terms and conditions applicable to the banking relationship between Mr Manoukian and the defendant banks and held that, as a matter of construction of those terms, the banks were obliged to execute the international transfers in accordance with Mr Manoukian's instructions.

In addition to specific terms within each contract, Mr Manoukian also placed reliance on Articles 366 and 367 of the Lebanese Code of Obligations and Contracts, which provided that the parties' joint intentions and expectations needed to be ascertained in light of the context and purpose of the contract, and that any ambiguities should be resolved on this basis. Picken J agreed with Mr Manoukian that, given he opened the account from London, it must have always been intended that he would have the right to make international transfers, otherwise he would not have been able to operate the account as a normal bank account.

In *Bitar,* the court concluded that unravelling the '*far from direct*' terms of the contract required a '*textual exegesis*'. It held that, pursuant to Lebanese law, the court needed to have regard to the context in which the agreements were entered into and found that it had been the parties' joint intention to contract on the basis of making use of international transfers. Against that background, the court construed the contract as providing a contractual obligation on the part of the bank to accede to a request for an international transfer.

Custom

While in both cases the court concluded that the express terms of the contracts provided for an international transfer right, it was also accepted that under Lebanese law, 'custom' is treated as a source of law within the realm of contractual interpretation.

In *Manoukian,* the parties' Lebanese law experts referred to various doctrinal writings and Lebanese court decisions to support the existence (or lack) of banking customs.

Picken J held that both the doctrinal writings and the Lebanese court decisions clearly supported the existence of a transfer right as a matter of Lebanese banking custom, and disagreed with the banks' contention that any such custom was qualified by a 'legitimate reason' exception, which would include the current financial difficulties Lebanese banks find themselves in.

In *Bitar,* the court concluded that for conduct to qualify as 'custom' from a Lebanese law perspective, it needed to be '*subjectively regarded as a binding norm'*. Banks adhering to international transfer requests fell squarely within that definition of 'custom'.

It was clear in both cases that the banks were contractually obliged to effect the international transfers, both as a matter of construction of the express contractual terms, and by virtue of Lebanese banking custom. The current Lebanese financial crisis and/or a desire to avoid a rush on banks was

not a legitimate or acceptable reason (if such an exception to the banks' obligation existed) for the banks not to transfer money to the order of their customers.

Practical implications

As the cases were heard under Lebanese law, expert evidence on foreign law was an integral part of the case. In both cases, the banks used the same expert, Dr Moghaizel.

Of particular interest, in *Bitar,* the judge criticised Dr Moghaizel for inconsistencies in his evidence given in the two cases. In particular, the court was critical of the fact that Dr Moghaizel did not confront the fact that he was now taking different positions from those adopted in *Manoukian 'upfront'.* Instead, the inconsistencies had to be '*extracted from him in cross-examination'.* In *Bitar,* the judge also commented on an error made by Dr Moghaizel in the *Manoukian* case which had been repeated in *Bitar.* Specifically, Dr Moghaizel had relied on a particular author's writings to support the proposition that Article 26 of the Lebanese Consumer Protection Law did not apply to bank contracts with consumers, when in fact the author had corrected his statement in a subsequent text. The court held : '*This mistake would have been easy to understand, but for the fact that this issue had arisen in the evidence in the Manoukian case'.* The court also expressed concern about the expert's '*tending towards being an advocate which impaired the independence of his evidence'.*In between the decisions in *Manoukian* and *Bitar*, the English courts have given further consideration to disputes between Lebanese banks and their British customers. In *Makki v Bank of Beirut S.A.L*[2] (in which both the *Manoukian* and *Khalifeh* judgments were considered), the court set aside a statutory demand served on Mr Makki on the basis that litigation commenced by Mr Makki in Lebanon (to seek an international transfer of funds held in Lebanese accounts) was legitimate and substantial and not '*inherently incredible*'. While in *Makki* there was no expert evidence on Lebanese law, the court was persuaded that the claim raised a genuine, triable issue giving rise to a genuine set off or cross demand. It did not accept the bank's assertion that the Lebanese court would dismiss Mr Makki's argument that he had a right to an international transfer of funds. Given the conflicting judgments in *Khalifeh* and *Manoukian*, the court determined that the outcome of the Lebanese litigation was '*arguable both ways*'. Now that the judgment in *Bitar* has approved the finding in *Manoukian,* the prospects for customers of Lebanese banks seeking international transfers look even more positive.

[2] [2022] EWHC 733 (Ch)

Reservation of Rights Letters

With signs of distress in the market increasing, lenders are likely to see more defaults occurring under facilities they have advanced. In turn, this makes it more likely that lenders will be considering their options and issuing reservation of rights letters while they do so.

Earlier this year, the High Court handed down its judgment in the case of *Lombard North Central Plc v European Skyjets Ltd (in liquidation)*[3] ("**Lombard v Skyjets**"). This case provides a useful reminder that a lender (or an agent acting on behalf of a syndicate of lenders) must consider carefully what rights it has following a breach by the borrower and decide how to respond, and that its conduct and its reservation of rights letter must be consistent with that decision. If it is not, a lender could inadvertently waive rights that it may have consequent on such a breach, on which it may have wished to rely.

1 What is a reservation of rights letter, and when and why should one be sent?

If an obligor is in default under any finance documents but the lender does not wish to enforce its rights immediately, a lender will commonly issue a reservation of rights letter.

It is now well recognised that when a right to terminate (or, in the context of a loan agreement, accelerate/cancel a facility) arises, the non-defaulting party has to make an active choice whether to exercise its contractual rights. Case law suggests that the non-defaulting party is permitted some time to make up its mind about what to do. However, failure to act for any significant period of time, or acting inconsistently with its rights, could result in a court determining that the non-defaulting party has waived the breach or affirmed the contract.

Following the occurrence of an event of default, a reservation of rights letter is commonly issued by a lender to its defaulting borrower. A reservation of rights letter will usually specify the default that has occurred under the relevant finance document (usually the facility agreement). It will also usually go on to state that the lender is reserving its rights and remedies under the relevant finance document and state that the lender's failure to act will not constitute a waiver of the relevant default.

A reservation of rights letter is intended to give the lender breathing space to gather background information on the default that has occurred and take expert advice on the options available to it, while seeking to ensure that the lender is not prevented from taking action against the borrower or its assets at a later stage.

2 Limitations to reservations of rights letters

The recent case of *Lombard v Skyjets* is a timely reminder that the issue of a reservation of rights letter by a lender is not a guaranteed method of preventing a waiver of rights.

In *Lombard*, the court considered the effect of both a "no waiver" clause in the relevant loan agreement and a so-called "no waiver statement", which appeared repeatedly in email correspondence between the parties, and which purported to reserve Lombard's rights in relation to defaults which had occurred under the finance documents.

The court held that the "no waiver statement" constituted merely a general reservation of rights

[3] [2022] EWHC 728 (QB)

and that "*the ritual incantation of this language*" could not prevent an affirmatory act from having its "objective effect" (i.e. affirming the contract and thereby waiving the non-defaulting party's rights in relation to any breach).

The court found in *Lombard* that the lender had waived its right to rely on the event of default through its conduct, which included agreeing extra time to make payments, accepting late payments, claiming interest on unpaid payments and agreeing a late payment fee that appeared to be in return for not terminating. Because of that conduct, the court held that neither the "no waiver" clause in the loan agreement, nor the "no waiver statement" had any effect.

This follows the Court of Appeal decision in *SK Shipping Europe Plc v Capital VLCC 3 Corp*[4] (handed down a matter of weeks before the *Lombard v Skyjets* judgment), which similarly held that a reservation of rights is not effective in all circumstances:

> ***"While a reservation of rights will often have the effect of preventing subsequent conduct constituting an election, this is not an invariable rule. The court must have regard to all the circumstances, including the nature and terms of any reservation of rights which has been communicated and the nature and consequences of any demand for future performance."***

3 Practical tips for lenders when sending reservation of rights letters

- Lenders should review the relevant contractual documentation as soon as it is aware of an event of default or potential event of default, and consider carefully what rights it may have, and what restrictions, formalities and/or time limits might apply to the exercise of those rights.
- Unless the lender intends to enforce immediately, the safest course is to send a reservation of rights letter without delay. This will reduce the risk that delay in taking enforcement action constitutes waiver of the relevant default.
- Once a lender has issued a reservation of rights letter, it should keep the situation (and the time elapsed since the occurrence of the relevant default) under continual review, and in the meantime investigate the situation and decide without delay whether it wishes to exercise the rights it has following a breach. A lender should include reservation of rights language in any further communications with the obligors exchanged after the relevant breach but before the lender has decided what action it wishes to take in respect of the breach.
- A lender must always ensure that any actions it takes, including its communications with obligors (whether written or oral) and its acceptance of any further payments from the borrower, are consistent with the reservation of rights letter. If the lender does not do this, it may inadvertently waive the breach and the reservation of rights letter will be deemed to be of no effect. To do this, it must obtain clear advice on the nature of the breach, the rights available to it, and how those rights can be exercised. This will involve a careful review of the express contractual terms, and advice as to what conduct and what demands would be consistent with preserving its rights.
- In *Lombard v Skyjets* the lender allowed the borrower additional time to make late payments and accepted late payments. However, a less obvious action which (depending on the circumstances, the conduct of the parties, and the wording used) may defeat a reservation of rights letter, is issuing a demand for payment of any default interest (as distinct from merely asserting that default interest is accruing). While a lender may

[4] [2022] EWCA Civ 231

contractually be entitled to such sums in a default scenario, a demand for payment of default sums may indicate that the lender is affirming the contract, which may be inconsistent with asserting other contractual remedies, such as acceleration or the ability to enforce its security. Legal advice should therefore be sought before any such demand is made. As the name suggests, a reservation of rights letter usually does nothing more than reserve the rights of the lender. It is possible that after a default the lender may decide that it is willing to waive a breach, renegotiate the terms of the facility agreement or embark on some form of restructuring. These would, of course, need to take place following the issue of a reservation of rights letter and be documented separately.

4 Practical tips for borrowers upon receipt of a reservation of rights letter

- If you receive a reservation of rights letter, this does not always mean that termination, acceleration and/or enforcement action is inevitable:
    - while a breach may have occurred, it may not necessarily be a breach which gives rise to termination rights, and even if it does then there may be restrictions on when and how the lender can exercise them; and
    - the issue of a reservation of rights letter is often standard procedure for lenders where they become aware of a default.

Check whether the alleged breach has in fact occurred, including whether there may be factual uncertainty over what has occurred and/or legal uncertainty over whether the factual circumstances fall within the meaning of relevant contractual provisions.

- Wherever appropriate, keep channels of communication with the lender open. This is often the best way to allay a lender's concerns about a business' solvency and may result in the lender choosing not to take enforcement action, or to delay any further action while you remedy the breach. Lenders are key stakeholders in consensual restructurings or refinancings, so maintaining a good relationship and open channels of communication with them can assist with future plans.
- The issue of a reservation of rights letter is not guaranteed to have its stated effect – the lender may waive its rights at a later stage, either expressly or inadvertently by inconsistent conduct.
- If you are unsure of your rights and options, or if you may require restructuring, refinancing or reorganisation advice, consider seeking legal and/or financial advice.

Authors: James Linforth, partner, Charlotte Drake, of counsel, and Sarah Alton, finance team and Dan Smith, finance litigation team.

Banca Intesa v Venezia: valid or void?

For the first time in the history of the Italian swaps litigation before the English courts, the Commercial Court has ruled that a swap transaction entered into in 2007 between an Italian authority and two Italian banks is void. In **Banca Intesa Sanpaolo SPA & Anor v Comune Di Venezia [2022] EWHC 2586 (Comm)**, Foxton J held that the banks are therefore liable to make restitution. While the court also concluded that a defence of change of position may be available to the banks, it acknowledged the *'potentially profound implications for the sanctity of English law contracts'.*

Background

Commune Di Venezia (**Venice**) claimed that it was not bound by interest rate swaps entered into with Banca Intesa Sanpaolo SpA and Dexia Crediop SpA on the terms of an ISDA 1992 Master Agreement (the **Swaps**) because it lacked capacity to enter into them. While the Swaps were governed by English law, the question of Venice's capacity to enter into them was governed by Italian law. Venice argued that the 2020 decision of the Italian Supreme Court in *BNL v Cattolica*[5], meant that Venice (in common with all Italian regional authorities) lacked the substantive power to enter into the Swaps. The Commercial Court agreed.

This conclusion is a significant departure from the findings reached by Cockerill J in the recent (and similar) case of *Deutsche Bank v Busto Arsizio*[6], summarised in our article here. In *Busto*, the Commercial Court interpreted *Cattolica* as relating to the principles of Italian contract law, and not the authorities' capacity to contract. Accordingly, it found it had no impact on the Swaps which were governed by English law. On very similar facts, the Commercial Court in *Venezia* has reached a wholly different conclusion.

The *Cattolica* decision

In *Cattolica* (in which the derivatives in question were governed by Italian law) the Italian Supreme Court held that Cattolica could enter into derivatives contracts if they were for hedging purposes but not if

[5] Banca Nazionale del Lavoro S.p.A v Commune di Cattolica n. 8770 2020

[6] *Deutsche Bank AG London v Comune di Busto Arsizio* [2021] EWHC 2706 (Comm)

they were for speculative purposes. There was no explicit formulation of what makes a derivative speculative as a matter of Italian law. While the court considered other aspects of *Cattolica*, in this article we focus on the question of Venice's capacity and whether or not the Swaps were 'speculative'.

The meaning of *Cattolica*

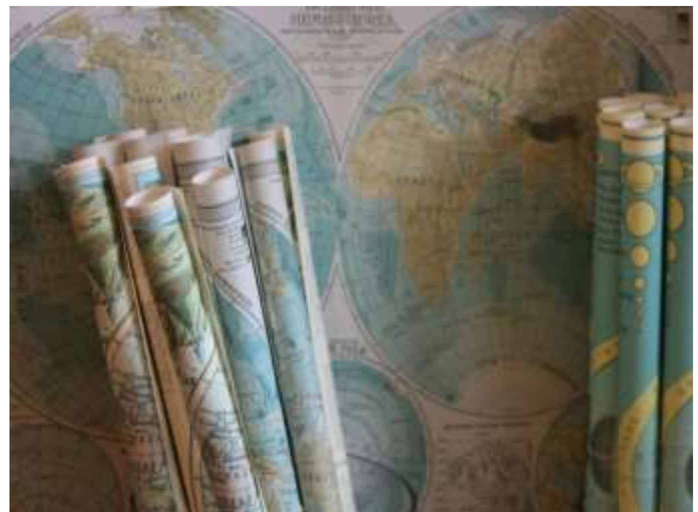
In *Venezia,* Foxton J conducted a detailed analysis of the expert evidence on Italian law, including the banks' argument that the Italian Supreme Court's conclusions in *Cattolica* were wrong. He concluded that the Italian statutory restrictions on regional authorities entering into speculative transactions meant – as a matter of English law classification - that Italian regional authorities lacked the legal ability or substantive power to enter into contracts for such transactions. It was not simply the case (as per the interpretation in *Busto)* that Italian law imposed a prohibition on regional authorities exercising their powers to enter into the transactions. This difference in interpretation is fundamental; the Swaps were null and void *ab initio,* as opposed to being valid contracts governed by English law (in respect of which the Italian law prohibition had no relevance).

The definition of 'speculative'

In *Busto*, the court found that *Cattolica* did not apply to issues of capacity. However, it went on to determine that even if that were wrong, the transactions in *Busto* had been entered into for the purposes of hedging interest rate risks and not for speculative purposes. They were thus permitted. By contrast, in *Venezia*, the court conducted an analysis of the purpose for which Venice entered into the Swaps and determined it was speculative. It held that Venice entered into the Swaps because it needed to restructure a bond, in particular by lengthening the repayment date by 15 years in order to 'free up' its budget. The court accepted the evidence of Venice's experts that in entering into the Swaps, it undertook significant new risk to which it was not exposed under the bond. It also accepted that the probability of Venice losing money on the Swaps was high. The cumulative effect of these (and other) factors led the court to conclude that the Swaps were predominantly speculative rather than hedging.

Proving foreign law

The question of how foreign law is proved in the English courts is one which has received significant attention recently. One of the ways in which the meaning of foreign law can be established through the English courts is by reference to other decisions of the English courts on the meaning of the foreign law. Giving judgment in *Venezia,* Foxton J noted that the decision in *Busto* was not '*strictly binding'* on him. However, the findings of fact made in *Busto* on Italian law could have been admissible as evidence had the banks served a notice under the Civil Evidence Act 1972. The banks placed significant reliance on the *Busto* decision but without the benefit of a Civil Evidence Act Notice, the *Busto* decision had no evidential status and the Commercial Court was free to depart from it.



By contrast, in **Dexia Crediop SPA v Provincia Di Pesaro E Urbino [2022] EWHC 2410 (Comm)** (a judgment given just a month earlier for the second claimant in these proceedings on very similar facts), the Commercial Court followed the judgment in *Busto*, partly because Dexia served a notice under s4 of the Civil Evidence Act 1972 in relation to it, which made the findings in that case admissible as evidence of Italian law.

Contractual estoppel and capacity

The banks' secondary argument, namely that if the swaps were deemed to be void, Venice would be estopped from relying on a lack of capacity because of the representations and warranties in the ISDA Master Agreement, also failed. Strictly speaking, the court concluded that the issue of whether Venice had capacity to 'promise' that it had capacity was a matter of Italian law. However, as the court was not referred to Italian law evidence on the question, the legal argument was conducted by reference to English case law and commentary. The court held this did not assist the banks. The decision in *Credit Suisse v Vestia*[7] (in which an estoppel argument succeeded in similar circumstances) did not support the banks' estoppel argument here. In that case, the ISDA Master Agreement set a framework for future transactions to be entered into over a period of time. By contrast, the Venice ISDA Master Agreement was, essentially, entered into at the same time as (and solely for the purpose of) the Swaps. In those circumstances, the court held that Venice could not be estopped from contending that the transaction was a speculative one, as that would amount to it promising it had capacity, which in fact it lacked. The court noted that the same conclusion had been reached in *Busto* (although for slightly differing reasons) and that in that case, Cockerill J had held that, had it been necessary, she would have been prepared to depart from the decision in *Vestia* in any event.

Restitution and the change of position defence

The applicable law of Venice's restitution claim was found to be English law, as the law of the country with the closest and most real connection with the transactions (a decision also reached in *Busto*). As Italian law does not recognise a 'change of position' defence, this was plainly welcomed by the banks.

While acknowledging that he was entering *'treacherous terrain'* in reaching judgment on the issue, Foxton J held that the banks were, in theory, able to rely on a change of position defence in relation to the back-to-back hedging swaps they entered into in connection with the Swaps. The court considered, but dismissed, the following principle grounds of challenge, derived from previous case law, that the defence is not available where:

- restitution is sought because a condition for conferring the benefit has not been satisfied;
- the change of position occurred *before* receipt of the payments for which restitution was sought;
- payments were made because of a legal liability to do so;
- the recipient cannot (yet) establish whether or not they were worse off because of their change of position.

Foxton J concluded (following extensive analysis of how the defence of 'change of position' has evolved since its inception[8]), that there was no reason why it should not be available in this case. In entering into the back-to-back hedging swaps, the banks had assumed conditional payment obligations in anticipatory reliance of receiving (essentially) the same payments from Venice. There had been no bad faith or illegality; on the contrary the entry into the back-to-back hedging swaps had been routine and objectively foreseeable. This fulfilled the necessary requirements for establishing a change of position defence. In reaching that decision, the court acknowledged that it was not following a number of first instance authorities[9]. However, Foxton J held that the reasoning in those first instance cases could not survive developments in the law of unjust enrichment over the subsequent 25 years. He also derived support from Cockerill J's assessment, on an obiter basis, that she would not have followed those judgments if the issue had arisen.

While the court found the defence was available, quantification of the value of the claim (and any

[7] Credit Suisse International v Stichting Vestia Groep [2014] EWHC 3103 (Comm)
[8] *Lipkin Gorman v Karpnale Limited* [1991] 2 AC 548, 558, and 580

[9] *Westdeutsche Landesbank Girozentrale v Islington LBC* [1994] 4 All ER 890 and *South Tyneside MBC v Svenska International plc* [1995] 1 All ER 545

defence) remains to be carried out. Net payments by Venice under the swaps at the date restitution was sought were €71,995,659.95. In determining that a change of position defence was available, Foxton J noted that this "*tempers at least some of the consequences which would otherwise flow from a legal development in 2020 leading to a transaction which both parties had treated as binding for nearly 13 years being held to be void from the outset.*"

What does this judgment mean for the future of swaps litigation?

Italian regional authorities are currently pursuing many claims for restitution relating to similar swap transactions before the Italian and English courts. The decision in *Cattolica* has been followed by four subsequent decisions of the Italian Supreme Court[10] and, as Foxton J noted in *Venezia*, there is nothing to suggest that the Italian Courts are experiencing any "*buyer's remorse*" at the significant changes in Italian law effected by *Cattolica*.

However, while the regional authorities have had recent success in Italy, the 2021 decision in *Busto* led to a number of settlements of such claims, notably by the Sicilian regional authority. Now that the Commercial Court has concluded that in fact, *Cattolica* does relate to the capacity of such regional authorities to enter into swap transactions, this is likely to have a significant impact on future litigation.

Jurisdictional jeopardy

Foxton J himself was also clearly conscious of the impact of this decision, noting that he had reached his conclusion with *'some diffidence'*. In particular, he expressed concern on the impact of foreign law decisions on questions of capacity for the enforceability of English law contracts:

> ***"There may be room for a legitimate debate as to whether, when the issue arises before an English court, the security of obligations governed by English law should be capable of being subject to a continuing jurisprudential jeopardy of this kind arising from the courts of the domicile of one of the contracting parties."***

[10] *Decisions Nos 2157/2021, 21830/2021, 24014/2021 and 8603/2022*

What should an ISDA notice of default include? Macquarie Bank v Phelan

You enter into a foreign exchange swap under an ISDA Master Agreement with a party who later fails to pay amounts when due. You then prepare a notice of default but turning to the Master Agreement for assistance, it does not address all of your questions regarding the specific form of that notice. So what should the notice of default include?

Mr Justice Foxton considered this question and provided some welcome guidance as to the content of notices of events of default under section 5(a)(i) of the 2002 ISDA Master Agreement in his judgment in **Macquarie Bank Limited v Phelan Energy Group Limited [2022] EWHC 2616 (Comm)**.

Granting summary judgment to Macquarie Bank Limited ("**Macquarie**"), Foxton J held that the contents of such a default notice must be clear, unambiguous and include sufficient information to enable the reasonable recipient to understand the trade to which it relates, the particular obligation which has not been performed, and the necessary steps to cure any failure within the applicable grace period.

Provided those criteria are met, a notice will still be valid, even where there is a dispute about whether the transaction's underlying terms are accurately reflected in the default notice or where it is silent as to a particular term, such as currency or price.

Background

In September 2019, Phelan Energy Group Limited ("**Phelan**") entered into a series of forex swaps with Macquarie under an ISDA Master Agreement. These were rolled over with an eventual expiration date of 14 May 2021.

On 13 and 14 May 2021, there were communications between the parties about the terms of a proposed new USD/ZAR swap. These included a trade recap email sent on 14 May 2021 which referenced the USD amount of the trade and its date of settlement but incorporated a ZAR strike price which was disputed. It was not in dispute that the swap was concluded on 14 May 2021 for settlement on 28 May 2021 (the "**Trade**").

On 28 May 2021, Macquarie emailed Phelan saying it was owed ZAR118 million that day (a figure arrived at using the disputed strike price). Phelan responded the same day disputing that settlement figure. On 31 May 2021, Macquarie sent a default notice notifying Phelan of its failure to make payment in the disputed amount in respect of the Trade (the "**Default Notice**"), which specified that if payment was not made on or before the first local business day after notice was given it would constitute an Event of Default under s5(a)(i) of the ISDA Master

Agreement. Phelan again responded on the same day to dispute the sum claimed.

On 2 June 2021, Macquarie wrote reserving its right to designate an Early Termination Date as a result of the continuing Event of Default and, on 3 June 2021, served a notice designating 4 June 2021 as the Early Termination Date (pursuant to s6(a) of the ISDA Master Agreement).

On 4 June 2021, Phelan contended that in light of its notice of dispute, it was not open to Macquarie to call an Event of Default. Notwithstanding this disagreement, on 9 June 2021, Macquarie sent a notice designating an Early Termination Amount in respect of all open transactions under the ISDA Master Agreement, which, if valid, triggered substantial immediate repayment obligations.

Thereafter, Macquarie brought a debt claim and applied for summary judgment, seeking an order for an interim payment, acknowledging that the effective strike price remained a live issue and, in this regard, its claim was not suitable for determination summarily.

While Foxton J identified three key issues to be considered in determining Macquarie's application, it is the first of these which is of primary relevance, namely; was there an Event of Default by reason of Phelan's failure to pay?

Was there an Event of Default within s5(a)(i) of the ISDA Master Agreement?

Section 5 of the ISDA Master Agreement provides as follows:

*"(a) **Events of Default**. The occurrence at any time … of any of the following events constitutes … an Event of Default (an 'Event of Default'):-*

> *(i) **Failure to Pay or Deliver**. Failure by the party to make, when due, any payment under this Agreement … if such failure is not remedied on or before the first Local Business Day in the case of any such payment … after … notice of such failure is given to the party."*

It was not disputed that there had been a failure to pay or that such failure had not been remedied.

However, Phelan contended that because the sum claimed in the Default Notice was based on an incorrect strike price, the Default Notice had no legal effect. Consequently, Macquarie had no right to designate an Early Termination Date.

Foxton J considered whether a default notice served in accordance with s5 of an ISDA Master Agreement needed to specify an outstanding amount at all and, further, what the consequence would be of including an incorrect figure. In addressing these questions, Foxton J analysed the construction both of: (i) the relevant contractual provision in the ISDA Master Agreement providing for the notice to be served; and (ii) the Default Notice itself.

Given the ubiquity and importance of ISDA Master Agreements, Foxton J noted prior authorities which emphasised core principles applicable to their interpretation, namely:

- The ISDA Master Agreement *"should as far as possible be interpreted in a way that serves the objectives of clarity, certainty and predictability so that the very large number of parties using it should know where they stand"* (per Briggs J in **Lomas v JFB Firth Rixson Inc [2010] EWHC 3372 (Ch)** at [53]); and
- The focus is *"ultimately on the words used, which should be taken to have been selected after considerable thought and with the benefit of the input and continuing review of users of the standard forms and of knowledge of the market"* (per Hildyard J in **Lehman Brothers International (Europe) [2016] EWHC 2417 (Ch)** at [48(3)]).

As to the content of default notices, Foxton J referred to the judgment of Lord Goff in ***Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749, 755**, which made clear that identifying whether a notice of default complies with relevant contractual requirements engages an assessment of "*whether the key represented by the notice fits the lock constituted by the contractual provision requiring the service of a notice to achieve a particular legal effect*".

Foxton J found that the language of s5(a)(i) of the ISDA Master Agreement offered only limited guidance regarding the content required for a default notice to be effective thereunder, but did express a more general view regarding the requirements in this regard, which he considered gave rise to an obligation that a default notice should:

- Communicate clearly, readily and unambiguously to the reasonable recipient in the context in which it is received the failure to pay (such that the reasonable recipient will clearly understand the trade to which it relates, and the particular obligation which it is said has not been performed); and
- Thereby enable the reasonable recipient to identify what the relevant trade requires it to do in order to cure any failure to pay within the applicable grace period.

Foxton J also emphasised that the presence of minor errors in the default notice would not invalidate that notice; this would, in his view, be a commercially unreasonable outcome.

Before turning to the default notice in the instant case, Foxton J examined the context in which the notice was received:

- The parties had entered the Trade on 14 May 2021 for settlement on 28 May 2021 in a USD amount which was not in dispute;
- This was the only trade between the parties involving payment on 28 May 2021 or indeed during the whole of May 2021;
- On 14 May 2021, Macquarie had sent the recap email;
- On 14 and 26 May 2021, Macquarie had sent trade confirmations for signature, setting out all details of the Trade;
- On 28 May 2021, Macquarie had sent an email to Phelan asking it to confirm that it had agreed that on 28 May 2021, Macquarie would receive a ZAR amount and Macquarie was due to pay the undisputed USD amount; and
- Phelan had at that point made no payment in respect of the Trade.

Foxton J also determined that a reasonable recipient would have understood that:

- Macquarie was complaining that Phelan had failed to make payment on 28 May 2021 under the Trade which was due to be settled that day;
- Phelan had made no payment in respect of that Trade at all; and
- There was only 1 trade between the parties due for settlement on 28 May 2021.

Consequently, Foxton J held that the Default Notice had met the requirements of a valid notice and, accordingly, that Macquarie was entitled to call an Event of Default as a result of Phelan's subsequent inaction. In arriving at that conclusion, he rejected Phelan's arguments that s5(a)(i) of the ISDA Master Agreement required a default notice to contain express and wholly accurate statements of the following to be effective:

- The identification of documents and other confirming evidence for the relevant trade;
- A precise and entirely accurate statement of the amount for payment; and
- The currency in which the payment was due.

Whilst, on the facts, Macquarie was successful in arguing that there had been an Event of Default, it is clear that had there been any ambiguity regarding the specific trade which was the subject of the Default Notice, the Default Notice would have been invalid. This is likely to be of greater significance where, unlike in the instant case, there are a large number of trades between contractual counterparties which become due for settlement on the same day.

In summary, Foxton J's judgment makes clear that:

- Where a party is preparing to serve a default notice under s5(a)(i) of the ISDA Master Agreement, that party must ensure that the default notice is as unambiguous and precise as possible and that it includes, at the least,

sufficient information such that the reasonable recipient will clearly understand the trade to which it relates, the particular obligation which has not been performed, and the necessary steps to cure any failure within the applicable grace period;

- Insignificant errors in a default notice under s5(a)(i) of the ISDA Master Agreement will not necessarily invalidate that notice; and
- Where a recipient of a default notice under s5(a)(i) of the ISDA Master Agreement fails to make payment of amounts that are said to be outstanding thereunder, with which they disagree in amount only, they place themselves at serious risk if they refuse to perform their obligation at all, rather than paying the amounts which they consider are, in fact, due and payable.

Whilst in this case Foxton J was willing to tolerate, at least in principle, a degree of imprecision in the form of the default notice, it should be emphasised that this decision, made in the context of the ISDA Master Agreement, is fact specific and should not be assumed to have a more general application. The prudent course remains for parties to ensure that notices of default or termination are properly prepared and sent in strict accordance with relevant contractual provisions, and where there is any ambiguity as to the meaning of those provisions, to err on the side of caution when deciding the extent of the information to provide a recipient.

When is an Event of Default no longer "continuing" under the ISDA Master Agreement?

When an Event of Default is "continuing" is not defined or addressed in the ISDA Master Agreement. Until now it does not appear to have been expressly considered in case law either.

In **Grant & Ors v FR Acquisitions Corporation (Europe) Ltd & Anor (Re Lehman Brothers International (Europe) LBIE) [2022] EWHC 2532 (Ch)** the Court determined that the correct test to apply is whether the event or state of affairs that constituted the Event of Default remains, not whether creditors' rights remain affected. When Lehman Brothers International (Europe) ("**LBIE**") exits administration as a solvent company, any Events of Default under the ISDA Master Agreements[11] will no longer be "continuing", and the respondents ("**Firth Rixson**") will be contractually obliged to pay sums owed to LBIE under interest rate swap transactions.

Practical points:

- Parties should carefully consider their options under any contract. When LBIE entered administration in 2008, Firth Rixson, as a "Non-defaulting Party", was entitled to terminate the transactions under Section 6(a) of the ISDA Master Agreements by designating an Early Termination Date. Instead, it made the "*unusual*" choice to suspend its payment obligations under Section 2(a)(iii), quite possibly thinking that LBIE would eventually be dissolved rather than re-emerge as a solvent company. Also, any party that has previously relied on Section 2(a)(iii) may want to check, in light of this judgment, whether the Events of Default relied on are continuing.

- In 2014 (following the Court of Appeal's decision in **Lomas & Ors v JFB Firth Rixson Inc & Ors [2012] EWCA Civ 419**) ISDA published an optional amendment to insert a time limit on the operation of Section 2(a)(iii) where an Event of Default has occurred, which might help to avoid such a scenario in future.

- As the Court noted, the ISDA Master Agreement is one of the most widely used standard form agreements in the financial world and serves as the contractual foundation for more than 90% of the over-the-counter derivatives transactions globally. Mr Justice Burton commented in Lehman Brothers Finance SA v SAL Oppenheim JR & CIE. KGAA [2014] EWHC 2627 that "*the ISDA Master Agreement is intended to be normative, and to apply in as many situations and with as much straightforward application as possible*." That meant the Court here had to "*ascribe even more than usual deference to the words used, and take as the context not the specific position as between the parties, but its*

[11] One governed by the 1992 ISDA Master Agreement and one by the 2002 ISDA Master Agreement (together, the "**ISDA Master Agreements**"). For the purposes of these proceedings there is no material difference between the two ISDA Master Agreements.

anticipated use by such a variety of intended users in such a variety of circumstances".

- The Court also referred to the comments of Lady Justice Gloster in Pioneer Freight Futures Co Ltd v TMT Asia Ltd [2011] 1 CLC 885: "*…the commercial function or purpose of the condition precedent to payment as set out in Section 2(a)(iii) is to mitigate counterparty credit risk…*". These comments were repeated in Lomas v Firth Rixson Inc [2012] 1 CLC 713: "*… the purpose of Section 2(a)(iii) is to protect the Non-defaulting Party from the additional credit risk involved in performing its own obligations whilst the defaulting counterparty remains unable to meet its own*." When there is no longer a continuing Event of Default which has suspended contractual obligations to make payments, this case shows that the Courts will uphold obligations to make such payments.

Background:

LBIE had entered into separate interest rate swap transactions governed by the ISDA Master Agreements with two Firth Rixson group companies. The parties agreed that principal amounts of more than £8m and $53m were owed to LBIE under the terms of the swaps. However, since LBIE entered administration in 2008, Firth Rixson had relied on Section 2(a)(iii) in the ISDA Master Agreements to suspend its payment obligations to LBIE. Under Section 2(a)(iii), any payment obligation is subject to the condition precedent that "*no Event of Default or Potential Event of Default with respect to the other party has occurred and is continuing*". LBIE entering administration and failing to make payments when due triggered that condition. In previous litigation[12], the Court held that Firth Rixson was entitled to suspend its payment obligations until there were no "continuing" Events of Default in respect of LBIE.

Now the administrators of LBIE are getting ready for LBIE to exit administration as a solvent company. They argued that, when certain steps have been taken and LBIE's directors re-take control of the company, there will no longer be any "continuing" Events of Default. Firth Rixson on the other hand contended that: (i) termination of the administration cannot "cure" all the Events of Default; and (ii) certain further Events of Default have arisen during the course of the administration. The administrators therefore applied to the Court for directions.

The Court's decision in relation to each alleged Event of Default:

- *Failure to pay*
  The parties agreed that LBIE's failure to make payments under one of the swaps gave rise to an Event of Default under s5(a)(i) of the ISDA Master Agreement[13]. However, insolvency set-off (which took place in December 2009) meant that LBIE's liability for the unpaid amounts under the swap was discharged and "cured" LBIE's failure to pay.

- *Insolvency*
  Under Section 5(a)(vii)(2) of the ISDA Master Agreement, an Event of Default will occur if a party "*becomes insolvent or is unable to pay its debts or fails or admits in writing its inability generally to pay its debts as they become due*." The parties agreed that LBIE was no longer

[12] Lomas v JFB Firth Rixson Inc [2012] 1 CLC 713

[13] "*Failure by the party to make, when due, any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) required to be made by it if such failure is not remedied on or before the third Local Business Day after notice of such failure is given to the party*".

insolvent or unable to pay its debts, but it had admitted in writing its inability to pay its debts as they become due. In order to "cure" this Event of Default, the administrators proposed that LBIE would publish a notice that LBIE now has a surplus of assets over liabilities and is able to pay its debts as they fall due.

- *Administration*

  The parties agreed that LBIE's entry into administration triggered an Event of Default under Sections 5(a)(vii)(4) and (6) of the ISDA Master Agreements[14], and that that Event of Default was currently "continuing". The key issue was whether it would still continue when the appointment of the administrators of LBIE was terminated. LBIE argued that the Event of Default would end with the administration.

  LBIE's administration was converted to a distributing administration in 2009. In a distributing administration the role of the administrator is, in many ways, "*functionally equivalent to a liquidation*". Effectively the entirety of LBIE's assets have been realised and the proceeds distributed to creditors under a statutory regime. Firth Rixson contended that the process has a permanent impact on creditors' rights and the Event of Default could not be "cured" by exiting administration, but instead only when its legal effects end.

  The Court agreed with the administrators' interpretation: "*the focus is on the state of coming to be and continuing to be in administration; and, in my judgment, that state of affairs will no longer be "continuing" when the administration terminates, whether or not the administration at some earlier point became a distributing administration*."

- *Scheme of Arrangement*

  There will be an Event of Default under Section 5(a)(vii)(3) of the ISDA Master Agreements if a party "*makes a general assignment, arrangement or composition with or for the benefit of its creditors*". Firth Rixson argued that the scheme of arrangement, which had been proposed by the administrators and sanctioned by the Court in 2018, was an arrangement for the purposes of Section 5(a)(vii)(3), triggering an Event of Default when it was sanctioned and acting as a "continuing" Event of Default because it permanently varied creditors' rights. The administrators countered that it did not trigger an Event of Default: although it was a scheme of arrangement for the purposes of Part 26 of the Companies Act 2006, it was not an "*arrangement*" for the purposes of Section 5(a)(vii)(3) of the ISDA Master Agreements. The Court agreed with the administrators. The term "*arrangement*" is not a term of art and must be interpreted according to its context. The phrase "*general assignment, arrangement or composition with or for the benefit of its creditors*" describes processes entered into by a debtor in financial distress, or which involve a fundamental change in status (such as dissolution or winding-up). That was not the case here – the scheme of arrangement's purpose was to maximise the surplus of assets.

[14] Where a party "*(4) institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights… (6) seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for it or for all or substantially all its assets*".

However, the judge commented *obiter* that, if he was wrong and the scheme did in fact trigger an Event of Default, that would continue for as long as the scheme has effect, even after termination of the administration.

- *Chapter 15 Order*
  Firth Rixson also argued that an order made by the US Bankruptcy Court recognising the scheme of arrangement under Chapter 15 of the US Bankruptcy Code triggered an Event of Default under Section 5(a)(vii)(4) and (8) of the ISDA Master Agreement[15]. The Court held that it did not constitute an Event of Default. If the scheme of arrangement itself was not an Event of Default, an order for its recognition should not, without more, constitute an Event of Default either.

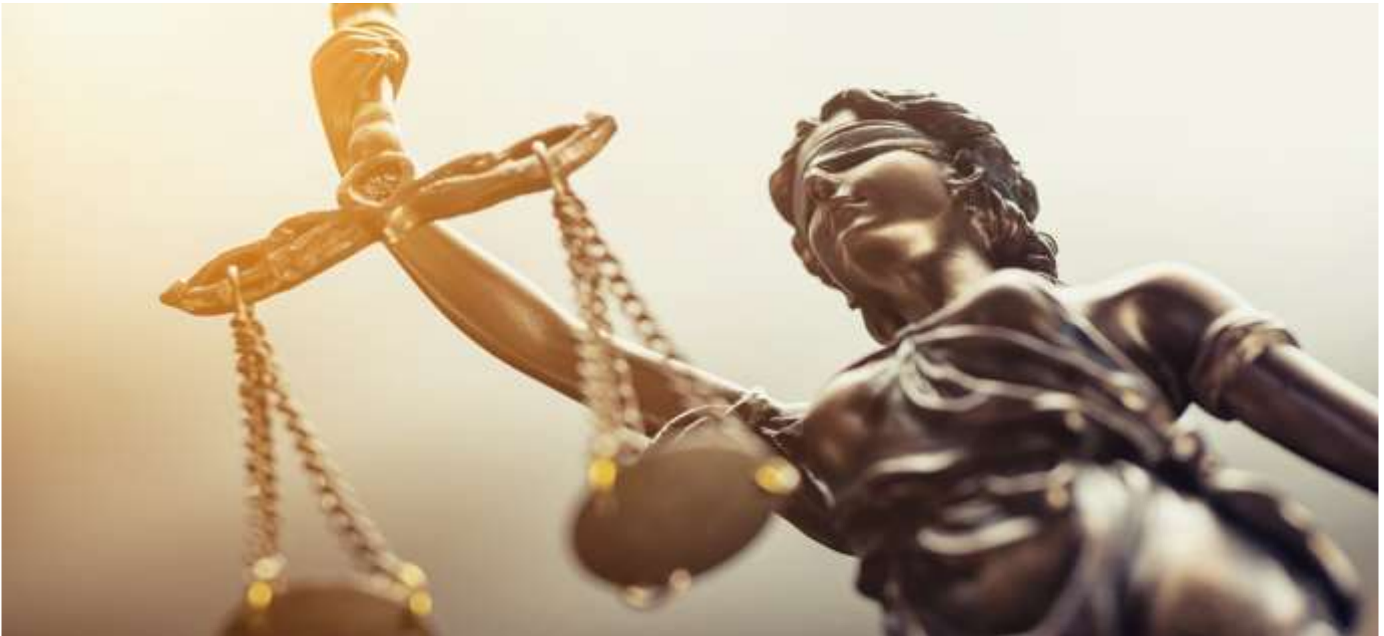
- *Spanish and French Exequaturs*
  Finally, Firth Rixson argued that orders made in France and Spain giving recognition and effect to the English administration order also gave rise to Events of Default under Section 5(a)(vii)(4) because they constituted proceedings *"seeking…relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights"* and within the meaning of Section 5(a)(vii)(8), they had an "*analogous effect to*" the Events of Default under Section 5(a)(vii)(4) and (6). The Court held that they did not constitute standalone Events of Default. Section 5(a)(vii)(4) does not extend to proceedings simply intended to recognise and give effect to an Event of Default (i.e. the English administration order).

Mr Justice Hildyard noted that, although he came to his conclusions by interpreting the words used in the ISDA Master Agreements, the judgment he reached also reflected the commercial purpose of Section 2(a)(iii) as set out by Lady Justice Gloster in Pioneer Freight Futures Co Ltd v TMT Asia Ltd) and the Court of Appeal in Lomas v Firth Rixson Inc (detailed above). Once the relevant steps have been taken for LBIE to exit administration, none of the alleged Events of Default will have any substantive adverse effect on Firth Rixson nor affect its credit risk. At that point there will no longer be any need for protection to mitigate counterparty credit risk.

[15] *"The party… (4) had instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights…"*

"The party… (8) causes or is subject to any event with respect to it which, under the applicable laws of any jurisdiction has an analogous effect to any of the events specified in clauses (1) to (7) above (inclusive)."

Litigation privilege: Loreley v Credit Suisse



For the first time, the Court has considered the issue of whether the identities of those authorised to give instructions to solicitors on behalf of a corporate client are covered by litigation privilege. The Court of Appeal determined in Loreley Financing (Jersey) No 30 Ltd v Credit Suisse Securities (Europe) [2022] EWCA Civ 1484 that the general position is that their identity will not be privileged.

Practical takeaways

- Generally, the identity of the person giving instructions on behalf of a corporate entity will not be privileged. If a party considers that it should be privileged (i.e. it might reveal something about the content of the communication or the litigation strategy being discussed), they will need to explain why, but will need to do so in general terms so as not to disclose the privileged information.
- Even if the information is not privileged, the party seeking disclosure will still need to persuade the court that it either falls within a duty of disclosure, or (as here) that the request for the information under Part 18 of the CPR is reasonable and proportionate.

Background

The claimant ("**Loreley**") alleges fraudulent misrepresentation and unlawful means conspiracy in relation to its purchase of US$100m of notes from the defendant ("**Credit Suisse**") as part of a collateralised debt obligation transaction.

Credit Suisse's defence alleges that Loreley's claims are time barred, which would be a complete defence to the claim. It alleges that Loreley knew, or could with reasonable diligence have known, of certain relevant facts necessary to plead the claim, at an early enough point that the claim was now time-barred. In particular, Credit Suisse relied on the fact that Loreley was an SPV with no employees, and directors provided by a professional services company and argues that the knowledge of either of two German banks: IKB, on whom Loreley relied for its book-keeping; or KfW, a creditor of Loreley with security over its assets, including the claim against Credit Suisse, should be attributed to Loreley.

In a Part 18 Request for further information of Loreley's pleaded case, Credit Suisse asked whether individuals at KfW were providing instructions to Loreley's solicitors in relation to the litigation. Loreley refused to answer, claiming that this information was subject to litigation privilege.

First instance decision

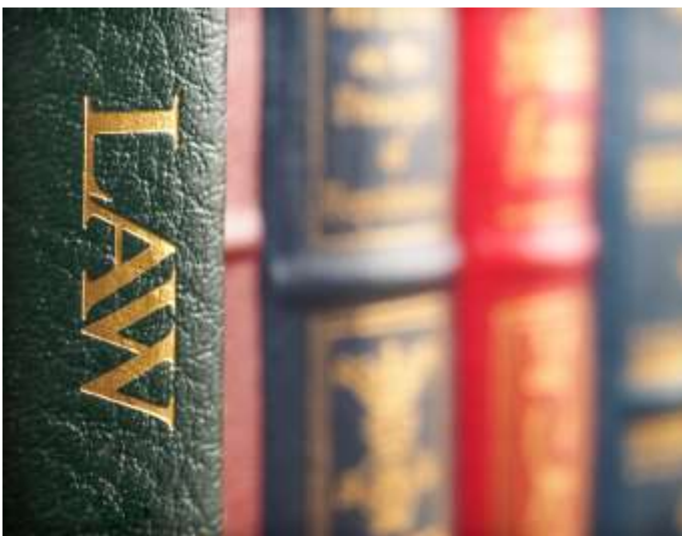
At first instance, the High Court held that the identities of the individuals authorised to give instructions on Loreley's behalf to its solicitors were not subject to legal professional privilege and ordered Loreley to disclose their identities. Mr Justice Robin Knowles determined that the identity of the person communicating with a lawyer on behalf of a corporate client would only be privileged if: (1) the communication is privileged; and (2) privilege would be undermined by disclosure of the identity.

Mr Justice Robin Knowles also made a declaration:

"*In the present case, the identities of the individuals who are, or have been, authorised to give instructions to Reynolds Porter Chamberlain LLP ('RPC') on behalf of the Claimant in relation to these proceedings are not subject to legal professional privilege*."

For further details, please see our article covering the first instance decision.

Appeal



Loreley appealed, arguing that the identities of the individuals authorised to give instructions to solicitors on behalf of a corporate client in the course of ongoing litigation are necessarily covered by litigation privilege and it does not depend on whether privilege would be undermined by disclosure of their identity. Loreley also submitted that: (i) the purpose of litigation privilege is to establish a "zone of privacy" around a party's preparation for litigation; and (ii) the identities of the individuals authorised to give instructions are "paradigmatically" within the scope of litigation privilege because its disclosure might provide an advantage to the opponent.

There was no prior authority addressing the issue here. The Court of Appeal therefore considered it as a matter of principle. Lord Justice Males gave the leading judgment, with which Lady Justice Nicola Davies and Sir Geoffrey Vos agreed.

Lord Justice Males referred to Lord Carswell's statement in Three Rivers District Council v Governor & Company of the Bank of England (No. 6) [2004] UKHL 48, [2005] 1 AC 610 setting out the requirements for litigation privilege:

"*communications between the parties or their solicitors and third parties for the purpose of obtaining information or advice in connection with existing or contemplated litigation are privileged, but only when the following conditions are satisfied: (a) litigation must be in progress or in contemplation; (b) the communications must have been made for the sole or dominant purpose of conducting that litigation; (c) the litigation must be adversarial, not investigative or inquisitorial*"

and the purpose of litigation privilege (as set out in Three Rivers (No. 6): see R v Derby Magistrates Court, ex parte B [1996] AC 487, amongst other cases):

> **a client must be certain that whatever she says to her lawyer in confidence will not be disclosed without her consent.**

Lord Justice Males concluded that, if disclosing the identity of a person communicating with their lawyer regarding litigation would "*inhibit candid discussion*" between them, the person's identity should be privileged. Otherwise, it is unnecessary and may in fact deprive the court of relevant evidence.

Lord Justice Males considered that, in general, there would be no such inhibition: disclosing the person's identity would not reveal anything about the contents of the communications. Indeed, there was

no evidence that it would do so here. Lord Justice Males acknowledged, however, the possibility in "*an unusual case*" that identifying the person giving instructions might reveal something about the content of the communication or the litigation strategy being discussed, but that would need to be explained as the basis of a claim for privilege[16] (albeit in general terms not to disclose the privileged information).

Lord Justice Males agreed with Credit Suisse that there was no support in English authorities or in the principles underpinning litigation privilege for the concept of a "**zone of privacy**". The examples put forward by Loreley did not support its existence.

Request for further information

Whilst the identities of those giving instructions to Loreley's solicitors are not privileged, and so would not be a ground to refuse disclosure or inspection, in the circumstances, Lord Justice Males did not agree that such disclosure should be ordered through CPR Part 18. A request under CPR Part 18 "*should be concise and strictly confined to matters which are reasonably necessary and proportionate to enable the first party to prepare his own case or to understand the case he has to meet*." Lord Justice Males held the information request to be unnecessary and disproportionate. It was only of peripheral relevance and did not cause any difficulty for Credit Suisse's preparations for trial. Lord Justice Males warned that he would not encourage such requests.

Declaration

The Court of Appeal also set aside the declaration made by Mr Justice Robin Knowles at first instance that the identities of the individuals who are, or have been, authorised to give instructions on Loreley's behalf in relation to the proceedings are not subject to legal professional privilege. That was because: (i) a declaration in such general terms serves little or no purpose; and (ii) the question of privilege ought to be tested by reference to particular communications rather than in the abstract.

[16] As was the case in JSC BTA Bank v Ablyazov [2012] EWHC 1252 (Comm).

MUR Shipping v RTI – Court of Appeal rules on interpretation of force majeure clause

On 27 October 2022 the Court of Appeal handed down judgment in MUR Shipping BV v RTI Ltd [2022] EWCA Civ 1406, finding that MUR (owners) could not rely on a force majeure clause in a contract of affreightment (COA) to suspend performance, because they should have accepted payment of freight in euros (as opposed to US dollars, required by the contract) in exercise of their obligation to overcome the state of affairs resulting from the imposition of sanctions on RTI's (charterers) parent company.

Facts

In 2016, MUR entered into a COA with RTI in respect of monthly consignments of bauxite, from Conakry in Guinea to Dneprobugksy in Ukraine. In 2018, OFAC added RTI's parent company (Rusal) to the Specially Designated Nationals and Blocked Persons (SDN) list. MUR served a force majeure notice on RTI saying that it would be a breach of sanctions for MUR to continue performing the COA. It further noted that the sanctions would prevent RTI making payment in US dollars, which was required under the COA. RTI's position was that (a) sanctions would not interfere with cargo operations; (b) MUR was not a US person caught by the sanctions; and (c) MUR could in any event receive payment in euros instead.

Issue

The key issue (and the subject of appeal to the Commercial Court and subsequently the Court of Appeal) was whether acceptance of RTI's proposal that MUR pay in euros would have overcome the state of affairs caused by the difficulty of making timely payments of US dollars resulting from the sanctions imposed on RTI's parent (such that MUR was not entitled to rely on the force majeure clause).

Arbitral Award

The matter went to arbitration, and the Tribunal found in favour of RTI. It held that MUR's case on force majeure would have succeeded save that MUR could have overcome the force majeure event using reasonable endeavours, specifically to accept payment in euros. The Award was appealed by MUR under section 69 of the Arbitration Act 1996 (appeal on a point of law).

First Instance decision

MUR's primary case before the Commercial Court was that there is no authority to support the argument that the exercise of reasonable endeavours under a force majeure clause requires the affected party to vary the terms of the contract

or agree to non-contractual performance. RTI argued that the Tribunal had been correct to find that accepting a transfer made by RTI that would automatically be converted into euros (with all additional charges borne by RTI) constituted reasonable endeavours, and that there was nothing in the COA to exclude the exercise of reasonable endeavours involving non-contractual performance. RTI also focused on the importance of causally linking the force majeure event with the actual loading of the cargo, and the fact that payment in euros was commercially indistinguishable from payment in US dollars. Mr Justice Jacobs found in favour of MUR and allowed the appeal, holding that exercising reasonable endeavours to avoid a force majeure event does not include non-contractual performance (or accepting non-contractual performance from another party) in order to circumvent the effect of a force majeure or similar clause. RTI appealed to the Court of Appeal under section 69 of the Arbitration Act 1996.

Court of Appeal decision

RTI's appeal was allowed. The Court of Appeal (Males LJ giving the leading judgment) found that acceptance by MUR of RTI's proposal to pay in euros would have overcome the state of affairs in question. The Court gave the following reasons in support:

1. The correct approach was to construe the specific terms of the force majeure clause (in particular clause 36.3(d) which read: "[The event or state of affairs] cannot be overcome by reasonable endeavours from the Party affected"), and the Court was not concerned with reasonable endeavours clauses or force majeure clauses in general. Each clause was to be considered on its own terms.

2. Clause 36.3 defined "Force Majeure Event" as an "event or state of affairs". The former (i.e., something which happens at a particular time and place) was not necessarily the same as the latter (i.e., the situation which results from the happening of one or more events), and accordingly it was relevant to consider not only (a) the event (the imposition of sanctions), but also (b) the state of affairs resulting from that event (the likelihood of delay in making US dollar payments) when deciding whether the force majeure event could not be overcome by MUR exercising reasonable endeavours.

3. Considerations as to whether MUR had exercised reasonable endeavours, in the abstract, were irrelevant, as were broader legal principles (including mitigation of damage and frustration). The real question was whether acceptance of RTI's proposal to pay freight in euros and to bear the cost of converting those to US dollars would have overcome the state of affairs caused by the imposition of sanctions. If it would, MUR's contractual right to receive payment in US dollars would remain unaffected.

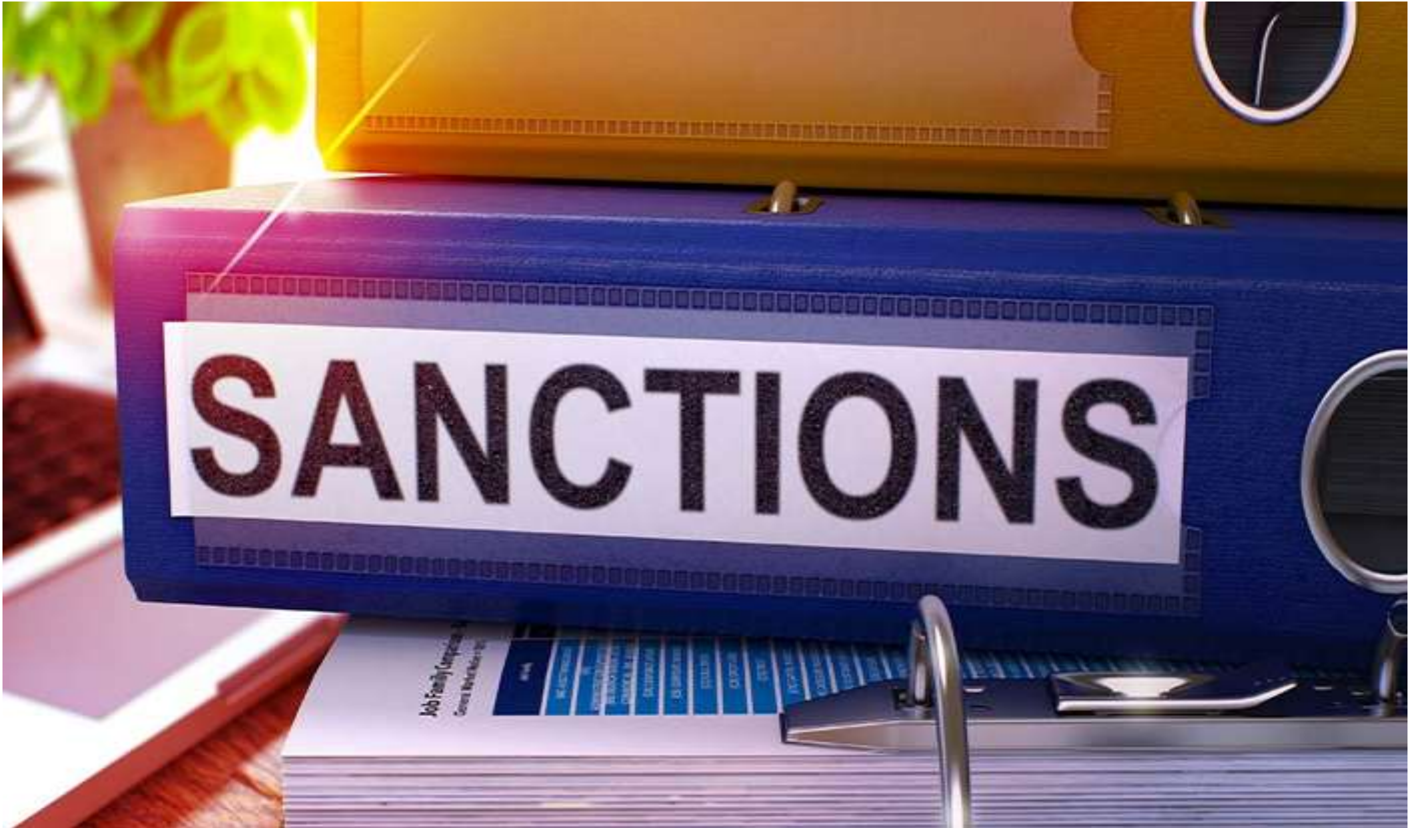
4. Applying the wording of clause 36 in a common sense way, RTI's proposal achieved the underlying objective in the contract (namely MUR's right to receive the right quantity of US dollars in its bank account at the right time) with no detriment to MUR, and therefore would have overcome the state of affairs in question.

Comment

The Court of Appeal has given a clear signal that when construing parties' obligations under force majeure clauses, the express wording chosen by the parties will be of key importance, and that more general legal principles are less relevant. As shown by this decision, the wording chosen by the parties may increase or reduce the scope a force majeure clause, with considerable consequences, and parties should closely bear this in mind when drafting such clauses.

Authors: Emma Skakle, partner and Ben Bryant, associate, commodities team

UK sanctions: Russian-owned customers? Beware extended payment terms



The UK has recently amended its sanctions regime against Russia, The Russia (Sanctions) (EU Exit) Regulations 2019 (the "Regulations"), for the 15th and 16th times this year.

In this article, we look at the wide potential impact of the expansion of the ban on loans to certain companies connected with Russia (regulation 17 of the Regulations, as amended by The Russia (Sanctions) (EU Exit) (Amendment) (No. 15) Regulations 2022 (the "15th Amendment")). We will look in a separate article at the upcoming ban on the maritime transportation of certain Russian oil and oil products (inserted by The Russia (Sanctions) (EU Exit) (Amendment) (No. 16) Regulations 2022).

Regulation 17 relates to the granting of a "*relevant loan*". Prior to the recent amendment, the UK had limited the categories of "*relevant loans*" so as largely to exclude loans granted to non-Russian companies (other than in connection with the 11 Russian companies listed in Schedule 2 to the Regulations[17]). The 15th Amendment has now significantly expanded the scope of regulation 17 so that it covers certain loans and credit granted to any non-Russian company "*owned*" by either:

1 an individual located or ordinarily resident in Russia; or

2 a Russian company unless that Russian company was, or is "*owned*" by another legal person that was, incorporated or

[17] Sberbank, VTB Bank, Gazprombank, Vnesheconombank (VEB), Rosselkhozbank, OPK Oboronprom, United Aircraft Corporation, Uralvagonzavod, Rosneft, Transneft and Gazprom Neft, all of which were targeted prior to Brexit.

constituted outside Russia on 29 October 2022.

In this context, "*owned*" means holding directly or indirectly more than 50% of the shares or voting rights. To fall within this new category of loans covered by regulation 17, the loan or credit must have a maturity exceeding 30 days and been first made or granted on or after 29 October 2022.

Businesses outside the financial sector should note the wide potential impact of regulation 17. Guidance issued by the Office of Financial Sanctions Implementation ("**OFSI**")[18] indicates that the provision of payment terms for any goods or services (i.e. delayed payment of more than 30 days) that are not in line with normal business practice or which have been substantially extended may constitute circumvention of regulation 17. Circumvention is itself a criminal offence and may be subject to a monetary penalty of up to £1 million (or, if greater, 50% of the estimated value). Businesses operating in the UK and UK businesses operating internationally should consider carefully their customer base and the payment terms agreed with any customers that may fall within the expanded regulation 17.

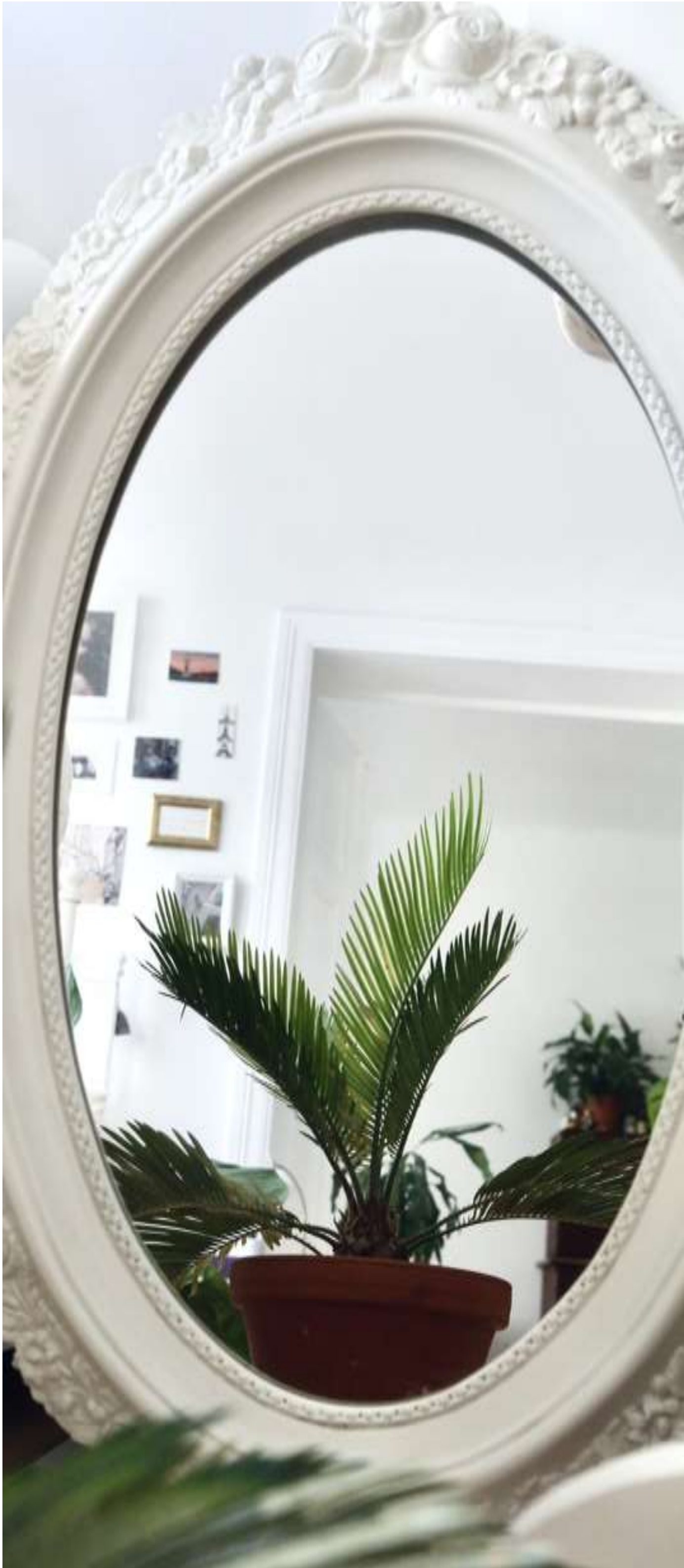
Those operating in the financial sector should also be aware that the OFSI guidance indicates that payment and settlement services, including through correspondent banking, regarding "*relevant loans*" are also caught by regulation 17.[19] Combined with the risk of circumvention referred to above, the expanded regulation 17 could create additional compliance issues in relation to the processing of payments from Russian-owned companies.

If you would like to discuss the impact of the sanctions, then please contact one of our team.

[18] OFSI's Guidance for the financial and investment restrictions in the Regulations, FAQ 21: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1105463/Russia_guidance_21.09.22.pdf

[19] FAQ 31

Court of Appeal confirms reflective loss can't be recovered



The scope of the rule against reflective loss is sufficiently certain for it to be determined on summary judgment. The Court of Appeal in Burnford & Ors v Automobile Association Developments Ltd [2022] EWCA Civ 1943 rejected arguments that the law on reflective loss was too '*uncertain and developing*', observing that the Supreme Court's decision in *Sevilleja v* Marex[20], had clarified the position. The Court of Appeal also agreed with the first instance decision that the claim should be struck out because it was barred by the reflective loss rule. In reaching this conclusion, the Court of Appeal set out a helpful summary of the seven factors that must be present for the reflective loss rule to apply:

What makes loss reflective?

The following factors amplify those set out at first instance (and in *Marex*):

1. A shareholder must have suffered loss in their capacity as a shareholder. The loss must be a reduction in the value of their shares or distributions. The loss must be caused by a loss sustained by the company. The company must have a cause of action against the same wrongdoer (*Marex* at paragraph 79);

2. A shareholder cannot escape the "reflective loss" principle just because they have an independent cause of action against the defendant. They must also have suffered "separate and distinct" loss, and the law does not regard a reduction in the value of shares or distributions which is a knock-on effect of loss suffered by the company as "separate and distinct";

3. There need be no exact correlation between the shareholder's loss and the company's for the "reflective loss" principle to apply. The "reflective loss" principle can apply "where recovery by the company might not … fully replenish the value of its shares" (see *Marex* at

[20] *Sevilleja v Marex Financial Ltd [2020] UKSC 31*

paragraph 42). Equally, the company's loss can exceed the fall in the value of its shares;

4. The "reflective loss" principle will not apply if, although the shareholder's loss is a consequence of loss sustained by the company, the company has no cause of action against the defendant in respect of its loss;

5. The "reflective loss" principle will not apply to a claim which is not brought as a shareholder but instead, for example, as a creditor or an employee;

6. The Court has no discretion in the application of the "reflective loss" principle, which is a rule of substantive law;

7. The applicability of the "reflective loss" principle relates to the circumstances when the shareholder suffered the alleged loss, not those when the claim was issued.

Background and grounds of appeal

The claimants were former shareholders in Motoriety (UK) Limited (**Motoriety**). Motoriety entered into various agreements with the defendant, Automobile Associations Developments Limited (**AAD**) (a group company within the AA group). In August 2015, Motoriety and the claimants entered into an investment agreement with AAD, through which AAD subscribed for shares in return for board representation and the option to acquire further shares. Motoriety also granted AAD a licence to use its software. Motoriety failed to prosper. It went into administration and was bought by another company within the AA group, before being dissolved in 2019. The claimants alleged that Motoriety entered into the agreements because of the defendant's misrepresentations, and that AAD breached the investment agreement. They argued that but for the misrepresentations, they would have entered into an investment agreement with a third party and the value of their shareholdings would have increased. Alternatively, they argued that but for AAD's breaches of the investment agreement it would have exercised its option to acquire more shares, for which the claimants would have received further consideration.

AAD denied the allegations and applied for strike out or summary judgment on the basis that all of the claimants' claims were barred by the rule against reflective loss.

The courts' decisions

At first instance, the court granted AAD's application and struck out the claim. That decision was upheld on appeal. Both judgments emphasised that the rule on reflective loss had been clarified by the Supreme Court in *Sevilleja v Marex* and that its scope and application was now sufficiently certain. In relation to both the misrepresentation and breach of contract claims, the Court of Appeal agreed that it was clear that Motoriety itself would have had the same cause of action against AAD and that any loss suffered by the claimant shareholders was in the form of a reduction in the value of their shares. Their claim fell squarely within the principles set out in *Sevilleja v Marex* (listed above) and was barred by the rule against reflective loss.

However, there was one area in which the reasoning of the Court of Appeal differed slightly to that expressed at first instance, and that concerns the timing of the application of the rule.

Timing of the test for reflective loss

In *Nectrus v UCP*[21] (a judgment given on an application for permission to appeal), the court held that the time for assessing whether loss is reflective or not should be the date the claim is issued. Subsequently, however, in *Primeo v Bank of Bermuda*[22], the Privy Council concluded that *Nectrus* was *'wrongly decided'* and the time for assessing loss should be the date the loss was suffered. At first instance in *Burnford*, the court considered these conflicting authorities and determined that it was bound (as a matter of authority) to follow *Nectrus* and not *Primeo*. However, it considered it was able to distinguish *Nectrus* on the facts. In *Nectrus*, unlike

[21] *Nectrus Ltd v UCP plc [2021] EWCA Civ 57*

[22] *Primeo Fund v Bank of Bermuda (Cayman) Ltd [2021] UKPC 22*

Burnford, the shareholder had sold their shares before the claim was issued, and at the time of issue the company had not been dissolved. The company's loss had therefore been '*passed on*' to the shareholder. When the shareholder brought the claim, there was therefore no risk of double recovery for the same loss. In *Burnford*, however, the company had been dissolved before the claim was issued and the claimant shareholders had not sold their shares at a reduced price. The loss therefore remained with the company where, were the company to be restored to the register, it would be able to bring the same claim. At first instance, *Nectrus* was therefore distinguished.

The Court of Appeal considered the conflicting authorities in *Nectrus* and *Primeo*. It held that *Primeo* had established that the rule against reflective loss is not simply a procedural rule designed to prevent double recovery. Instead, it is a substantive rule of law and the time for assessing it is the time the loss was suffered, not the time a claimant chooses to bring a claim.

The court also noted that the Court of Appeal in *Allianz Global Investors GmbH v Barclays Bank plc* [2022] EWCA Civ 353 had indicated this was the correct view. The Court of Appeal therefore crystallised this position by confirming that the correct time to assess the loss is when the loss is suffered, not when the claim is issued.

Contacts

If you have any questions about any of the issues raised in these articles, please get in touch with one of the authors below, or your usual Stephenson Harwood contact.

Edward Davis

Partner

T: +44 20 7809 2327

E: edward.davis@shlegal.com

Sue Millar

Partner

T: +44 20 7809 2329

E: sue.millar@shlegal.com

Richard Garcia

Partner

T: +44 20 7809 2346

E: richard.garcia@shlegal.com

Donna Newman

Partner

T: +44 20 7809 2357

E: donna.newman@shlegal.com

Genevieve Quierin

Partner

T: +44 20 7809 2174

E: genevieve.quierin@shlegal.com

Ben Sigler

Partner

T: +44 20 7809 2919

E: ben.sigler@shlegal.com

Dan Smith

Partner

T: +44 20 7809 2369

E: dan.smith@shlegal.com

Stephen Ashley

Of Counsel

T: +44 20 7809 2362

E: stephen.ashley@shlegal.com

Alina Neal

Of Counsel

T: +44 20 7809 2266

E: alina.neal@shlegal.com

Adam Polonsky

Managing Associate

T: +44 20 7809 2780

E: adam.polonsky@shlegal.com

Jeremy Livingston

Managing associate

T: +44 20 7809 2086

E: jeremy.livingston@shlegal.com

Chris Pettett

Managing associate

T: +44 20 7809 2396

E: chris.pettett@shlegal.com

Camille Brien

Associate

T: +44 20 7809 4157

E: camille.brien@shlegal.com

Ciaran Fitzpatrick

Associate

T: +44 20 7809 2840

E: ciaran.fitzpatrick@shlegal.com

Maria Harris

Associate

T: +44 20 7809 2702

E: maria.harris@shlegal.com

Sophie Mahal

Associate

T: +44 20 7809 2203

E: sophie.mahal@shlegal.com

Rebecca Mansbridge

Associate

T: +44 20 7809 2134

E: rebecca.mansbridge@shlegal.com

Megan Pettinger

Associate

T: +44 20 7809 2009

E: megan.pettinger@shlegal.com

Lucy Walsh

Associate

T: +44 20 7809 2923

E: lucy.walsh@shlegal.com

Harriet Campbell

Senior knowledge lawyer

T: +44 20 7809 2517

E: harriet.campbell@shlegal.com

Rebecca Garrick

Senior knowledge lawyer

T: +44 20 7809 2548

E: rebecca.garrick@shlegal.com

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