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Search orders

First, a definition: "A 'search order' is an order made on a without notice application which requires permission to be given for certain representatives of the claimant and the supervising solicitor to enter premises for the purpose of searching them, and removing articles or documents, or obtaining information (e.g. from computers). It is extreme relief because, if complied with, it will result in the representatives entering premises (e.g. a private house) and searching them, and, what is more, doing so before the defendant has put his side of the case to the court…."[1]

From Steven Gee QC's description we can identify the following characteristics of the search order: (a) it arises from a without notice application, albeit they can be used not only before proceedings are issued, but also during proceedings and even post-judgment in relation to execution; (b) it requires permission to be given by the respondent for representatives of the claimant accompanied by the supervising solicitor to enter premises for the purpose of searching them, and removing articles or documents, or obtaining information (e.g. from computers); (c) it is an extreme form of relief: perhaps the most extreme in the civil justice armoury. It is the second of the law's two nuclear weapons, developing the tasteless analogy, perhaps the thermonuclear counterpart to the *Mareva's* basic fission approach. In the words of Neil Andrews: "The applicant aims to swoop like a hawk upon the defendant and seize vital evidence before it can be conveniently lost or destroyed."[2]

The grounds for obtaining relief of this type emerged virtually fully formed in the eponymous *Anton Piller* case.[3] In strict theory the basis of the search is the respondent's consent to the execution of the order, albeit refusal is, of course, a contempt of court. This is made crystal clear by the Penal Notice on the standard form. When the search order was put on a secure statutory footing by section 7 of the Civil Procedure Act 1997 the Lord Chancellor, Lord Mackay told the House of Lords section 7(3)'s main purpose was "to dispense with the fiction that entry on the premises is with the consent of the owner/respondent" and that it "will have the effect that in the future it is more clearly the court order which is the basis for the requirement to permit entry, not the implied consent of the owner."[4] Notably the respondent's fear of violence at the hands of third parties in complying with the order is not a factor the courts will take into account, considering that his remedy lies with the police, save "just possibly, in the very most exceptional circumstances." (Simon Brown LJ)[5]

The safeguards for respondents developed more slowly, including the now invariable requirement of a Supervising Solicitor. Three significant cases in the late 1980s and early 1990s featuring three brilliant Chancery judges – Scott J, Hoffmann J and Sir Donald Nicholls V-C - together with an influential article in the *Law Quarterly Review* in 1990 by the late Professor Martin Dockray and Hugh Laddie QC (as he then was), the man responsible for the invention of this species of order,[6] were responsible for halting the excessive use of Anton Piller relief. There were blatant abuses during the heady days

[1] Steven Gee, *Commercial Injunctions*,para 17-001.

[2] *Principles of Civil Procedure*, para 17.107.

[3] *Anton Piller v Manufacturing Processes* [1976] Ch 35, although it was first developed in *EMI Ltd v Pandit* [1975] 1 WLR 302.

[4] Cited in Gee *Commercial Injuctions*, para 17.009.

[5] *Coca Cola v Gibley* [1995] 4 All ER 711, affd [1996] FSR 23.

[6] M Dockray and H Laddie, "Piller Problems" (1990) 106 LQR 601-620.

of the late 1970s and 1980s, with many a promising new business stifled by the ruthless deployment of such orders by powerful commercial concerns, aided by major law firms. In *Universal Thermosensors Ltd v Hibben*[7] an order was executed on a woman at home with her children in bed, called to the door at 7.15am in her night clothes, faced with the search team. Some 500 orders were estimated to have been made between 1975 and 1980, with 50-100 per annum in the 1980s.[8] More recent data is hard to locate. Such orders appeared then to be granted as a matter of routine. Hoffmann J in *Lock International plc v Beswick* [1989] 1 WLR 1268, 1279 noted his "common experience of the evident surprise of counsel when I have refused applications."

Universal Thermosensors was the third of the cases leading the backlash against excessive deployment of this type of relief, and insisting on stronger safeguards for respondents. It involved former employees dishonestly taking customer lists and pricing information with them to their new business. An Anton Piller Order was sought in support of a claim based on breach of confidence. Sir Donald Nicholls V-C took the opportunity to issue general guidelines as to the granting an execution of Anton Piller Orders. The effect of the grant of the injunction was to stifle the fledging business, effectively putting the plaintiff into a better position than if there had been no breach of confidence. Sir Donald Nicholls V-C cited with approval the article by Dockray and Laddie and the earlier judgments of Scott J in *Columbia Picture Industries Inc v Robinson* [1987] Ch 38 and Hoffmann J in *Lock International plc v Beswick* [1989] 1 WLR 1268. His Lordship observed that such orders "are rightly made much more sparingly than previously" (at 860). Sir Donald Nicholls V-C concluded: "it must be appreciated, and certainly it is in view, that *in suitable and strictly limited cases*, Anton Piller Orders furnish courts with a valuable aid in their efforts to do justice between two parties. Especially is this so in blatant cases of fraud. It is important therefore that these orders should not be allowed to fall into disrepute." (at 861). The concerns expressed in these three cases culminated in the Judges Council Consultation Paper chaired by Sir Christopher Staughton.[9] Whilst the number of orders awarded is perceived to have fallen off the ***White Book*** still laconically records that such orders are "granted far too routinely for them to be regarded as exceptional."[10]

Other Orders for obtaining and preserving evidence

Accordingly it is worth briefly surveying some of the less extreme orders which the Court has at its disposal, which may be more proportionate, and involve less risk of the application failing at one of the hurdles facing a search order application.

First, disclosure, including pre-action disclosure (CPR 31.16) and third party disclosure (CPR 31.17). The general rule before the Civil Procedure Rules was that it is not possible to obtain discovery against a non-party. This was an aspect of the "mere witness" rule. A party could not obtain discovery against a non-party except in certain exceptional cases.[11] The CPR provisions clearly envisage disclosure orders against non-parties becoming more available and provides a distinct procedure: CPR Part 31.17.[12] However that the former practice is followed so that the orders are not oppressive to third parties and is explicitly preserved: CPR Part 31.18.

Secondly, orders for the detention, custody or preservation or property or for the inspection of property or carrying out of an experiment on property (CPR 25.1(1)(c)(i)-(iii)), coupled with an order authorising entry onto land (CPR 25.1(1)(d)).

Thirdly, orders for interim delivery up of goods (CPR 25.1(1)(e)). The basis of this relief is section 4 of the Torts (Interference with Goods) Act 1977. As Hoffmann J indicated in *Lock International plc v Beswick* [1989] 1 WLR 1268 "the court must employ a graduated response." Accordingly in many cases "it will therefore be sufficient to make an order for delivery up of documents." It should not go unremarked that the jurisdiction under section 4 for interim delivery up does not impose a requirement that goods are delivered up to their true owner or the person with the best possessory entitlement (which is a precondition to a final delivery up order). Alternatively such a delivery up of goods (even the defendants' goods) order pending trial may be made under the *Mareva* jurisdiction or section 37 of the Supreme Court Act. Useful guidelines on this jurisdiction were provided in *CBS United Kingdom Ltd v Lambert* where the defendant was a self-confessed record pirate, and the applicants discovered he was spending money on mobile assets, such as expensive motor cars, which could be easily disposed of for cash, and the apparent intention was to render himself judgment proof. The Court of Appeal was prepared to order, on an ex parte basis, that he should be ordered to give discovery of assets and deliver them up pending trial. Lawton LJ, giving the judgment of the Court gave the following guidelines:

- "First, there should be clear evidence that the defendant is likely, unless restrained by order, to dispose of or otherwise deal with his chattels in order to deprive the plaintiff of the fruits of any judgment he may obtain. Moreover, the court should be slow to order the delivery up of property belonging to the defendant unless there is some evidence or inference that the property has been acquired by the defendant as a result of his alleged wrong-doing. …
- Secondly, no order should be made for the delivery up of a defendant's wearing apparel, bedding, furnishings, tools of his trade, farm implements, live stock or any machines (including motor vehicles) or other goods such as materials or stock in trade, which it is likely he uses for the purposes of a lawful business. …
- Thirdly, all orders should specify as clearly as possible what chattels or classes of chattels are to be delivered up. A plaintiff's inability to identify what he wants delivered up and why is an indication that no order should be made.
- Fourthly, the order must not authorise the plaintiff to enter on the defendant's premises or to seize the defendant's property save by permission of the defendant. …
- Fifthly, no order should be made for delivery up to anyone other than the plaintiff's solicitor or a receiver appointed by the High Court. The court should appoint a receiver to take possession of the chattels unless satisfied that the plaintiff's solicitor has, or can arrange, suitable safe custody for what is delivered to him.
- Sixthly, the court should follow the guidelines set out in *Z Ltd. v. A-Z and AA-LL* [1982] Q.B. 558 in so far as they are applicable to chattels in the possession, custody or control of third parties.
- Finally, provision should always be made for liberty to apply to stay, vary or discharge the order."[13]

Fourthly, *Norwich Pharmacal* orders and Bankers Trust orders. An important exception to the "mere witness" rule was the leading House of Lords case of *Norwich Pharmical Co v Customs and Excise Commissioners* [1974] AC

[7] [1992] 1 WLR 840.

[8] M Dockray and H Laddie, "Piller Problems" (1990) 106 LQR 601, fn 5.

[9] "Anton Piller Orders: A Consultation Paper" (LCD, 1992).

[10] (2008), para 15-91.

[11] *Sunderland Steamship P and I Association v Gatoil International Inc, The Lorenzo Halcoussi* [1988] 1 Lloyd's Rep 180, 184 ***per*** Steyn LJ.

[12] Leading case: *Three Rivers DC v Bank of England (No 4)* [2002] 4 All ER 881 (CA)

[13] [1983] 1 Ch 37, 44-45.

133 in which the plaintiffs became aware that goods were being imported which infringed their patent. They sought discovery of the names of the importers from the Commissioners for Customs and Excise. It was held that the applicant must demonstrate the existence of a prima facie case against the intended defendant. Further, it must be demonstrated that the party against whom the order is sought has the relevant information. The gist of the claim is that the party with the information has become mixed up with the alleged wrongdoing, or has somehow facilitated it. It was not necessary that the non-party's involvement in the wrongdoing was not contemporaneous. Accordingly in one case discovery was ordered against the wife of a judgment debtor where she was involved in the dissipation of the proceeds of the misdirected funds: *Mercantile Group (Europe) AG v Aiyela* [1994] QB 366. The "mere witness" rule was irrelevant where disclosure was sought against a third party in aid of a post-judgment Mareva injunction. All that had to be shown was that the third party had become mixed up in the relevant transaction, and that it was just and convenient to make the order. There was evidence that the defendant's wife held assets, which in truth belonged to her husband. "She was therefore 'mixed up' in her husband's attempts to make himself judgment proof." per Steyn LJ (at 376).

The established jurisdiction to order disclosure against a third party is of particular assistance where a claimant seeks to trace and claim misdirected funds. This is known as the *Bankers Trust* Order after the leading case of *Bankers Trust Co v Shapira* [1980] 1 WLR 1274. The order compels a non-party, usually a bank, to give disclosure of information and documentation in relation to the defendant's financial affairs. In Shapira two men defrauded a New York bank of US$1million by means of two forged cheques drawn on a Saudi Arabian bank. On their orders the American bank transferred over US$700,000 of the proceeds of the fraud to the London branch of a Swiss bank. Having obtained a Mareva injunction against the Swiss bank, the plaintiff bank sought discovery of documentation relating to the fraudsters and the money. The Court of Appeal granted the order, explicitly recognising the novelty of the jurisdiction. Lord Denning MR stated: "If the plaintiff's equity is to be of any avail, he must be given access to the bank's books and documents - for that

"… it requires permission to be given by the respondent for representatives of the claimant accompanied by the supervising solicitor to enter premises for the purpose of searching them, and removing articles or documents, or obtaining information."

is the only way of tracing the money or knowing what has happened to it." (at 1282) Waller LJ agreed whilst apparently acknowledging that the relief was wider that that available under the Bankers' Books Evidence Act 1879. The principle was applied in relation to a claim alleging massive commercial fraud: *Arab Monetary Fund v Hashim (No.5)* [1992] 2 All ER 911. However, in that case Hoffmann J cautioned: "Orders for discovery before trial in aid of Marevas or in the Banker's Trust form against third parties are extraordinary remedies and should not be regarded as the common coin of litigation." (at 916) Such orders will generally not be made against banks located outside the English jurisdiction: *MacKinnon v Donaldson Lufkin & Jenrette Securities Corp* [1986] Ch 482.

The Grounds of the Application

I have taken the grounds from the recent but extensive litigation in

Indicii Salus Ltd (in receivership) v Chandrasekaran[14], which yielded at least five separate judgments of Warren J, two applications for permission to appeal[15] and early this year a decision of the Court of Appeal dismissing an appeal against Warren J's decision not to set aside the search order.[16] It was a characteristic case concerning the development of cryptographic security software. D1 was the former CEO of the C company and D2 his wife, and the allegation was that D1 would be using C's software in breach of copyright in his new business. C came to believe Ds had desktop and laptop computers belonging to it at their home, because whilst investigating its network it discovered a fibre optic connection from its premises to Ds' dwelling. Etherington J made an order and Warren J considered on the evidence presented it was perfectly proper order to make. The challenge was ultimately on the grounds of non-disclosure and abuse of process. It was an extreme order in that it permitted a search of Ds' home and D2 had recently had a child. Accordingly a female supervising solicitor was used. The search yielded no fewer than 14 items of hardware and C's software on all the machines, together with hard copies of C's business plans. Unsurprisingly the substance of the claim for delivery up and permanent injunctions was quickly resolved.

1 an "extremely strong prima facie case"

2 "damage potential or actual must be very serious for the applicant"

3 "there must be clear evidence that the defendants had in their possession incriminating documents or thing"

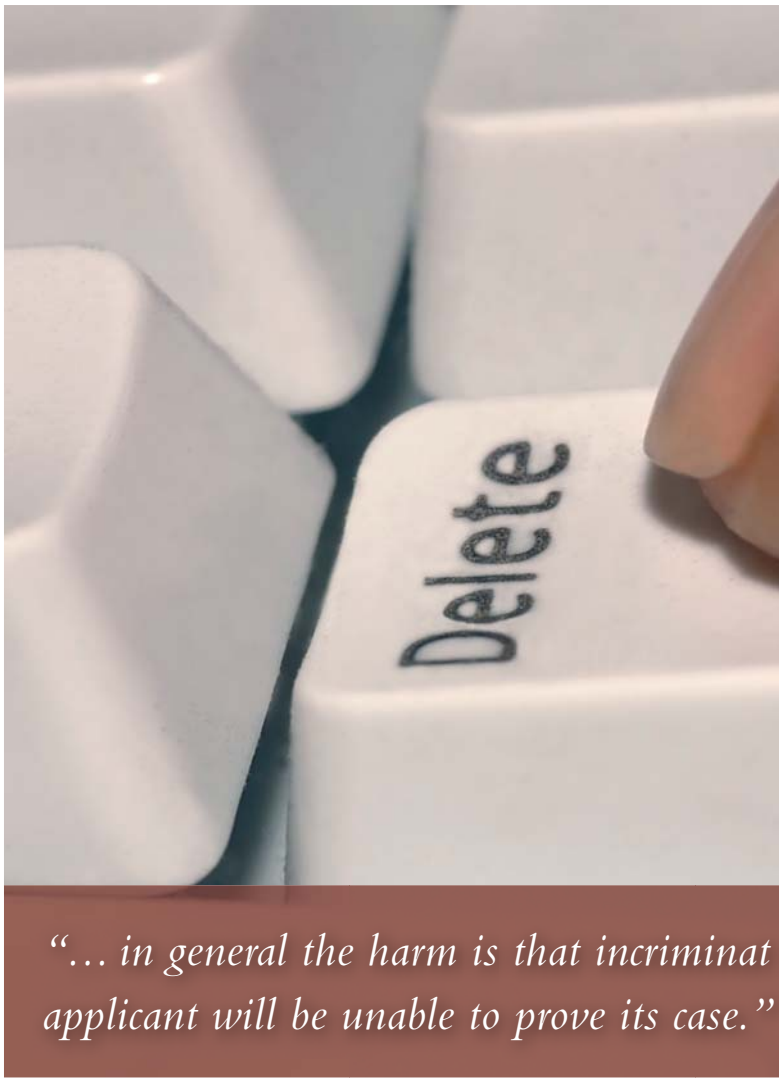
4 "there is a real possibility that the defendants may destroy such material before an on notice application is made"

5 "the harm likely to be caused by the execution of the search order on the respondent in his business affairs must not be out of proportion to the legitimate object of the order"

6 the applicant's obligation to make full disclosure.

1 "extremely strong prima facie case"

The first three requirements are based on the judgment of Ormrod LJ in Anton Piller itself, and continue to be used almost unchanged. The substance of the applicant's main complaint must be extremely strong. According to the Judges Council chaired by Sir Christopher Staughton: "The overriding principle [is that] of necessity. Nor order ought to be made unless it is necessary in the interests of justice."[17] In contrast Steven Gee in his work



cautions that "this should not be viewed as an inflexible requirement."[18] In *Yousif v Salama* the CA granted relief directed to preserving documents in two files and a desk diary which were described by Lord Denning as "the best possible evidence to prove the plaintiff's case."[19]

More helpfully the Judges Council chaired by Sir Christopher Staughton contrasted Ormrod LJ's hallowed words with "suspicion" that there may be a cause of action which "should not be enough."[20] An applicant can expect to have its affidavit and any draft Particulars of Claim carefully scrutinised by the Judge to examine the cogency and strength of the allegations and the evidence garnered at that point. Obviously where there is effectively evidence that a trader has been caught red-handed infringing intellectual property rights or where it can be shown that employees have downloaded customer information and other commercially sensitive information from computers onto memory sticks at 3.45 am there may be a reasonable basis for considering an application. However in Hoffmann J in *Lock International plc v Beswick* [1989] 1 WLR 1268 warned that "the fact that there is overwhelming evidence that the defendant has behaved wrongfully in his commercial relationship does not necessarily justify an Anton Piller order." What is clear is that a "balance of convenience" approach or a "serious issue to be tried" test are irrelevant.

[14] [2006] EWHC 521 (Ch) para [85] (15 February 2006). Other judgments were given on 27 March 2006, 3 April 2006/4 April 2006 and 2 March 2007. The original search order was made by Etherton J on 12 August 2005.

[15] [2006] EWCA Civ 1022 and [2007] EWCA Civ 816.

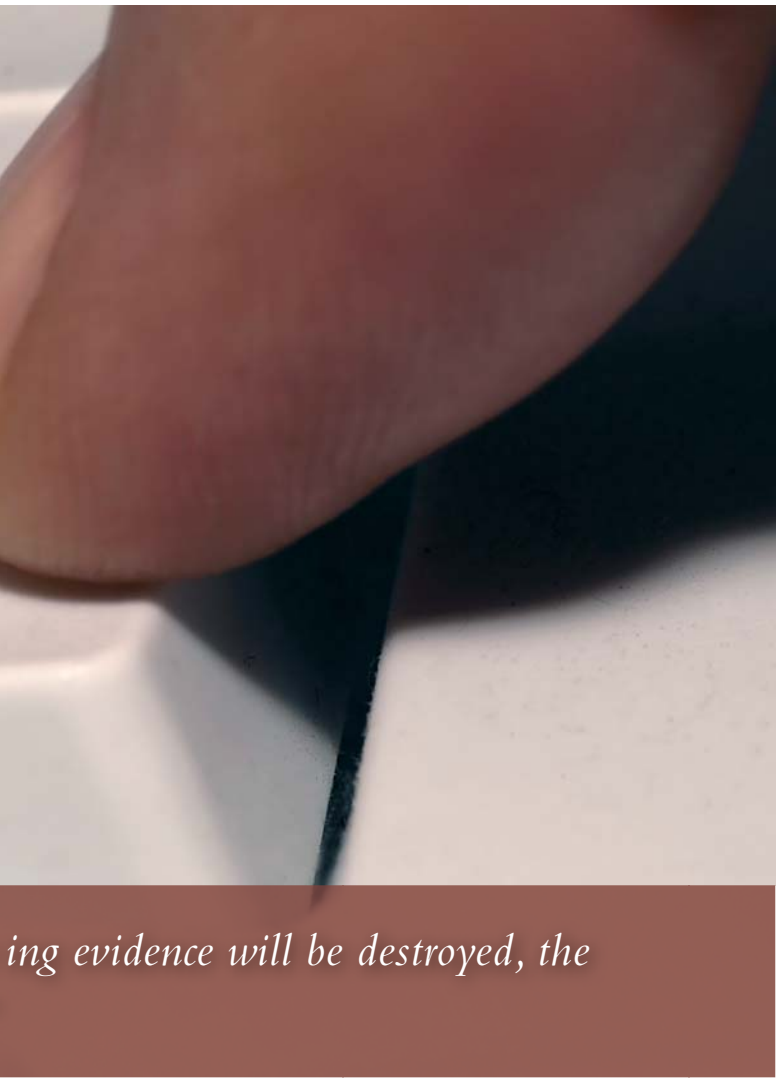
[16] [2008] EWCA Civ 67; upholding [2007] EWHC 406 (Ch).

[17] Para 2.3.

[18] Para 17.018.

[19] [1980] 1 WLR 1540.

[20] Para 2.5.



2 "damage potential or actual must be very serious for the applicant"

With respect to the second requirement, in ***Anton Piller*** itself and Intellectual Property cases in general the harm is that incriminating evidence will be destroyed, the applicant will be unable to prove its case, and the proposed respondent will simply set up shop again, and start boot-legging or passing off once the dust settles. In recalcitrant employee cases the concern is often that, armed with trade secrets, the competitor or newco will promptly secure the business of once loyal customers. The requirement is somewhat ambiguous between irreparable harm in the applicant proving its case at trial and harm to the applicant's business, but in practice the Courts have taken into account both types of harm.

3 "there must be clear evidence that the defendants had in their possession incriminating documents or thing"

The purpose of a search order is to preserve ***vital*** evidence. It is not to identify or locate new evidence which might form the basis of a case or an additional case which may be made against the respondent or others. Micawberism has no place in the Anton Piller jurisdiction. "A search order must not be used as a means of fishing for a cause of action."[21] The evidence or type and category of evidence which it is sought to preserve, together with a brief account of its probative significance, must be described in the affidavit.

4 "there is a real possibility that the defendants may destroy such material before an on notice application is made"

In *Anton Piller* itself Lord Denning spoke of "grave danger that vital evidence will be destroyed."[22] But Hoffmann J in *Lock International plc v Beswick* [1989] 1 WLR 1268 cautioned that: "People whose commercial morality allows them to take a list of the customers with whom they were in contact while employed will not necessarily disobey an order of the court requiring them to deliver it up. Not everyone who is misusung confidential information will destroy the documents in the face of a court order requiring him to preserve them." Consideration should therefore be given as to whether an injunction preventing the defendant from dealing with or destroying the evidence would be sufficient.[23] A real possibility must be contrasted with a "mere" possibility or the condition which Dillon LJ once identified: the "extravagant fears which seem to afflict all claimants who have complaints of breach of confidence, breach of copyright and passing off."[24]

5 "the harm likely to be caused by the execution of the search order on the respondent in his business affairs must not be out of proportion to the legitimate object of the order"

This was first clearly articulated by Hoffmann J in *Lock v Beswick*, an employee/trade secrets case, where he observed that the lack of particularity in the applicant's evidence as to the precise nature of the trade secrets sought to be protected is often " a symptom of an attempt to prevent employees from making legitimate use of the knowledge and skills gained in the plaintiff's service." So whilst there might be strong evidence that an employee has taken what is an undoubtedly confidential customer list the Court "must employ a graduated response."[25] According to the Judges Council chaired by Sir Christopher Staughton: "No such order ought to be made in wider terms than is necessary to achieve the legitimate object of the order."[26] Furthermore, whilst failing to meet any of these five requirements should ordinarily result in the application being dismissed, satisfying all five does not automatically entail success, because the Judge must still consider in his discretion whether the order can be justified.

6 the applicant's obligation to make full disclosure.

Whilst sometimes seen as a ground for discharge, Warren J in *Indicii* also added this sixth factor as a threshold requirement. Because of the risks to the defendant, such as the order effectively stifling a legitimate or largely legitimate start up business it is incumbent on the applicant to present the application with scrupulous fairness. Central to this is the obligation to disclose all material facts, including the applicant's investigations to date and the fruits of that. The basis for the concern that evidence will

[21] Andrews, para 17.115; *Hy-trac v Conveyors Int* [1983] 1 WLR 44 (CA).

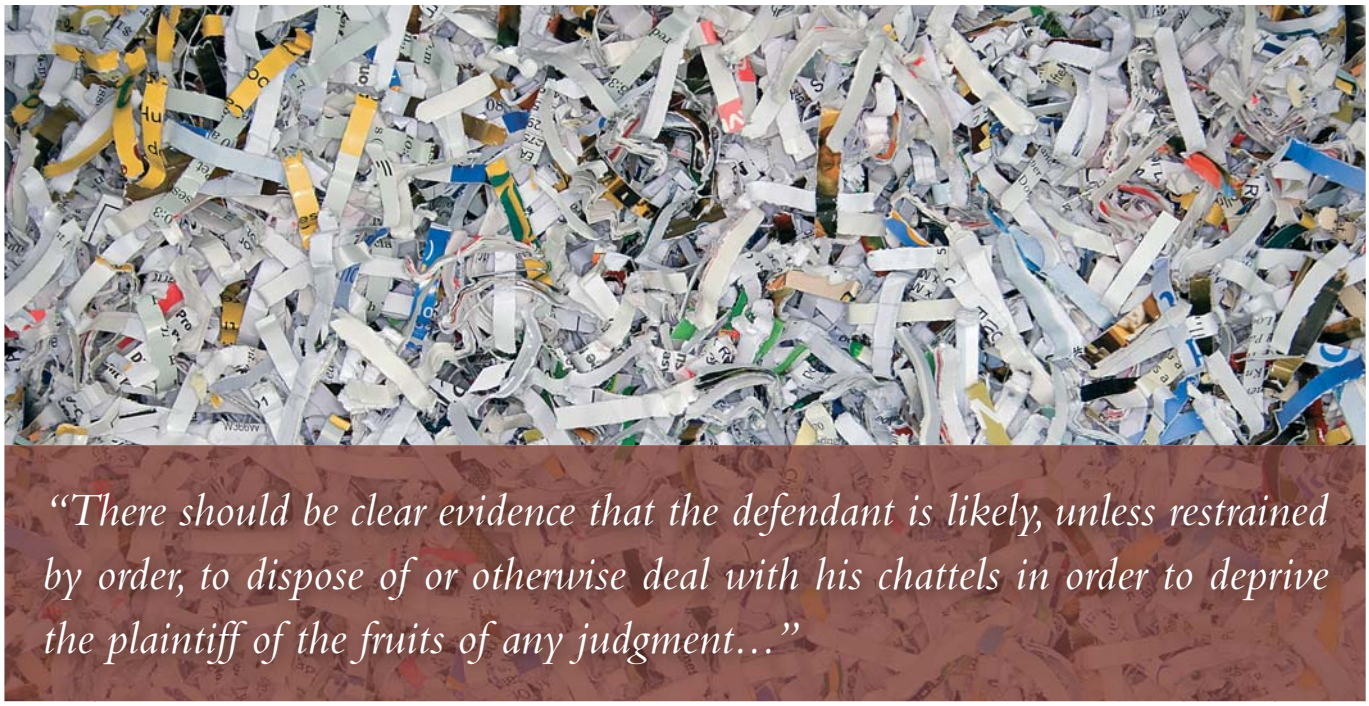
[22] At 59-60.

[23] *Brown v Bennett (No 2)* [2002] 1 WLR 713 (Neuberger J).

[24] *Booker McConnell v Plascow plc* [1985] RPC 425, 441.

[25] [1989] 1 WLR 1268, 1281.

[26] Para 2.3.



be destroyed must be spelt out. The guidance of *Siporex v Comdel* (in the context of Marevas must apply here: the affidavit must "identify any likely defences."[27] The best guidance is that of Scott J in *Columbia Picture Industries* that affidavits "ought to err on the side of excessive disclosure. In the case of material falling into the grey area of possible relevance, the judge, not the plaintiff's solicitors, should be the judge of relevance."[28]

Making the Application

We turn now to the territory of making the application. Obviously you need a High Court Judge (or section 9 Judge)[29], and in IP cases the application must be made to the Chancery Division: failure to disclose that rule of practice may be material non-disclosure.[30] The evidence must be in affidavit form.[31] The Court will want to be sure that the applicant is good for the money in the eventuality that it is called upon under its cross-undertaking in damages. This should appear in the affidavit, with particulars in support.

The starting point must be the standard form, albeit intelligent customisation, rather than unintelligent copy-out is the hallmark of a good application. The representative must draw to the court's attention to any deviations from the standard form, and current guidance on the practice of the courts in making such orders. In discharging the duty of fair presentation of the case the applicant's advocate must consider the points for and against making the application, including the impact of the law of privilege on the evidence sought. Whilst the standard from has been around since 1994 in various versions, Steven Gee QC warns that in his view paragraph 11 of the current form is inconsistent with the privilege against self-incrimination and legal privilege, and should be modified to exclude any materials which fall within the scope of those privileges.

Costs

Recoverability of costs falls within section 51 of the Supreme Court Act 1981 and therefore can be awarded to either applicant or respondent within the court's discretion, and can include costs incurred before proceedings were commenced, including potentially expert's expenses incurred while executing order: *Admiral Management Services v Para-Protect Europe* [2002] 1 WLR 2722, (Stanley Burnton J). Costs can lead to protracted satellite litigation as the *Inidcii* case demonstrates.

Grounds for Discharge

See finally again *Indicii Salus Ltd (in receivership) v Chandrasekaran* [2006] EWHC 521 (Ch, paras [76] to [79] for a useful summary:

1 "there is a distinction to be made between the conditions for granting a search order and the grounds for discharging it. There are strict conditions for non-compliance which will result in discharge."

2 "although it too can be seen as a condition of the grant, a claimant must make full disclosure, and failure to make full disclosure is a separate ground for discharge."

3 "a claimant can only disclose what he knows. If a defendant can show that an apparently strong *prima facie* case can be explained away he might be entitled to come to the court to have the search order discharged, particularly if it has not been fully executed. But even of the search order is not discharged, the defendant may want his costs and he may want to proceed on a cross-undertaking. If he has won the action the latter would be likely to follow, but there may be other circumstances in which he would be entitled to argue that the search order should be discharged and to argue for compensation under the cross-undertaking, notwithstanding that the search order was perfectly properly made on the material available."

4 "there is the possibility of discharging the search order on the grounds that it was brought for an improper purpose, and was therefore an abuse of process."

Gerard McMeel

[27] (1986) 136 NLJ 538 (Bingham J).

[28] At 77.

[29] Practice Direction (Allocation of Cases to Levels of Judiciary) para 2.1.

[30] Practice Direction (Interim Injunctions) para 8.5; *Elvee Ltd v Taylor* [2001] EWCA Civ 1943.

[31] Practice Direction – Interim Injunctions para 3.1.

Costs and injunction applications

It is useful to consider the range of costs orders which may be made on an injunction application in the following two scenarios: (1) Where the applicant is granted an interim injunction or procures an undertaking; and (2) Where the applicant fails to obtain an interim injunction or an offer of an undertaking.

The "successful" applicant

Where the applicant succeeds in obtaining an interim injunction (at an on-notice hearing) or procuring an undertaking, the applicant will consider, with some justification, that he or she has succeeded and should therefore be awarded his or her costs. That, however, is not the general rule for interim injunction applications; usually (though not invariably) the court will order costs in the case or that costs should be reserved. The reason is that ordinarily the injunction application will not finally decide the merits of the arguments advanced, and accordingly it will usually be premature to consider the applicant as being the successfully party; see the decision of the Court of Appeal in *Desquenne Et Giral UK Ltd v Richardson* [2001] FSR 1.

The decision in *Richardson* was applied and followed by Neuberger J (as he then was) in *Picnic At Ascot Inc v Derigs & Ors* [2001] FSR 2, where he helpfully set out a number of guiding principles to apply when considering the appropriate cost order to make in interim injunction applications:

i Absent any special factors, if an interim injunction application is obtained applying ordinary balance of convenience principles the court will normally reserve the costs. Whilst this guiding principle should not "tie the court's hands" on questions of costs, it was desirable to have some consistency in the area;

ii It followed that a respondent who offered an undertaking or agreed to an interim injunction should not be the subject of a more disadvantageous order, since that would be to discourage the respondent from sensible conduct;

iii If, however, the Court was able to form the view that an injunction was clearly justified, and, for example, the respondent fought the application instead of, reasonably promptly, offering to accede to the application or provide equivalent relief, an immediate costs order against the respondent might be justified;

iv Overall, it would be appropriate for the Court to ask itself whether (a) it was fair for the applicant to have its costs even if it lost at trial and (b) whether the respondent's opposition was justified.

See also *Albon v Naza Motor Trading Sdn Bhd* [2007] EWCA Civ 1124; [2008] 1 Lloyds Rep 1 at para 21 per Waller LJ, where a costs order was made in favour of the applicant, and it was noted that it was not an invariable rule that costs would be reserved on interim injunction applications.

The "successful" respondent

There is some evidence of a more favourable approach to the respondent who successfully fights off an injunction application. The reasons for that were also the subject of discussion in the *Picnic At Ascot* case and may be summarized as follows:

i It is the applicant's choice whether or not to come to court; on the other hand the respondent is compelled to attend;

ii The Courts wish to encourage applicants not to launch unmeritorious applications.

Equally, however, it may be said that a respondent's success cannot be properly measured until trial; it may be found at trial that the injunction application ought, with the benefit of final findings of fact, to have been granted. In those circumstances it might be said that it would be unfair for the respondent to have its costs of the application having regard to the risk of defeat at trial. Furthermore, independently from that question, the applicant may be able to point to some justification for the application, even if it is not successful.

The marginal case

In marginal cases the parties might give consideration to whether the court should be persuaded to make a "costs in the case" type order. It is one thing to say that an immediate costs order in favour of an applicant who obtains his order would not be fair to a respondent who was ultimately successful at trial. It is another to state that the respondent should necessarily have his costs of the application even if he succeeds at trial. Of course, the order that costs be reserved does not take away the opportunity to make such a submission after trial, but consideration should be given to whether there will be difficulty in persuading a trial judge to reconstruct how matters looked at the interim stage. Ordinarily it will pay for the successful applicant to ask for his or her costs of the application, especially in the absence of a strong judicial indication to the contrary, since even then some helpful judicial indications may emerge which can be deployed at trial, even if costs are reserved.

Given that many interim applications are determinative of the litigation as a whole, any order which reserves costs or provides for costs in the case ought sensibly to provide for the contingency that the claim may never come to trial in order to avoid distracting and potentially expensive squabbles just about costs. That said, the Court may be persuaded that it will hinder rather than assist the settlement of the case for the Court to keep its "powder dry" on the question of costs at the interim stage.

Conclusion

The general rule in interim injunction application cases is to reserve costs where the applicant is successful. That general rule does not apply so strongly where the applicant is unsuccessful. Like all rules as to costs however, they are not to be construed as inflexible rules which "tie the hands" of the tribunal. There is always a place for persuading the court to take a different view.

Hugh Sims and Richard Ascroft

To construe or to rectify, that is the question.

We are all familiar with the two ways in which the Courts can approach a contract so as to produce a result contrary to its literal wording: the technique of construction and the equitable remedy of rectification, but the division between the two is by no means a clean one. Indeed, some commentators have been prompted to postulate that the expansion of the ambit of construction may soon swallow rectification altogether.

Construction and rectification: the paradigms

The paradigm difference between the two is how the mistake is established: where the written instrument contains a coherent agreement but the complaint is that it is not the agreement the parties actually made in some respect, the instrument must be rectified so that it properly records the actual bargain between the parties. The source material for identifying the mistake is outside of the contract, it is the actual bargain. The document is altered to accord with the agreement it purports to record. Importantly, the Courts have consistently said that it is the document, and not the agreement, which is rectified.

By contrast, for construction it has been said there must be a clear mistake on the face of the instrument and it must be clear what correction ought to be made in order to cure the mistake. "If these conditions are satisfied then the correction is made as a matter of construction, but if they are not satisfied then either a claimant must pursue an action for rectification or he/she must leave it to a court of construction to reach what answer it can on the basis that the uncorrected wording represents the manner in which the parties decided to express their intention."[1]

The modern approach to construction

Two observations can be made on this formulation of construction in the light of two modern authorities, *Littman v Aspen Oil*[2] and *KPMG LLP v Network Rail Infrastructure Ltd*[3]:

First, it is clear that a mistake "on the face of the instrument" does not just include mistakes of spelling, grammar, or the mistaken omission or inclusion of words. The Courts are prepared to find there is a mistake on the face of a totally coherent instrument, where it can be said to be so uncommercial that it is a nonsense:

Littman v Aspen Oil: The Decision

The lease contained a break clause with a proviso in the following terms "provided that up to the termination date in the case of notice given by the landlord the tenant shall have paid the rents hereby reserved and shall have duly observed and performed the covenants on the part of the tenant". This was the result of a mistake on the part of the landlord's solicitor, who had

[1] Per Brightman LJ in *East v Pantiles (Plant Hire) Ltd* [1982] 2 EGLR 111, applied more recently in *Dalkia Utilities Services Plc v Celtech International Ltd* [2006] 1 Lloyd's Rep 599.

[2] [2006] 2 P& CR 2

[3] [2007] EWCA Civ 363

"The Courts are prepared to find there is a mistake on the face of a totally coherent instrument, where it can be said to be so uncommercial that it is a nonsense…"

intended to make the tenant's right to break conditional on the tenant not being in breach of his obligations in the lease, a clause which no well advised tenant would accept. The tenant's solicitor identified her mistake but, as the clause stood it did his client no harm, he did not raise the issue. When the Claimant landlord purported to bring the lease to an end under the clause, the Defendant disputed the effectiveness of the notice on the grounds that it was in breach of its obligations. The Claimant's primary case was that on its true construction, "landlord" should be read as saying "tenant".

The judge at first instance said this "It is quite plain that clause 10 as it stands is an absurdity. There can be no rhyme or reason in making the exercise by the landlord of its right to terminate conditional on performance by the tenant of its obligations under the lease. No commercial purpose in such a provision can be imagined… Although there is nothing grammatically or syntactically wrong with the formulation, it is in my judgment obvious that something has gone wrong with the clause. A landlord needs a condition of this kind in relation to its right to break in the same way that a fish needs a bicycle."

In the Court of Appeal both sides agreed that the judge was right to so hold – the clause cannot have been intended to convey a nonsensical meaning. But Counsel for the Defendant argued that if the clause was not rectified it must be read as it stands or void for uncertainty. Lord Justice Jacobs said ""I do not accept the former – for a nonsense cannot be what a reasonable man would conclude the parties meant…once one concludes that a clause as it stands cannot have been intended, there is no going back…the Court should, so far as possible, strive to find a meaning rather than to throw up their hands and say "nothing can be done". This was so even though he recognised that "it means holding the tenant accepted an onerous condition (for his right to break depends on full compliance with all the covenants) but that is not the same thing as reading the clause to mean something daft."

Littman v Aspen Oil: Comment

This is a very interesting decision for two reasons. The first is that the Court was willing effectively to construe the bargain made by the parties in the face of its express wording so as to bring it into line with good business sense. A slippery slope argument can fairly be made here: it may not be easy to tread the line between legitimately identifying where something makes so little commercial sense it must be a mistake and the parties must have meant something else and fixing a bad bargain between the parties. And difficult lines and grey areas undermine the certainty that English contract law holds so dear.

The second is that in this case the Court was willing to construe the contract so as to save it even where there was a strong case for saying the parties were not ad idem: the precedent book stated that a well advised tenant would not agree to such a clause and this tenant certainly did not think he was agreeing to it. Lord Justice Longmore expressed some concern about this, but concluded that "Any concern which this observation may instil must, however, be squashed because, even if the precedent book is correct, the lease has been entered into by the Tenant who must abide by the meaning of the agreed wording, well advised or not. The internal thought processes of one side or the other are irrelevant to the construction of the written document".

The practical lesson which can be drawn from this case is that all those who are involved in the negotiation and drafting of agreements must be on their guard where their counterpart has made a drafting or typographical mistake. The right course is likely to be to draw the client's attention to the error and explain to him fully what the consequences of that mistake may be, including the possibility that the document might be successfully construed in such a way as to put right the mistake. It may then be a difficult call for that party to decide whether to say nothing and hope for the best or to draw the mistake to the other party's attention, which may lead to an ultimately unsuccessful negotiation on the point. Either way, the solicitor's duty to warn the client of the risks is clear and, depending on the circumstances, it is probably better to recommend the mistake is remedied at that stage.

KPMG LLP v Network Rail Infrastructure Ltd: The Decision

This case involved a dispute over the effect of a break clause in a reversionary sub–underlease dated 11 July 1985, but following generally the form of a draft lease attached to an agreement dated 13 December 1974. After pointing out that, unlike mere drafts and negotiations, prior concluded agreements can be admissible to construe a contract, Carnwarth LJ (with whom the other Lord Justices agreed) went on to say that the 1974 agreement was on its face a detailed, carefully negotiated document to be departed from only for specified reasons and that it was sufficient in itself to create an equitable lease so that if nothing further had occurred the tenants predecessor in title's occupation would have continued on that basis. It was "an important part of the background and is a permissible aid in the construction of the lease in its final form."[4] Commenting on *The Starsin*, in which the House of Lords corrected an omission in a Himalaya clause in a bill of lading by interpolating them from a standard bill of lading form (the "Conline" form) Carnwarth LJ made three comments:

"First, it should not matter in principle that the draft in this case was tailor – made, rather than "off-the-peg", as in The *Starsin*. What matters is the help it can give in practice, as a matter of common sense rather than law, as to the nature of the mistake and how it should be corrected. Secondly, it is to be noted that the House was untroubled by the facts that this clause appeared in a number of versions, and that there were changed of detail. What mattered was its relevance to the particular passage in issue. So here, the changes made to other parts of the lease, or even to this paragraph, do not detract from the value of the 1974 draft in explaining the place of the relevant words in the parenthesis.

Thirdly, and perhaps more contentiously, I think it would be wrong to apply too literally Lord Bingham's reference [in the Starsin] to the need for clarity both as to the omission of words and "what those relevant words were". As Lord Millett said, it is sufficient if the court is able to ascertain "the gist" of what has been omitted. I would go further. Once the court has identified an obvious omission, and has found in admissible background materials an obvious precedent for filling it, it should not be fatal that there may be more than one possible version of the replacement, or more than one explanation of the change."[5]

KPMG LLP v Network Rail Infrastructure Ltd: Comment

Thus the second observation on the modern approach to construction is that it is not necessary to establish a precise form of words that would correct the mistake. It is sufficient if the Court can ascertain the gist of the missing or wrongly included words.

What Role does Rectification Retain?

We have seen that construction can be used to fix apparent problems with contracts in a widening range of circumstances. What role then, does rectification retain? It will still be relevant in the case where the instrument is internally consistent and makes sense on its face, but one of the parties simply argues that it does not record what was agreed. But there must be little practical scope for making such claims: there would have to be very "cogent" evidence to displace a written contract since the Courts rightly assume that some care was taken in drafting it.

Such cogent evidence will almost always take the form of evidence of prior negotiations between the parties. Such evidence is admissible as a matter

[4] At paragraph 43.

[5] At paragraphs 63 and 64.

of course for rectification claims, but the Courts have steadfastly refused to allow its admission for construction claims. This rule has become the subject of some controversy.

Prior negotiations in Construction claims – should they be admissible?

While in the paradigm case for construction the error is clear on the face of the document, it is clear that the construction exercise does not begin and end within the four corners of the document. The Court may take into account all of the background, even precedents[6] and even prior drafts[7], except prior negotiations. Some commentators take the view that this distinction is not sustainable – that if evidence is admissible for one purpose it is artificial not to allow it to be taken account of for all purposes. Indeed, it is a long standing and well recognised ploy to include claims for rectification alongside claims for construction simply to get the relevant evidence before the Court. Lord Nicholls has questioned (extra– judicially) whether if evidence admitted for the rectification purpose may in practice affect how a judge views the outcome of the interpretation issue, why is it not openly admissible for this purpose?[8]

The policy reasons against extending the ambit of construction in this way have been recently summarised by Lord Justice Lawrence Collins in *Chartbrook Limited v Persimmon Homes Limited, Stephen Vantreen*[9] as follows: (1) increased uncertainty and unpredictability in dispute resolution; (2) the adverse effect on third party rights; (3) the use of the evidence would be unhelpful (Lord Wilberforce's reason); (4) subversion of the objective approach; (5) without such a rule sophisticated and knowledgeable negotiators would be tempted to lay a paper trail of self-serving documents. His finding on the question of the admissibility of negotiations as an aid to construction was "First, this court is bound to accept the exclusionary rule as the starting point. Second, the policy reasons for a strict application of the rule are not compelling, and I do not accept the judge's emphasis on the effect on third parties as a strong policy reason for the rule."[10]

Conclusion

Chartbrook will be going to the House of Lords and a reasoned review and authoritative decision on this controversial point will be very welcome. As the law currently stands however, prior negotiations are generally not admissible for the purpose of construing the terms of a contract, although given that they are admissible for rectification claims and the two are so often pleaded hand in hand, in practical terms in many cases the distinction may have more form than substance.

Holly Doyle

[6] *Homburg Houtimport BV v Agrosin Ltd (The Starsin)* [2004] 1 AC 715

[7] See *KPMG LLP v Network Rail Infrastructure Ltd* [2007] EWCA Civ 363

[8] From *"My Kingdom for a horse: the meaning of words"* (2005) 121 LQR 577

[9] 2008] EWCA Civ 183

[10] *Ibid*, at paragraph 131.

The shield of *The Achilleas*

A market-based approach to assessment of contractual damages

"First fashioned he a shield, great and sturdy, adorning it cunningly in every part, and round about it set a bright rim, threefold and glittering, and therefrom made fast a silver baldric. Five were the layers of the shield itself; and on it he wrought many curious devices with cunning skill."

In this way Samuel Butler translates the section of Book XVIII of the *Iliad*, "The Shield of Achilles", which describes the creation of Achilles' shield. After Hector has seized Achilles' armour as spoils of war, Achilles' mother pleads to the gods to protect him. The gods accept her submissions and forge the famous shield, which will ultimately prove decisive in the dogfight between Achilles and Hector many books later.

Observers of the litigation in *The Achilleas* [2008] 3 WLR 345 would be forgiven for concluding that the House of Lords reversed the decision in the *Iliad* and instead employed cunning skill and curious devices to protect Achilles' adversary. After all, a strong cohort of commercial judges in the courts below (Christopher Clarke J in the Commercial Court, [2007] 1 Lloyd's Rep 19, and Rix LJ with agreement of Ward and Tucker LJJ in the Court of Appeal, [2007] 2 Lloyd's Rep 555) had upheld the majority decision of the arbitrators in favour of the owners of the vessel *The Achilleas*, on the face of it an orthodox application of *Hadley v Baxendale* (1854) 9 Exch 341. The appellant charterers were not entitled to look to remoteness as a shield from damage. The reasons why the House of Lords disagreed are informative and important to any commercial litigator charged with advising on the quantification of unliquidated damages for a breach of contract.

Background

What had happened was that the Achilleas had been chartered by the owners at a daily rate with a latest date for redelivery set at 2nd May 2004. Between the date of chartering and the final date for redelivery, the market became peculiarly volatile, and the owners managed to fix the vessel to new charterers at a rate of more than double the rate applicable to the existing charter. The charterers, however, fixed the vessel for a final voyage two weeks before the redelivery date, to which the owners made no objection. As a result of this final fixture, the vessel was tendered outside the laydays cancelling clause in the new charter. In the meantime, the market had plumetted and the owners were forced to negotiate a lower charter rate with the new charterers.

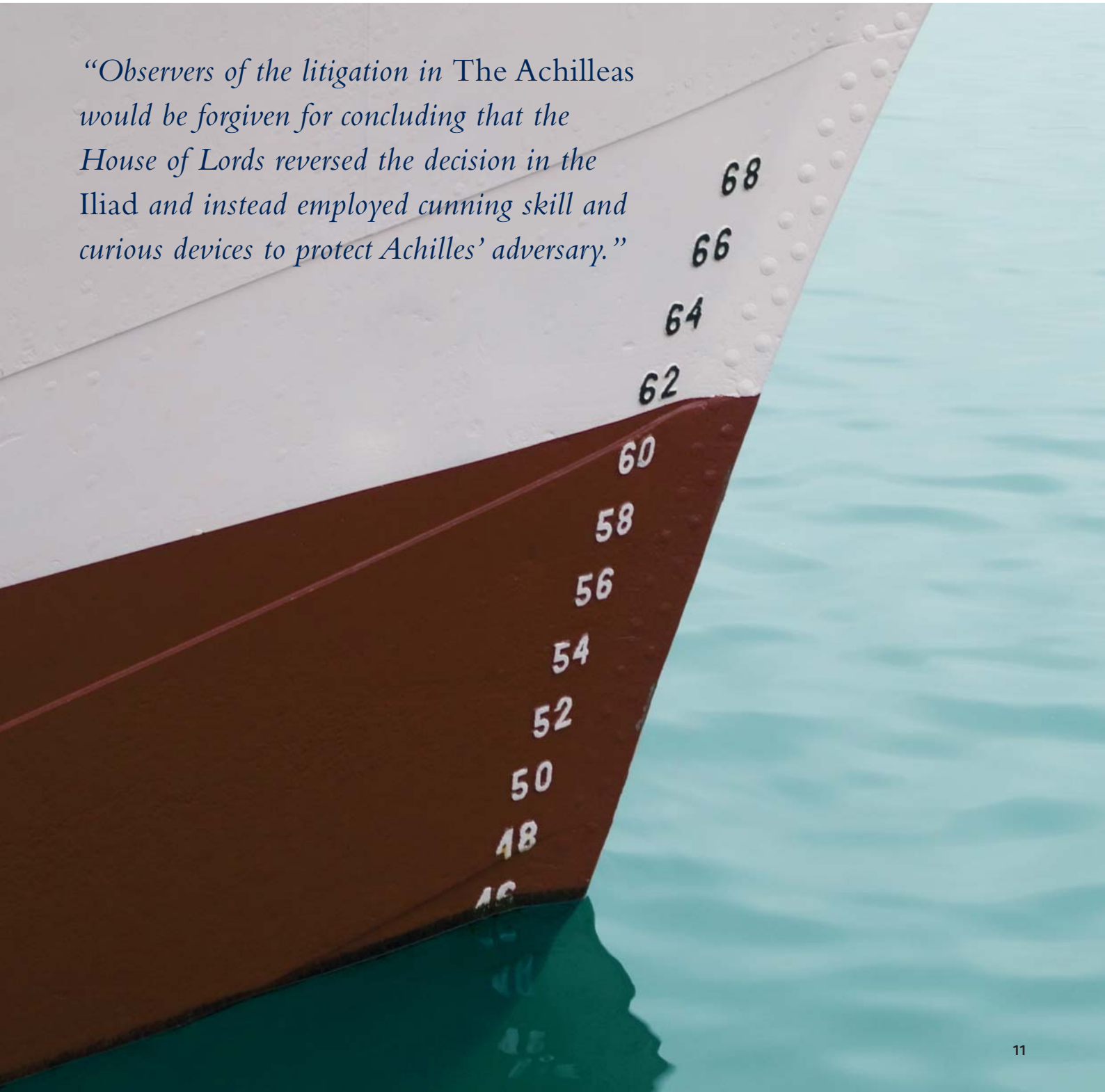
The owners claimed damages for the duration of the new charter assessed as the difference between the original rate and the reduced rate ("the new charter rate"). The charterers admitted breach of contract but denied this basis of assessment of damage, contending that the rate should be that which reflected the general assumption of the shipping market: i.e. the difference between the market rate and the charter rate for the nine days during which the owners were deprived of the vessel ("the market rate"). At issue was over $1 million.

Decisions below the House of Lords

The majority arbitrators found as a fact that the loss claimed by the owners arose (to paraphrase *Hadley v Baxendale*) in the usual course of things out of the admitted breach, and found for the owners. On appeal, Christopher Clarke J agreed: to have awarded damages on the market rate would have compensated the owners for only a fraction of their true loss, and the charterers knew that a recognised hazard of late redelivery was that the vessel may be tendered late to any new charterers. The Court of Appeal also agreed: the market was *"an open book"* to the charterers, however volatile, and the risk that eventuated arose in the ordinary course of things. From a commercial perspective, the difficulty with these decisions was that they ran contrary to the general understanding of the shipping market, implicitly assumed in a number of cases of high authority, which for decades had been that the rate of damages for late redelivery was the market rate.

Decision of the House of Lords

Their Lordships unanimously reversed the unanimous judicial decisions below. The claim was limited to the market rate. The approaches taken by their Lordships fall broadly into two camps: that of Lords Hoffmann, Hope and (less stridently) Walker, and that of Lord Rodger and Baroness Hale. What might be labelled the minority approach was the more traditional, and perhaps less interesting, of the two.



"Observers of the litigation in The Achilleas *would be forgiven for concluding that the House of Lords reversed the decision in the* Iliad *and instead employed cunning skill and curious devices to protect Achilles' adversary."*

Lord Rodger noted that the starting point was to ask whether damage at the new charter rate would result in the ordinary course of things from the particular breach (overrun by nine days). In the absence of special knowledge (often described as the second limb of *Hadley v Baxendale*), the contract-breaker is responsible only for those damages which are a *"not unlikely"* consequence of the breach. He considered that *"the parties would... have contemplated that, if the owners lost a fixture, they would then be in a position to enter the market for a substitute fixture... [T]he parties would reasonably contemplate that, for the most part, the availability of the market would protect the owners if they lost a fixture."* The charterers did not have special knowledge of the owner's onward fixture. The damage had been occasioned by the extreme volatility of the shipping market, which was not within the parties' contemplation at the time of fixing the original charter, and which did not therefore satisfy the test that it should be a *"not unlikely"* consequence of the breach. That is orthodox *Hadley v Baxendale*, suggested Lord Rodger. This approach was adopted too in the short speech of Baroness Hale, which was influenced by the *"unusual volatility"* of the market.

Lord Hoffmann's speech is founded on a more radical and more commercial approach to assessment of damages generally. He appears to have been influenced by the general assumption of the market as to the proper measure of damages, and in any event felt that the starting point for the purportedly orthodox approach was set too late in the analysis. He said, *"[i]t seems to me logical to found liability for damages upon the intention of the parties (objectively ascertained) because all contractual liability is voluntarily undertaken. It must be in principle wrong to hold someone liable for risks for which the people entering into such a contract in their particular market would not reasonably be considered to have undertaken."* Outside the consumer context, a claim in contract depends upon the bargain struck by free economic agents in a market who therefore have the opportunity to assess and quantify risk and who have the opportunity to require payment for large or unpredictable risk: *"[a] rule of law which imposes liability upon a party for a risk which he reasonably thought was excluded gives the other party something for nothing."*

Thus one asks what *"kind"* or *"type"* of responsibility the contract-breaker undertook, or might fairly be taken to have undertaken, when making the contract. How does one go about the analysis of whether the loss is of a type for which a party undertook responsibility, or whether it is of a different type? As it happens, there is some overlap with the analysis one carries out when construing a contract to decide whether a particular term is implied. The word "type" is somewhat ambiguous, but *"[i]t is not a question of Platonist metaphysics. The distinction must rest upon some principle in the law of contract... [T]he only rational basis for the distinction is that it reflects what would have been reasonable and have been regarded by the contracting party as significant for the purposes of the risk he was undertaking."* The risk of loss of a following fixture was wholly unquantifiable, save to the extent that it was governed by the market rate. Unsurprisingly, Lord Hoffmann ruled that on the facts found by the arbitrators, loss was limited to the market rate.

Lord Hope similarly considered that the key issue was the assumption of responsibility: this is what differentiates remoteness in contract from remoteness in tort. *"[A] party cannot be expected to assume responsibility for something that he cannot control and, because he does not know anything about it, cannot quantify. It is not enough for him to know in general and on open-ended terms that there is likely to be a follow-on fixture... What he needs is some information that will enable him to assess the extent of any liability."* Under the first limb of *Hadley v Baxendale*, it can be assumed that the contract-breaker takes responsibility for what happens in the great multitude of cases. Although in *The Achilleas* the charterers could be taken to have assumed responsibility for a loss which an operator in the market would suffer generally by late redelivery (i.e. the market rate), they could not be taken to have known *"how"* the owners would deal under any forward fixture: thus the loss was *"not the product of the market itself"* but resulted from unpredictable arrangements with new charterers.

Lord Walker was more diffident but appeared to support the "assumption of responsibility" basis. He asked, *"what was the common basis on which the parties were contracting?... Businessmen who are entering into a commercial contract generally know a fair amount about each other's business. They have a shared understanding... as to what each can expect from the contract, whether or not it is duly performed without breach on either side."* He went on the analyse in detail the various phrases used to describe risk in *The Heron II* (some of which appear to have been adopted without argument on the probability theories applied to professional gambling), but went on to hold that it was contrary to principle to hold that the parties were contracting on the *"basis"* (assumption) that the charterers would be liable for any loss caused by late redelivery.

Conclusion: The layers of the shield Itself

The approach of Lord Rodger and Baroness Hale depends heavily on the finding that the market was *"unusal[ly] volatile"*. Presumably losses caused by ordinary market fluctuation would be within the parties' contemplation, notwithstanding that the market had operated on the basis that loss was limited to that for which the charterers contended. But this only begs the question of when volatility in any market becomes sufficiently unusual or extreme to take the loss out of the first limb of *Hadley v Baxendale* and to require special knowledge in order that it be recoverable. That said, Lord Rodger's approach might be said to have the benefit of confining the decision to the shipping market and so allowing the wider commercial world to continue to work on pre-*Achilleas* principles.

The approaches of the three other members of the House are unambiguously more far-reaching, and rightly so. The shipping market may be specialised, but it is not unique in being so: operators in a wide range of commercial endeavour (e.g. construction, finance, derivatives, the sale and purchase of controlling shareholdings) now contract in specialised markets on established assumptions and principles. Although the "assumption of responsibility" analysis might be thought novel outside the context of a contractual duty of care, it is firmly grounded in contract law, in which free commercial agents are supposed to assess, quantify and charge for risk voluntarily undertaken. It is thus legitimate to ask what the hypothetical contractor in a particular market would have known and expected both at the stage of construing a contract and when one comes to assessing liability for breach: following Lord Hoffmann, it could now be said that there is no real distinction to be drawn between the two stages of analysis.

Though it will require further judicial decisions to determine what principles will found the analysis of "assumption of risk", this is not in itself a bad thing. As Lord Hoffmann says, the prima facie rule will in any event the orthodox rule of *The Heron II*, albeit that the general rule may be rebutted where the general understanding of the market militates otherwise. Where the general rule is rebutted, it is better that the contract-breaker is entitled to point to the reasonable expectations of the ordinary businessman in his specific market in order to limit recovery than that the injured party should be allowed to throw an established market into turmoil by successfully contending that the assumptions of the market were not part of the basis on which the parties contracted. If the injured party is to obtain this result, the onus should be on him to show that he contemplated the risk of loss and provided for it in the contract.

What factors are relevant to the "assumption of risk" analysis? Clearly the general practice of the market, and from the speeches of their Lordships, questions of contract value, and of knowledge of and control over the relevant risk appear to be important. But beyond that, the ingenuity of lawyers and the curious devices of the judiciary are not easy to predict. Suffice it to say that the House of Lords has (re-)fashioned a shield, great and sturdy, for contract-breakers, but it remains for the future to determine quite how cunningly it will be adorned.

Ross Fentem

Consumer credit update

The Consumer Credit Directive

It seems that there is no respite for the consumer credit and retail banking industry. Following implementation in full of the Consumer Credit Act 2006, further upheaval is looming on the near horizon in the form of the Consumer Credit Directive, (the "CCD").

What is the CCD?

The CCD is the latest European Union directive aimed at harmonising consumer credit legislation across the EU. Amongst other things, the CCD addresses the scope of products subject to consumer credit legislation, the advertising and marketing of consumer credit products, the form and content of consumer credit agreements and issues relating to APRs and credit charges. The stated objective of the CCD is to enable the emergence of a well-functioning internal credit market across the EU, so as to facilitate consumer choice, consumer protection and confidence in the consumer credit market. The CCD aims to provide consumers with standardised information on interest rates and the cost of credit when quoted in consumer credit advertisements; standard pre-contractual and contractual information; a uniform calculation in respect of the APR; and harmonised rights of withdrawal and early termination.

When?

Work on the CCD is already well underway. The form of directive was officially adopted by the EU Commission in May 2008 and the CCD must be transposed into English law by June 2010. Consequently, the Department for Business, Enterprise and Regulatory Reform, ("BERR") which is leading the CCD project has already produced a number of informal consultation papers on the main discussion areas. The timetable circulated by BERR indicates that a formal consultation, incorporating draft regulations for comment, will be published on Monday, 6th April 2009, with a view to producing final draft regulations in November 2009. BERR has already stated that there is no opportunity to extend the June 2010 deadline for implementation, although the department has admitted that the deadline is optimistic.

Why is the deadline optimistic?

The CCD is a maximum harmonisation directive. This means that in relation to the areas within the scope of the CCD, the UK does not have a discretion to implement (or retain) legislation which is contrary to, or otherwise more sophisticated than the equivalent provisions of the CCD. Unfortunately for the consumer credit industry, there is a long list of areas where the current consumer credit regime embodied in the Consumer Credit Act 1974 (as amended by the Consumer Credit Act 2006 (the "CCA")) conflicts with the equivalent provisions of the CCD. Generally speaking, the provisions of the CCA, when compared with the equivalent provisions of the CCD, are markedly wider in scope, more prescriptive and offer more comprehensive levels of consumer protection. Consequently, the main issue for BERR in seeking to implement the CCD is how to prune the CCA regime to harmonise with the provisions of the CCD and how to treat those agreements currently regulated by the CCA, but which will fall outside the scope of the CCD. Some of the key problem areas are discussed below. An important practical point for BERR to negotiate is the issue of available Parliamentary time. It is likely that many of the amendments required to implement the CCD will need to be effected via primary legislation. Given the tight timeframe for transposition, there is a serious question mark over whether there is sufficient time available for Parliament to scrutinise and pass the necessary legislation.

What are the problem areas?

Definition of consumer: the CCD [article 3(a)] defines "consumer" as a natural person who is acting outside the purposes of their business, trade or profession. The CCA regulates lending to "individuals" [s.189(1) CCA] and the definition of "individual" encompasses not only natural persons, but also unincorporated associations and small (3 partners or fewer) partnerships. Equally, the CCA regulates lending for business purposes where the debtor is an individual and the amount of credit is £25,000 or less. Business lending above £25,000 may be exempted if the creditor and debtor seek to take advantage of the business purposes exemption [s.16A, CCA]. In summary, facilities to small partnerships and unincorporated associations and business lending, all of which are currently regulated by the CCA, are outside the scope of the CCD.

Financial limits: the CCD regulates consumer credit agreements where the amount of credit exceeds Euros 200 and is less than Euros 75,000. Other than in respect of the limited application to business lending noted above, the 2006 Act removed all financial thresholds from the CCA regime. Consequently, subject to any available exemptions and the small agreements regime, all lending to individuals is CCA regulated, irrespective of value. The issue for BERR is how to deal with CCA regulated facilities where the amount of credit is outside the Euros 200 to Euros 75,000 band. In this context, it's also worth noting that unlike the CCA, the CCD does not contain any provisions which allow the exemption of agreements entered into with high net worth individuals.

Types of agreement: significantly, the CCD does not regulate hire and lease agreements, loans secured by a second charge over land and pawnbroking, all of which are currently regulated by the CCA. It is likely that hire purchase agreements will also fall outside the scope of the CCD and there is confusion over the scope of conditional sale agreements – BERR are taking advice on this point, but at this stage, it is more likely that conditional sale agreements are within the CCD. Again, the issue for BERR is the extent to which the current CCA regime will remain in place in respect of those facilities outside the scope of the CCD and whether in respect of those facilities outside the CCD, the applicable provisions of the CCA will nonetheless be harmonised so as to avoid two separate regimes.

Credit worthiness of the customer: under the CCD [article 8] there is an obligation on every lender to assess the creditworthiness of the customer with reference to "sufficient information" and where necessary, to a credit reference search. The requirement is ongoing and where after the agreement is made, the total amount of credit is changed, the lender must reassess the

credit information held about the customer and reassess the customer's creditworthiness before any significant increase in the amount of credit made available to the customer. There is no definition of what comprises a "significant increase" and BERR has yet to comment on this feature of the CCD. Although the CCA does not contain any directly equivalent provisions, general principles of responsible lending are already enshrined in the "Treating Customers Fairly" regime under the Financial Services & Markets Act 2000 and on a subscriber basis, under the Banking Code.

Advertising: if a credit advertisement includes any interest rate or any figures relating to the cost of credit, then the CCD requires [article 4] that the advertisement should include a standard representative example incorporating the amount of credit, the borrowing rate and charges, the APR, duration of the agreement, cash price of the goods (where relevant) and the total amount payable. Under the provisions of the Consumer Credit (Advertisements) Regulations 2004, the requirement to include representative examples in a credit advertisement was discarded. Article 4.1 of the CCD does not require that the standard information be included in advertisements which include an APR in circumstances where an interest rate or any other figures relating to the cost of borrowing are not shown.

APRs/charge for credit: the CCD [article 19 and Annex 1] contains an equation and some assumptions for calculation of the APR. Essentially, the CCD requires that a single set of assumptions be used to calculate the APR, with a further set of assumptions (the Annex 1 assumptions) to be used where necessary. This approach differs from the requirements of the CCA, where different assumptions for the calculation of the APR are available pursuant to calculation of the total charge for credit (see the Consumer Credit (Total Charge for Credit) Regulations 1980); for use in advertisements (Consumer Credit (Advertisements) Regulations 2004; and for use in agreements (Consumer Credit (Agreements) Regulations 1983 (as amended) (the "Agreements Regulations"). The CCD does not make the same number of distinctions and significantly, there is no allowance for different assumptions to be applied to running account credit in comparison with other types of facility. Equally, the assumed credit limit is Euros 1,500 which, depending on exchange rates, will differ from the current assumed credit limit under the CCA of £1,500. The problem is that with regard to agreements which are outside the scope of the CCD, a dual regime for calculation of the APR could evolve which would lead to widespread industry and consumer confusion.

Withdrawal/cancellation: under the current CCA regime, there is no universal right of withdrawal from a CCA regulated agreement. Cancellation rights will subsist under the CCA where, broadly, there have been negotiations concerning the agreement in the presence of the customer and the customer has signed the agreement away from trade premises. Cancellation rights will also subsist under the Financial Services (Distance Marketing) Regulations 2004 in respect of a regulated agreement which is also a distance contract. The key point however, is that there are some agreements regulated under the CCA which are not cancellable. The position under the CCD is different. The CCD [article 14.1] provides consumers with a universal right of withdrawal from a regulated agreement for 14 days starting with the day on which the agreement is made or, if later, the day on which the consumer received a copy of the contractual terms of the agreement. The CCD also makes provision for the mechanics of cancellation and the obligations of the consumer to repay any credit following cancellation. Following implementation of the CCD, all regulated agreements within scope will be cancellable.

Early repayment: the CCD [article 16] enshrines the rights of the consumer to repay at any time in full or in part (overpayment) and the right to seek a reduction in the cost of credit upon repayment or overpayment. Under the CCA, the consumer has the right to repay early but only in full and a rebate of credit charges is earned only upon repayment in full on the agreed settlement date. The CCD is short on detail in terms of the mechanics of early

repayment. For example, there is no requirement on the consumer to give the creditor notice of early repayment and there are no provisions relating to the method of recalculating the loan on overpayment, or establishment of the settlement date in the case of early repayment. This differs from the position under the CCA where there is a prescriptive regime in respect of early repayment which addresses notice periods, establishment of the settlement date and calculation of the rebate of credit charges. One small glimmer of hope arises from this particular amendment however. The provisions of the CCD relating to early repayment are intended to be a complete regime. Therefore, it is likely that the provisions of s.99 CCA on voluntary termination (which have caused so many problems for lenders) will fall away with regard to agreements within scope. The full benefit of this position will not be realised however until a final determination is made as to the status of hire purchase and conditional sale agreements.

Compensation upon early repayment: the CCD provides that lenders are entitled to "fair and objectively justified" compensation for costs directly incurred as a result of early repayment. The provisions of the CCD operate effectively to cap the amount recoverable on early repayment and compensation may be claimed only in limited circumstances. For example, the lender is entitled to compensation only where early repayment takes place during a period when the borrowing rate is a fixed rate. Compensation cannot be claimed in respect of overdraft facilities, or facilities which are covered by payment protection insurance. Compensation is capped at 1% of the amount repaid where the remaining term of the loan exceeds one year, and 0.5% of the amount repaid, if early repayment occurs within the final year of the relevant term. The CCD further provides that notwithstanding the caps on recoverable compensation, the amount of compensation shall not in any event exceed the amount of interest which the customer, but for early repayment, would have paid from the repayment date to the end of the term. These provisions essentially provide for a very low level of compensation and are bound to be resisted by the lending industry. BERR has not yet given any substantive response on these proposals.

Pre-contract information: although the requirements as to the precise items to be supplied pre-contract are broadly similar in the CCA and the CCD, there are some differences as regards the supply of pre-contract information [see article 5 CCD]. The CCA regime (see the Consumer Credit (Disclosure of Information) Regulations 2004) contains prescriptive requirements as to the form, prominence and legibility of the items required to be disclosed. The CCD does not contain any equivalent provisions and so the rules pursuant to the CCA are likely to fall away upon implementation of the CCD. The second point to note is that the CCD requires that pre contract information is delivered to the consumer "in good time" before the consumer is bound by the relevant consumer credit agreement. This differs from the approach under the CCA, whereby the consumer must be provided with the relevant pre contract information "before a regulated agreement is made". There is no definition under the CCD of "in good time" and BERR has already stated that it is unlikely that they will seek to define the phrase in any implementing legislation – certainly there will be no minimum period which must expire before the regulated agreement can be concluded.

Contractual information: the CCD [article 10] sets out comprehensive provisions as to the information which must be contained in a regulated agreement. The CCD information requirements are substantially in line with the information required pursuant to the Agreements Regulations. The CCD requires that the information shall be specified in a "clear and concise manner". The significant point to note however is that article 10 does not contain any provisions to regulate the order, form, prominence and legibility of the required information. This is in contrast to the position under the Agreements Regulations. BERR does not consider that there is any flexibility to impose requirements regarding the order and prominence of the required information which are more onerous than those contained in the CCD, which means that potentially, lenders will be at liberty to develop more bespoke forms of regulated agreement under a less prescriptive regime. One proposal is that BERR should develop "best practice" guidance containing more prescriptive indicators as to the form and content of regulated agreements. Such guidance would not be binding however.

A further problem which should be addressed in the forthcoming BERR consultation is that article 10 makes no provision as to a form of signature box or signature requirements in respect of regulated agreements. Potentially, this means that the current rules on the form and content of signature boxes pursuant to the Agreements Regulations may fall away. As part of this consultation, BERR has been asked to address the possibility of concluding regulated agreements electronically, rather than having all regulated agreements evidenced by a physical signature as is the current situation.

So what is BERR going to do?

The forthcoming formal BERR consultation document on the CCD should provide many clues as to BERR's likely approach to implementation of the CCD and the nature of the feedback which BERR has received from its informal consultations with stakeholder groups in autumn 2008.

The principal problem for BERR is not how to implement the terms of the CCD in respect of those agreements and facilities within the scope of the CCD – there is no question that the CCA will be amended so as to harmonise with the provisions of the CCD for agreements within scope – but instead, how to deal with those agreements, such as credit agreements over Euros 75,000, hire agreements and second charge mortgage loans, which are outside the scope of the CCD, but currently fall to be regulated by the CCA.

BERR has indicated that where a facility is CCA regulated, it will continue to be subject to the CCA even if outside the scope of the CCD. However, the real question is whether the CCA will continue to apply to those agreements outside scope in its current form or whether, as the CCA pertains to those agreements falling outside the CCD, it should be amended so as to harmonise with the CCD, even though the strict requirements of the CCD do not require any amendments to be made. BERR has indicated that amendment of the CCA in respect of agreements outside scope is an option upon which it looks favourably, the rationale being that amendment would maintain a homogenous set of rules. The alternative course of action would result in a dual regime: the CCA as amended by the CCD would apply to those agreements within scope, but the CCA in its current form would apply to agreements outside scope, which would be likely to result in widespread confusion and much higher costs with regard to staff training and the maintenance of systems and documentation. BERR has indicated that it will look at potential amendments on a case by case basis.

Conclusions

In summary, the consumer credit industry now has to prepare itself for another round of extensive amendments to documentation and practice. The consumer credit industry (there has been extensive lobbying by the Finance & Leasing Association and the British Bankers' Association) is very concerned that sufficient time is allowed to develop and test the new IT systems which will be necessary to accommodate the changes required by the CCD, particularly with regard to documentation.

Some lenders will also be affected by the Payment Services Directive ("PSD") which is due to be implemented by November 2009 and there are areas of overlap between the CCA and the PSD. BERR has agreed that in seeking to implement the CCD, it will attempt to ensure that any amended legislation takes account of the requirements of the PSD as well.

In the meantime, given the extensive list of areas of conflict as discussed above, the industry anxiously awaits the formal BERR consultation document in order to review the substantive proposals for reform.

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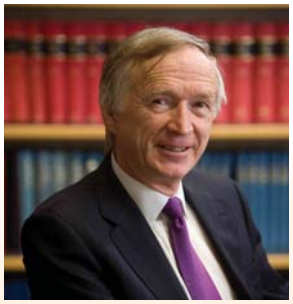

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