Guildhall CHAMBERS

Commercial Newsletter

Issue 17

In this issue

Welcome to the 2017 edition of Commercial news. This year has seen the Supreme Court hand down a plethora of long awaited judgments, and the first three articles in this edition consider a trio of the most important:

First, Hugh Sims QC and James Wibberley discuss the final decision in *Lowick Rose LLP (in Liquidation) v Swynson Ltd*, (in which they appeared, along with Gerard McMeel), and review the Supreme Court's analysis of the doctrine of collateral benefit and the principles of unjust enrichment.

Next, Richard Ascroft analyses *Wood v Capita Insurance Services Ltd*, in which the Supreme Court dispels any suggestion that its decision in *Arnold v Britton* was intended to signal a "rowing back" from the guidance on contractual interpretation contained in *Rainy Sky SA v Kookmin Bank*.

Gerard McMeel then considers *BPE Solicitors v Hughes-Holland*, in which the Supreme Court revisits the "scope of duty" issues first raised in SAAMCO in the context of solicitor's negligence.

Continuing the breach of duty theme, in our next two articles I review a number of recent authorities which suggest a shift away from application of the *Bolam* test for breach of professional duty in cases which involve advising on risks, and John Virgo summarises his recent success in a case involving the mis-selling of an unregulated collective investment scheme: *Jackson v Leslie & Nuding*.

In our sixth article , Hugh Sims QC and Jay Jagasia, pose the question "what is left of *Stone v Rolls*?" in the wake of the Supreme Court's decisions in *Bilta v Nazir* (2015) and *Patel v Mirza* (2016).

Data Protection issues were seldom out of the papers this year, but this is an area many practitioners are unfamiliar with. In our seventh article, Lucy Walker considers the Court of Appeal's recent guidance on *Data Subject Access Requests*, including, the extent of the obligation imposed upon a data controller to undertake a reasonable and proportionate search for data in response to a DSAR, the ambit of the legal professional privilege exception and the relevance of the motive of the data subject in making the DSAR to the question of compliance by the data controller.

Finally this year we welcome Allan Roberts into the Commercial Team. Already an established member of the Employment Team, in our final article Allan provides a helpful overview of an issue arising at the intersection between these practice areas: the potential impact of the *Equality Act 2010* on partnership disputes.

As ever, if you have any comments on this edition or suggestions for future topics, please do not hesitate to contact me at holly.doyle@guildhallchambers.co.uk.

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Collateral benefits and opening the legal black hole?

Lowick Rose LLP (in Liquidation) v Swynson Ltd[1]

A common question in professional negligence cases is whether sums received by the injured party after the negligence giving rise to the claim act to reduce the damage suffered or, in some cases, to discharge the tortfeasor's liability entirely.

It is well established that some collateral benefits, such as insurance payouts and gratuitous assistance from third parties, will not reduce the quantum of the claimant's claim. They are regarded as *res inter alios acta* and thus irrelevant to the assessment of loss.

Certain categories of collateral benefit are well established, but the extent of the principle, and its application in the commercial world where third party assistance may be motivated by economic rather than moral considerations, has always been unclear. Is it enough that it would be revolting to *"the ordinary man's sense of justice"* (to quote the language of Lord Reid in *Parry v Cleaver*[2]) for a tortfeasor's liability to be reduced, or should a more rigorous test be applied?

Swynson v Lowick Rose

The question of whether and how the collateral benefits principle might be applied arose in *Swynson v Lowick Rose*[3], a negligence claim by a lender against a firm of accountants arising out of financial due diligence provided by the accountants before a loan was provided to enable an MBO to take place. The decision is heavily fact sensitive and so it is worth considering the facts in some detail.

The lender, Swynson, was owned indirectly by a Mr Hunt. Swynson lent £15m to an SPV company, EMSL, the borrower, to facilitate an MBO of a US company called Evo ("the 2006 Loan"). The 2006 Loan was made in reliance upon due diligence by the defendant firm of accountants, then known as HMT. Swynson borrowed the money to lend it to EMSL, with Mr Hunt guaranteeing the loan to Swynson and giving security over his own assets. The trading of Evo before completion recorded a $3-$4m adverse difference between Evo's actual and forecast working capital. That information was not reported to Swynson and Hunt. If it had been, the transaction would not have proceeded and no lending would have been advanced. Swynson suffered loss on the 2006 Loan on the date of the transaction in 2006. Subsequent events showed the value of the underlying business, and borrower's covenant, were worthless. By June 2007, EMSL had missed a loan repayment. By July, Mr Hunt was told that Evo was at risk of financial collapse without further investment. In August 2007 Swynson granted a further facility to EMSL of £1.75m ("the 2007 Loan"). By the end of October 2007, EMSL should have repaid both loans, but it had failed to do so. In June 2008, to further alleviate Evo's cash flow problems, Swynson agreed to advance £3m to EMSL on 4 June 2008 ("the 2008 Loan").

At the same time, in 2008, Mr Hunt acquired majority control of EMSL leading to EMSL and Swynson being treated as connected entities for tax purposes. This meant that Swynson was taxed on the loan repayments owed to it by EMSL even though those loan repayments were not being made. Mr Hunt therefore needed to act to stem the losses (the tax charges on the notional loan repayments) being suffered by Swynson

On 31 December 2008, there was a refinancing of the 2006 and 2007 Loans. EMSL and Mr Hunt entered a loan agreement, whereby Mr Hunt made funds available to EMSL ("the Hunt Loan") for the purpose of enabling the 2006 and 2007 Loans to be repaid by EMSL to Swynson, leaving only the 2008 Loan outstanding ("the 2008 Partial Refinance"). The Hunt Loan was on un-commercial terms: a non-interest bearing loan to a Hunt "family" company, EMSL, to enable it to repay (and on terms that it could only be used for that purpose) another Hunt group company, Swynson. It was an internal "Hunt group" transaction for accounting and tax purposes only, made without reference to true market value.

Against this background there arose an important point of principle: did the 2008 Partial Refinance reduce Swynson's losses under the transaction?

Giving judgment at first instance, Rose J accepted that the purpose of the Hunt Loan, and the 2008 Partial Refinance, was not to give HMT an un-covenanted windfall. Mr Hunt believed/assumed the claim against HMT remained unaffected, and the transaction was peculiar to Swynson. Accordingly, Rose J held that the repayment of 2006 and 2007 Loans, effected by the 2008 Partial Refinance, should be disregarded when assessing the loss caused by HMT's breach of duty and treated as *res inter alios acta*. She concluded the refinance was far from an ordinary course event, and good fortune bestowed on Swynson by Hunt (via EMSL). In this respect her reasoning could be said to be based both on a consideration of legal causation principles and by analogy to the benevolence cases.

The Court of Appeal

Lowick Rose appealed. On 25th June 2015, the Court of Appeal handed down judgment[4] and in doing so by a majority decision (Longmore & Sales LJJ; Davis LJ dissenting) concluded that the refinancing exercise conducted did not act to release or reduce the liability of HMT, the negligent professional. The majority in the Court of Appeal, having considered the principles as to *res inter alios acta* as set out in *Parry v Cleaver*, and also as to mitigation in *British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd*,[5] concluded the borrower's repayment had not been made in the ordinary course of business. They also reasoned that the payments were analogous to a benevolent payment, since the loans themselves were effectively worthless at the time and the refinance had been driven by circumstances disconnected from the original transaction.

Accordingly, the sums repaid by the borrower were collateral, and did not reduce the compensation recoverable. Swynson could therefore

1 [2017] UKSC 32

2 [1970] AC 1 at p.14

3 [2015] PNLR 28

4 See *Lowick Rose LLP (in liquidation) v Swynson Ltd* [2015] EWCA Civ 629, [2016] 1 WLR 1045

5 [1912] A.C. 673

recover the money lent notwithstanding that most of it had been repaid. The majority considered that *Parry v Cleaver*, which emphasised the matter had to be looked at disregarding technicalities, and as a matter of justice, fairness and public policy, should lead to the conclusion that the refinance (and repayment) should be ignored.

The dissenting voice (Davis LJ) considered that, as the loan had been repaid by the refinance, the lender could not complain they had still suffered a loss. For Davis LJ, this was not to disregard technicalities but to look at the form of the transaction the parties had chosen for themselves; the form in Davis LJ's view was the substance. In that respect, Davis LJ suggested there was nothing to distinguish the decision from that of the Court of Appeal in *Preferred Mortgages Ltd v Bradford & Bingley Estate Agencies Ltd*.[6] In short, he was stating the law cannot reach what some may perceive as a "just" result without having regard to the structures the parties deliberately used. This dissenting view provided a platform for seeking permission for a further appeal.

The Supreme Court – the Arguments

Lowick Rose obtained permission to appeal the Court of Appeal decision on three grounds: the first was that the Court of Appeal had failed to have regard to the separate legal and corporate personalities; the second was that the Court of Appeal had failed to apply properly the principles as to *res inter alios acta* as set out in *Parry v Cleaver*; the third was relying on the decision of the Court of Appeal in *Preferred Mortgages* and contending that the Court of Appeal had been wrong to conclude that was not effective to dispose of the appeal.

In response, Swynson and Mr Hunt raised two additional grounds of argument as to why, even if the effect of the refinancing was not *res inter alios acta*, they could still recover for the losses caused by the negligent due diligence report. These were that:

(1) Mr Hunt was entitled to be subrogated to Swynson's (extinguished) claims against Lowick Rose as Lowick Rose had been unjustly enriched at Mr Hunt's expense (i.e. it was his money that, through the refinancing, had effected the reduction in Lowick Rose's liability). This argument was advanced applying the principles of unjust enrichment set out by the Supreme Court in *Menelaou v Bank of Cyprus*[7] and the earlier decision of the House of Lords in *Banque Financiere v Parc*[8]; and

(2) Applying the principles of transferred loss, Swynson had not received the services that it had contracted for and/or could be taken to have contracted for the benefit of Mr Hunt as well as itself.[9] These lines of arguments were based on the line of cases from *Albacruz (Cargo Owners) v Albazero (Owners), The Albazero*[10] through to *Alfred McAlpine Construction Ltd v Panatown ("Panatown")*[11] in which the courts have allowed a flexible approach to the question of loss to prevent the formation of a "legal black hole".[12]

Lowick Rose v Swynson was heard in the Supreme Court in November 2016. It was heard along with another case called *Fulton Shipping v Globalia*. This had been heard by a similarly constituted Court of Appeal to that in *Swynson* but in *Fulton Shipping v Globalia* the Court of Appeal concluded the collateral benefit obtained (the avoidance of a capital loss) should be included as it arose in the course of a claimant taking mitigating steps.[13]

Supreme Court – the Judgment

The leading judgment in the Supreme Court was given by Lord Sumption (with whom Lords Neuberger, Clarke and Hodge agreed), who began at [11] of his judgment by summarizing the collateral benefits principle as follows:

"The general rule is that loss which has been avoided is not recoverable as damages, although expense reasonably incurred in avoiding it may be recoverable as costs of mitigation. To this there is an exception for collateral payments (res inter alios acta), which the law treats as not making good the claimant's loss. It is difficult to identify a single principle underlying every case. In spite of what the latin tag might lead one to expect, the critical factor is not the source of the benefit in a third party but its character. Broadly speaking, collateral benefits are those whose receipt arose independently of the circumstances giving rise to the loss. Thus a gift received by the claimant, even if occasioned by his loss, is regarded as independent of the loss because its gratuitous character means that there is no causal relationship between them. The same is true of a benefit received by right from a third party in respect of the loss, but for which the claimant has given a consideration independent of the legal relationship with the defendant from which the loss arose."

Applying this causation based analysis, Lord Sumption went on to find that the refinancing could not be regarded as *res inter alios acta* on the basis that the fact that Mr Hunt was the ultimate source of the funds was entirely irrelevant. Mr Hunt's role did not therefore take the case outside the scope of the general rule, notwithstanding that Mr Hunt's majority ownership of Swynson took place in 2008 and was the only reason why additional tax charges were levied and the only reason why the 2006 and 2007 loans came to be repaid. At paragraph 13 he explained his view on the basis that:

"In the first place, the transaction discharged the very liability whose existence represented Swynson's loss. Secondly, the money which Mr Hunt lent to EMSL in December 2008 was not an indirect payment to Swynson, even though it ultimately reached them, as the terms of the loan required. Mr Hunt's agreement to make that loan and the earlier agreements of Swynson to lend money to EMSL were distinct transactions between different parties, each of which was made for valuable consideration in the form of the respective covenants to repay. Thirdly, as the Court of Appeal correctly held, the consequences of the refinancing could not be recoverable as the cost of mitigation, because the loan to EMSL was not an act of Swynson and was not attributable to HMT's breach of duty."

Accordingly, he reasoned, Swynson's losses fell to be reduced due to the way in which the refinancing transaction had been structured; a structure necessitated by the fact that HMRC ignored the distinct corporate personalities. Pausing briefly here, it is worth noting that this reasoning could apply equally to classic cases of collateral benefits, such as insurance or pure benevolence, and does little to explain why the decision at first instance - treating the matter as disconnected as a matter of causation - should be interfered with.

6 [2002] EWCA Civ 336. Preferred mortgage was a scope of duty case in circumstances where no loss was sustained under the transaction for which a duty was owed, but in respect of a further transaction, one that would not have been entered 'but for' the initial negligence, but that fell outside the scope of the defendant's duty.

7 [2015] 3 WLR 1334

8 [1999] AC 221

9 These are sometimes referred to as the 'broad ground' or 'expectation loss' – where a party can claim for the loss bargain – and the 'narrow ground' where a party (e.g. a consignor) can claim on behalf of the owner of goods where those goods are damaged by someone (e.g. a carrier) with whom the owner does not have privity of contract.

10 [1977] A.C.774

11 [2001] 1 A.C. 518. Although Panatown is a construction case, the application of transferred loss principles to professional negligence claims was confirmed by the decision of HHJ Thornton QC in *John Harris Partnership (a firm) v Groveworld Limited* [1999] P.N.L.R. 697.

12 The words of Lord Keith in *GUS Property Management Limited v Littlewoods Mail Order Stores Ltd* [1982] SLT 533 HL at p.538

13 See [2015] EWCA Civ 1299, [2016] 4 All ER 77. *Fulton Shipping* was a charter-party case and so it is not considered in further detail here..

Having accepted Lowick Rose's arguments on *res inter alios acta*, he went on to consider the additional grounds of transferred loss and unjust enrichment/subrogation.

In respect of the former, Lord Sumption was keen to adopt a restrictive approach, holding at [17] that the so-called narrow ground could only be applied where the party who suffered the loss owned the property that had been damaged. He then went on to reject the broader ground on the basis that protecting Mr Hunt's interests was not part of the relevant transaction (i.e. the initial due diligence undertaken by HMT) and thus even if Mr Hunt had suffered a loss, Swynson had not suffered a loss of contractual bargain as protecting Mr Hunt's interests was not something that HMT had been retained to do (see [17]).

Lord Sumption then devoted the majority of his judgment to unjust enrichment and equitable subrogation. This, the writers would suggest, is because; (i) on any common-sense view, Lowick Rose had been enriched at Mr Hunt's expense; and (ii) through the widening of the law on unjust enrichment in *Menelaou* and *Banque Financiere v Parc*, the courts had potentially created a means for non-parties to be subrogated to professional negligence claims notwithstanding the lack of duty owed to them.

Lord Sumption began his analysis by characterising the issue as [18] as follows:

"Equitable subrogation is a remedy available to give effect to a proprietary right or in some cases to a cause of action. This is not a case where subrogation is invoked to give effect to a proprietary right. It belongs to an established category of cases in which the claimant discharges the defendant's debt on the basis of some agreement or expectation of benefit which fails."

Lord Sumption then went on to analyse the leading subrogation cases through this prism, highlight how in each there had been some expectation on the part of the claimant that they would receive something from the transaction under consideration. He summarised these cases at [30] as follows:

"The cases on the use of equitable subrogation to prevent or reverse unjust enrichment are all cases of defective transactions. They were defective in the sense that the claimant paid money on the basis of an expectation which failed. Many of them may broadly be said to arise from a mistake on the part of the claimant. For example, he may wrongly have assumed that the benefit in question was available or enforceable or that his stipulation was valid, when it was not. However, it would be unwise to draw too close an analogy with the role of mistake in other legal contexts or to try to fit the subrogation cases into any broader category of unjust enrichment. It is in many ways sui generis … What this suggests is that the real basis of the rule is the defeat of an expectation of benefit which was the basis of the payer's consent to the payment of the money for the relevant purpose. Mistake is not the critical element. It is only one, admittedly common, explanation of how that expectation came to be disappointed."

Based on this analysis, Lord Sumption rejected any claim based on unjust enrichment on the basis that the refinancing was not a defective transaction as Mr Hunt had received all that he had expected, including the intended effects of reducing the tax liability and clearing up Swynson's balance sheet (see [32]). Equitable subrogation was not, therefore, being invoked in the correct circumstances. Although this was clearly not the result that Mr Hunt had intended, Lord Sumption held that:

"Mr Hunt's alleged mistake contributes nothing to this analysis … He is trying to invoke a remedy which the law provides for a specific purpose, and to deploy it for a different one. When Mr Hunt entered into the December 2008 refinancing, he did not in any sense bargain for a right to recover substantial damages from HMT. Nor was he mistaken about what he was going to get out of the refinancing. At best, he was mistaken about the effect that the discharge of EMSL's debt to Swynson would have on the latter's claims under the very different transaction which it had entered into in 2006 when it engaged HMT to carry out the due diligence. In fact, however, his evidence does not even go that far. What it shows is that he wrongly believed that he had already bargained for a right to substantial damages from HMT back in 2006. This was because he considered that as the owner of Swynson he was as much entitled under Swynson's contract with HMT as Swynson was. "As between me and Swynson," he wrote in the passage from his witness statement cited by the judge, "the consideration of who technically would be entitled to recover the money from HMT did not matter as I was the owner of Swynson." As a result, he did not think that by discharging EMSL's debt to Swynson two years later he would diminish his own entitlement."

Accordingly, Lord Sumption rejected the additional grounds raised by Mr Hunt and allowed the appeal. In so doing, Lord Sumption effectively held that where a third party intervenes to mitigate adverse consequences arising from the tortfeasor's negligence, they do so at risk of both extinguishing the tortfeasor's liability, and leaving themselves without any remedy.

Although not relevant to the result, it worth noting that Lord Mance gave his own judgment in which he adopted a much wider analysis of the unjust enrichment arguments that did not view the availability of equitable subrogation as being dependent upon Mr Hunt's defeated expectations (or the lack thereof). Instead, Lord Mance regarded the case as turning on an application of the four stage test for unjust enrichment set out in Lord Steyn in *Banque Financiere*.[14]

In Lord Mance's view, the key feature of the case was that any enrichment gained by HMT *"was not just unintended, it was incidental and indirect and arose from the consequences of Mr Hunt's deliberately structured arrangements on a relationship quite separate from that which the arrangements addressed in exactly their intended way."* Accordingly, he too allowed the appeal.

Analysis

The decision in Swynson may be said to give rise to an unjust outcome on the facts, giving the tortfeasor an unmerited windfall, but what as to the principles it establishes? It concerned three complex areas of law and therein lies part of the problem with the judgments given by the Supreme Court. In attempting decisive summaries of the various legal principles, their Lordships glossed over several important earlier decisions that should have either been overruled or affected the result.

The prime example of this is Lord Sumption's analysis of *res inter alios acta*. Putting aside for present purposes whether the causation test specified by Lord Sumption justified reversing the decision at first instance (where the finder of fact had concluded the receipt was independent of the wrong), was Lord Sumption right in positing causation as the underlying principle? Whilst it is true that the principle can be rationalised as one on based on causation, the decision of the House of Lords in *Parry v Cleaver* made clear that whether a benefit was collateral or not will turn on its *"intrinsic nature"* or character, disregarding technicalities, thus implicitly rejecting a single legal test.[15] The decision in *Parry v Cleaver* was heavily influenced by powerful decisions of the High Court in Australia, notably that of *The National Insurance Company of New Zealand Limited v Espagne*[16] where an analysis depending on causation alone was rejected, and the characterisation of the payment was found to depend on the intention of

14 i.e. (1) Has the defendant benefited or been enriched? (2) Was the enrichment at the expense of the claimant? (3) Was the enrichment unjust? (4) Are there any defences? See [56].

15 See p.15E

16 [1960] 105 CLR. Espagne was cited extensively in *Parry*. See Lord Reid at p.19, Lord Morris at p.28, Lord Pearce at p.38 and Lord Wilberforce at p.40.

the payor. In the Australian case law the focus is on the question of the intention of the payor: was the intention for the payment to operate in the interest of the tortfeasor and to diminish the damages he otherwise would be liable to pay? This remains the position in Australia: see *Zheng v Cai*[17]. Lord Sumption's causation test would not appear to allow any role for such a question, or for standing back and looking at the intention of the real decision maker. Causation, as it is normally understood, operates to connect the wrong with the loss. But *res inter alios acta*, is looking in another direction at a different time, and after the event, causation having already been established.

This adoption of a single test or underlying principle, is inconsistent with the wide body of caselaw in which a broad, merits based, approach has been taken by the courts, not just in the Commonwealth but also in England & Wales. Cases concerning government grants have disregarded benefits on the express grounds of public policy[18] and in commercial cases it has been found that benefits received because of the claimant's special relationship with a third party do not reduce their loss.[19] Similarly, there are cases where collateral benefits have been ignored because they are independent[20], accidental, peculiar to the claimant or simply irrelevant.[21]

Lord Sumption's focus on EMSL's liability to Swynson as representing Swynson's loss, and treating the receipt as reducing that loss, also glossed over previous authority. In *Needler Financial Services Ltd v Taber*[22] it was held that a (demutualisation) profit made from holding a mis-sold asset did not need to be taken into account since the demutualisation decision was an independent decision. Neither *Needler* though, nor the Court of Appeal decision in *Rubenstein v HSBC Bank Plc*[23] that followed it, were mentioned by Lord Sumption despite both being cited in argument. Lord Sumption's logic appears contrary to that underpinning *Needler*[24], but it is unclear whether it should be considered as disapproved of, much less implicitly overturned.

Similarly, Lord Sumption's analysis of equitable subrogation and unjust enrichment fails to make any mention of the case of *Niru Battery Manufacturing Co v Milestone Trading Ltd*.[25] There, a remedy in equitable subrogation was allowed notwithstanding that there was no question of any defeated expectation arising. Based on Lord Sumption's analysis in *Swynson*, *Niru Battery* would appear to have been wrongly decided, but again the issue was not directly addressed.

Lord Sumption's analysis of *Banque Financiere* is also open to criticism as in that case the lender did in fact gain the letter of postponement it was promised; the transaction was only defective in so far as the lender was operating under the tacit mistake that the letter would be binding. This, it can be seen, is incredibly close to the present case.

That said, is the Supreme Court to be faulted for its more restrictive (simplified) approach? Have difficult areas of law given rise to too many exceptions to general principles of determining duty of care and liability for loss?

The writers would suggest that approach adopted by the Supreme Court in *Swynson* is illustrative of a growing trend in recent cases towards a rationalisation of the law; making liability more predictable and harder to establish, and exceptions to general rules genuinely exceptional.[26] It is unfortunate perhaps, however, even if this trend has validity where creation of liability is concerned, that an overly rigid approach to assessment of damages is encouraged, which is a fact sensitive area where the first instance tribunal should be permitted a wide degree of flexibility to ensure a just outcome. Commercial judges always seek to provide commercial certainty. That does not mean that there is not room for the reality of a situation to be recognised. Certainty requires that there are principles that should be applied - that still permits cases to be decided on a fact sensitive basis.

This restrictive trend can also be seen from the decision in *Commissioners for Revenue & Customer v Investment Trust Companies (In Liquidation)*[27] where the Supreme Court refused to allow customers who had overpaid a supplier to reclaim their overpayments from HMRC (who had been the ultimate recipient of them). Common-sense would dictate that HMRC had been enriched at the customer's expense, but the claims failed on the basis that the transactions under which VAT was paid were not the transactions under which the same money was remitted to HMRC.

The decision in *BPE Solicitors v Hughes Hollands*[28] also illustrates the same point. There the Supreme Court took an (arguably) restrictive approach to the scope of the defendant's duty and the application of the SAAMCO cap, overruling the long-established cases of *Bristol and West Building Society v Steggles Palmer* and *Portman Building Society v Bevan Ashford (a firm)* in the process.

It is unclear whether these cases are all part of a conscious desire on the part of the Supreme Court to adopt a more rigid or formalistic approach, or whether the common direction of travel simply reflects the conservatism of some of its present members, and may not mark a permanent shift in the law.

Either way, commercial parties, especially in a family or group company context, will need to think long and hard about any assistance they provide, and how it is to structured, if it is not to undermine or reduce a claim for damages, and find the loss falling into a legal black hole.

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17 [2009] HCA 52

18 E.g. *Treml v Ernest W. Gibson & Partners* [1984] 2 EGLR 162, per Popplewell J at p.164 and *Palatine Graphic Arts Co Ltd v Liverpool City Council* [1986] 1 Q.B. 335 (CA), Per Glidewell LJ at p.344-345

19 See *Jones v Stroud District Council* [1988] 1 W.L.R. 1141}, per Neill LJ at p.1150.

20 *Titan Europe* [2015] EWCA Civ. 1083; [2016] 1 All E.R.(Comm) 990}, per Longmore LJ at {[30]- [38]}

21 E.g *John Harris Partnership (a firm) v Groveworld Limited* [1999] P.N.L.R. 697}, per HHJ Thornton QC at {p.720-722

22 [2001] EWHC Ch 5, [2002] 3 All ER 501

23 [2012] EWCA Civ 1184, [2013] 1 All ER (Comm) 915

24 The event of Mr Hunt becoming a majority owner in EMSL, which gave rise to the particular tax liabilities, appears no less disconnected than the decision by the board to demutualise in Needler

25 [2004] EWCA Civ 487

26 Certainly, the decision in Swynson seems an abrupt about turn following the direction of travel towards a more liberal approach to the law of unjust enrichment seen in *Banque Financiere, Niru Battery* and *Menelaou*.

27 [2017] UKSC 29, [2017] 2 WLR 1200

28 [2017] UKSC 21

It's still raining: contractual interpretation in the supreme court (again)

In the recent decision of *Wood v Capita Insurance Services Ltd*[29] the Supreme Court has dispelled any suggestion that its decision in *Arnold v Britton*[30] was intended to signal a "rowing back" from the guidance on contractual interpretation contained in *Rainy Sky SA v Kookmin Bank*[31].

On the approach to contractual interpretation, *Rainy Sky* and *Arnold* were, the Supreme Court held[32], saying the same thing.

The Supreme Court's peremptory rejection of the "rowing back" suggestion arose in the context of a written submission by the appellant in that case that the Court of Appeal had fallen into error because it had been influenced by a submission from the respondent's counsel that *Arnold* had signalled a retreat. That, it was submitted, had caused the Court of Appeal to place too much emphasis on the words of the relevant contract under consideration and to give insufficient weight to the factual matrix.

Rainy Sky SA v Kookmin Bank

In *Rainy Sky* the issue between the parties was the role to be played by considerations of business common sense in determining what the parties meant in the context of a shipbuilder's refund guarantees[33].

Lord Clarke (with whom all the other members of the Court agreed) referred to the now familiar authorities such as Mannai Investment *Co Ltd v Eagle Star Life Assurance Co Ltd*[34], *Investors Compensation Scheme Ltd v West Bromwich Building Society*[35] and *Chartbrook Ltd v Persimmon Homes Ltd*[36] and went on to agree with Lord Neuberger MR (as he then was) in *Pink Floyd Music Ltd v EMI Records Ltd*[37] that those cases show that the ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant.

After summarising aspects of the judgment of Patten LJ in the Court of Appeal[38], Lord Clarke continued as follows:

> 20. … It is not in my judgment necessary to conclude that, unless the most natural meaning of the words produces a result so extreme as to suggest that it was unintended, the court must give effect to that meaning.
>
> 21. The language used by the parties will often have more than one potential meaning. I would accept the submission made on behalf of the appellants that the exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other.
>
> 23. Where the parties have used unambiguous language, the court must apply it. … [citing the decision of the Court of Appeal in *Co-operative Wholesale Society Ltd v National Westminster Bank plc*[39]]. After quoting the passage from the speech of Lord Diplock [in *The Ataios*], Hoffmann LJ said at p 98:

This robust declaration does not, however, mean that one can rewrite the language which the parties have used in order to make the contract conform to business common sense. But language is a very flexible instrument and, if it is capable of more than one construction, one chooses

29 [2017] UKSC 24; [2017] 2 WLR 1095 (judgment delivered 29.03.17).

30 [2015] AC 1619

31 [2011] 1 WLR 2900

32 *Ibid* at [14].

33 [2011] 1 WLR 2900 at [15] per Lord Clarke.

34 [1997] AC 749

35 [1998] 1 WLR 896, 912F-913G, Where Lord Hoffmann summarised the relevant principles as follows:

a. Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

b. Subject to the requirement that it should have been reasonably available to the parties and to (3) below, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

c. The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life.

d. The meaning which a document would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax.

e. The "rule" that words should be given their "natural and ordinary meaning" reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had.

36 [2009] 1 AC 1101

37 [2010] EWCA Civ 1429; [2011] 1 WLR 770

38 With whom Thorp LJ agreed with Sir Simon Tuckey delivering a dissenting judgment.

that which seems most likely to give effect to the commercial purpose of the agreement.

> 30. [The approach to construction] is in essence that, where a term of a contract is open to more than one interpretation, it is generally appropriate to adopt the interpretation which is most consistent with business common sense.

Arnold v Britton

In *Arnold v Britton*[40] Lord Neuberger (with which the other members of the Court agreed, save Lord Carnwath who dissented), said this[41] when construing a lease:

> 15. When interpreting a written contract, the court is concerned to identify the intention of the parties by reference to "what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean",…And it does so by focussing on the meaning of the relevant words…in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions…
>
> 16. For present purposes, I think it is important to emphasise seven factors.
>
> 17. First, the reliance placed in some cases on commercial common sense and surrounding circumstances (e.g. in *Chartbrook* [2009] AC 1101, paras 16-26) should not be invoked to undervalue the importance of the language of the provision which is to be construed. The exercise of interpreting a provision involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision. Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract. And, again save perhaps in a very unusual case, the parties must have been specifically focussing on the issue covered by the provision when agreeing the wording of that provision.
>
> 18. Secondly, when it comes to considering the centrally relevant words to be interpreted, I accept that the less clear they are, or, to put it another way, the worse their drafting, the more ready the court can properly be to depart from their natural meaning. That is simply the obverse of the sensible proposition that the clearer the natural meaning the more difficult it is to justify departing from it. However, that does not justify the court embarking on an exercise of searching for, let alone constructing, drafting infelicities in order to facilitate a departure from the natural meaning. If there is a specific error in the drafting, it may often have no relevance to the issue of interpretation which the court has to resolve.
>
> 19. The third point I should mention is that commercial common sense is not to be invoked retrospectively. The mere fact that a contractual arrangement, if interpreted according to its natural language, has worked out badly, or even disastrously, for one of the parties is not a reason for departing from the natural language. Commercial common sense is only relevant to the extent of how matters would or could have been perceived by the parties, or by reasonable people in the position of the parties, as at the date that the contract was made…
>
> 20. Fourthly, while commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed. Experience shows that it is by no means unknown for people to enter into arrangements which are ill-advised, even ignoring the benefit of wisdom of hindsight, and it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice. Accordingly, when interpreting a contract a judge should avoid re-writing it in an attempt to assist an unwise party or to penalise an astute party.
>
> 21. The fifth point concerns the facts known to the parties. When interpreting a contractual provision, one can only take into account facts or circumstances which existed at the time that the contract was made, and which were known or reasonably available to both parties. Given that a contract is a bilateral, or synallagmatic, arrangement involving both parties, it cannot be right, when interpreting a contractual provision, to take into account a fact or circumstance known only to one of the parties."
>
> 22. Sixthly, in some cases, an event subsequently occurs which was plainly not intended or contemplated by the parties, judging from the language of their contract. In such a case, if it is clear what the parties would have intended, the court will give effect to that intention.

The seventh point related to service charges in leases and is not of general application.

Lord Hodge (who expressed agreement with the judgment of Lord Neuberger) gave a separate judgment. He expressed[42] agreement with paragraph 21 of Lord Clarke's judgment in *Rainy Sky* but added this[43]:

> This unitary exercise involves an iterative process by which each of the rival meanings is checked against the provisions of the contract and its commercial consequences are investigated: *In re Sigma Finance Corpn* [2010] 1 All ER 571, para 12, per Lord Mance JSC. But there must be a basis in the words used and the factual matrix for identifying a rival meaning. The role of the construct, the reasonable person, is to ascertain objectively, and with the benefit of the relevant background knowledge, the meaning of the words which the parties used. The construct is not there to re-write the parties' agreement because it was unwise to gamble on future economic circumstances in a long term contract or because subsequent events have shown that the natural meaning of the words has produced a bad bargain for one side.

In the wake of *Arnold*, a number of commentators suggested that Lord Neuberger's judgment might have signalled a turning of the tide in favour of literal construction and away from purposive construction[44].

A review of cases decided after *Arnold* does not, in the author's opinion, reveal any perceived retreat from *Rainy Sky* but some of the authorities certainly emphasise the importance of the language used by the contracting parties. Thus, in *Carillion Construction Ltd v Emcor Engineering Services Ltd and anr*[45] Jackson LJ said this (at [46]):

39 [1995] 1 EGLR 97

40 [2015] AC 1619

41 At [15] - [22].

42 At [76].

43 At [77].

> Recent case law establishes that only in exceptional circumstances can considerations of common sense drive the court to depart from the natural meaning of contractual provisions. See *Arnold* at [19] to [20]. In [*Grove Developments Ltd v Balfour Beatty Regional Construction Ltd* [2016] EWCA Civ 990; [2017] BLR1]] the Court of Appeal applied those principles to a construction contract, which operated harshly against the interests of a contractor. The court declined to depart from the natural meaning of the contractual provisions.

And in *English Electric Company Ltd v Alstom UK*[46] Longmore LJ (with whom Beatson and Sales LJJ agreed) said this (after referring to the apparent background to the agreement) at [18]:

> All this must, however, be subject to the words of the agreement which be the first port of call for any one charged with the question of construction.

In *Metlife Seguros De Retiro SA v JPMorgan Chase Bank, National Association*[47] Hamblen LJ said this (at [41]):

> As MetLife points out the Supreme Court in *Arnold*... have stressed the importance to contractual interpretation of the language used. As Lord Neuberger said at [17], the meaning of a provision is "most obviously to be gleaned from the language", observing that "unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract."

Wood v Capita Insurance Services Ltd

The question of construction which arose in *Wood* (ordered to be tried as a preliminary issue) was as to the proper meaning of an indemnity provision in a share purchase agreement (SPA). The sellers of the shares were the 3 shareholders in Sureterm Direct Ltd ("the Company") and included Mr Wood who held 94% of the issued share capital. The Company carried on business as an insurance broker, primarily focusing on the classic car market. The purchaser of the shares was Capita Insurance Services Ltd ("Capita").

Following the purchase by Capita of the shares in the Company, Mr Wood remained employed by the Company as its managing director until the end of 2010 when his employment was terminated. That termination was the subject of a claim by Mr Wood against Capita who then sought to counterclaim against him under the relevant indemnity provision in the SPA (clause 7.11).

Under clause 7.11 of the SPA the sellers agreed to indemnify Capita in respect of losses relating to the mis-selling or suspected mis-selling of insurance products or services in the period prior to the share sale. The dispute between the parties related to the trigger events for such losses and, more specifically, whether Mr Wood was liable (qua Seller) if the losses arose without any complaint or claim by a customer.

Clause 7.11 was in the following terms:

> The Sellers undertake to pay to the Buyer an amount equal to the amount which would be required to indemnify the Buyer and each member of the Buyer's Group against all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and all fines, compensation or remedial action or payments imposed on or required to be made by the Company following and arising out of clams or complaints registered with the FSA, the Financial Ombudsman or any other Authority against the Company, the Sellers or any Relevant Person and which relate to the period prior to the Completion Date pertaining to any mis-selling or suspected mis-selling of any insurance or insurance related product or service.

The SPA included the following relevant definitions:

Authority means any local, national, multinational, governmental or non-governmental authority, statutory undertaking, agency or public regulatory body (whether present or future) which has jurisdiction over the Business or any decision, consent or licence which is required to carry out the Business and Authorities shall be construed accordingly.

> **FSA** means the Financial Services Authority and any body which supersedes it.
>
> **Relevant Person** means an Employer or a former employee of the Company and any dependent of an Employee or former employee of the Company.

The preliminary issue first came before Popplewell J for determination[48]. The critical distinction between the rival constructions advanced by Mr Wood and Capita was, the judge recorded[49], whether the words "following and arising out of claims or complaints registered with the FSA, the Financial Services Ombudsman or any other Authority against the Company, the Sellers or any Relevant Person" governed and qualified:

> *"all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred"* and
>
> "all fines, compensation or remedial action or payments imposed on or required to be made by the Company"
>
> (as Mr Wood contended) or just (2) as Capita argued.

The judge concluded that Capita's construction was to be preferred for three main reasons:

The language of (2) and its overlap with (1) supported such a construction. Given (as was common ground) that the types of loss and damage enumerated in (1) were framed in wide enough terms to encompass all the types of loss and damage enumerated in (2), that suggested (2) was included to be illustrative of losses which fell within (1), a technique commonly employed for the avoidance of doubt[50].

It was supported by the commercial context and the practical consequences of the rival constructions[51]. The involvement of the FSA or other supervisory authorities might arise in a number of different ways (a direct claim or complaint by a customer, whistleblowing to the FAS by an employee, investigation by the FSA in response to management notification or its (the FAS's) perception of a marketwide problem), There was, said the judge, no good reason why the happenstance of what triggers an FSA investigation should be determinative of the Sellers' obligation to indemnify.

> Capita's construction was supported by a number of "more minor linguistic and syntactical points.

Mr Wood appealed successfully to the Court of Appeal[52]. Lord Justice Christopher Clarke (with whom Lord Justice Patten and Lady Justice Gloster agreed) summarised the reasoning of Popplewell J and then sought to state[53] the principles of contractual interpretation which he considered as most relevant for the purposes of the appeal, viz:

44 See, for example, *Conspiracy Theories*, Duncan, 166 NLJ 7712, p 12; *A turning tide?* Pilling, 165 NLJ 7665, p 18; *Un-Belize-able: the diminishing role of commerciality*, Ansell and Thorne, (2016) 27 1 Cons.Law 6; cf *The Interpretation of Contracts*, Lewison, 6th ed, which does not refer to any change of approach.

45 [2017] EWCA Civ 65

46 [2016] EWCA Civ 1314

47 [2016] EWCA Civ 1248

48 [2014] EWHC 3240 (Comm)

49 At [10].

> The aim of the court is to determine what a reasonable person who had all the background knowledge which would reasonably have been available to the parties when they contracted would have understood the parties to have meant: *Rainy Sky SA v Kookmin Bank*; this exercise relates to their understanding at the time that the contract was made: *Arnold v Britton* at [19].
>
> The exercise of construction is essentially one unitary exercise – *Rainy Sky* [21], which should be "neither uncompromisingly literal nor unswervingly purposive": per Sir Thomas Bingham MR in *Arbuthnott v Fagan* [1995] CLC 1396, 1400. It is also an iterative exercise: *Arnold* [76]. The court looks to see where different constructions lead, how they fit with the other provisions in the contract (or other phrases in the same clause), what obstacles to a particular interpretation are met upon the way, and what results are reached.
>
> In a case where, as here, parties have used language which is capable of more than one meaning, the court should consider the implications of the rival constructions: *Gran Insurance Co Ltd v Tai Ping Insurance Co Ltd* [2001] CLC 1,103 at [16]; and is entitled to prefer a construction which is consistent with business common sense and to reject one that is not.

Lord Justice Christopher Clarke went on[54] to sound a note of caution about the use of "business common sense" as a determinant of construction as such sense depends on the standpoint from which the question is asked. Moreover, the fact that the natural meaning of a provision appears imprudent for one of the parties does not mean it ought to be rejected as incorrect; it may be the result of a weak negotiating position, poor negotiating or drafting skills, in adequate advice or inadvertence. A bad bargain will not be re-written by the court through the process of interpretation.

At [31] of the judgment Christopher Clarke LJ said this:

> In effect a balance has to be struck between the indications given by the language and the implications of rival constructions. The clearer the language the less appropriate it may be to construe or confine it so as to avoid a result which could be characterised as unbusinesslike. The more unbusinesslike or unreasonable the result of any given interpretation the more the court may favour a possible interpretation which does not produce such a result and the clearer the words must be to lead to that result. Thus, if what is prima facie the natural reading produces a wholly unbusinesslike result, the court may favour another, even if less obvious, reading. But, as Lord Neuberger observed in *Arnold v Britton* [17] "commercial common sense and surrounding circumstances… should not be invoked to under value the importance of the language of the provision which is to be construed".

In concluding that Mr Wood's construction of the indemnity provision was to be preferred, Christopher Clarke LJ:

> was of the view that the natural reading of the clause (looking at its structure and read as a whole in its original form) started with an obligation to indemnify against two categories of loss or events giving rise to loss: (1) *"all actions, proceedings… suffered or incurred"* and (2) *"all fines, compensation or remedial action… required to be made by the Company"*. The subject matters of the indemnity are then qualified by the requirement that they must be:
>
> *"following and arising out of claims or complaints registered with the FSA etc against the Company, the Sellers or any Relevant Person";*
>
> and *"which relate to the period prior to the Completion Date"*; and
>
> *"pertaining to any mis-selling of any insurance or insurance related product or service".*
>
> The Capita construction had the effect that, if there is an action by a customer which does not involve a claim or complaint registered with the FSA or any other Authority, and in relation to which they have played no part, there is no part of the clause which specifies in terms against which entity that action must be brought.
>
> On the judge's construction the words "following and arising out of claims or complaints registered with the FSA, the Financial Services Ombudsman or any other Authority against the Company, the Sellers or any Relevant Person" are, in effect surplusage (albeit for the avoidance of doubt), at any rate so far as claims and complaints against the Company; whereas on the contrary construction they fulfil a function not provided for elsewhere, namely to delineate against whom the claim must be brought if the indemnity is to apply.

Under the heading *Commercial Considerations*, Christopher Clarke LJ referred to the view of Popplewell J that an exclusion from indemnity of compensation resulting from whistle-blowing, self reporting or action taken by the FSA of its own accord would lack commercial good reason but went on to identify other considerations to be taken into account but to which Popplewell J had not referred. Specifically, Capita had the benefit under the SPA of warranties in terms wide enough to cover mis-selling or suspected mis-selling. It followed, therefore, that Capita's ability to recover in respect of mis-selling was not dependent on brining the case within clause 7.11.

On Capita's appeal to the Supreme Court the only judgment was delivered by Lord Hodge (with whom Lord Neuberger, Lord Mance, Lord Clarke and Lord Sumption agreed). Thus, those justices who delivered the principal judgments in *Rainy Sky* and *Arnold* are to be taken as expressly associating themselves with the rejection of the perceived retreat from *Rainy Sky*.

At paragraph 9 of his judgment Lord Hodge said it was not appropriate to reformulate the guidance given in *Rainy Sky* and *Arnold*, adding that "the legal profession has sufficient judicial statements of this nature." He did, however, go on to explain why he did not accept the proposition that "*Arnold* involved a recalibration of the approach summarised in Rainy Sky". Lord Hodge said this:

> 10. The court's task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. It has long been accepted that this is not a literalist exercised focussed solely on a parsing of the wording of the particular clause but that the court must consider the contract as a whole and, depending on the nature, formality and quality of the drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to the objective meaning. In *Prenn v Simmonds* [1971] 1 WLR 1381 (1383H-1385D) and in *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 (997), Lord Wilberforce affirmed the potential relevance to the task of interpreting the parties' contract of the factual background known to the parties at or before the date of the contract, excluding evidence of the prior negotiations. When in his celebrated judgment in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 Lord Hoffmann (pp 912-913) reformulated the principles of contractual interpretation, some saw his second principle, which allowed consideration of the whole relevant factual background available to the parties at the time of the

50 *Ibid* at [13]-[14].
51 *Ibid* at [15].
52 [2015] EWCA Civ 839
53 At [28].
54 At [29].

contract, as signalling a break with the past. But Lord Bingham in an extra-judicial writing, *A new thing under the sun? The interpretation of contracts and the ICS decision* Edin LR Vol 12, 374-390, persuasively demonstrated that the idea of the court putting itself in the shoes of the contracting parties had a long pedigree.

11. Lord Clarke elegantly summarised the approach to construction in *Rainy Sky* at para 21f. In *Arnold* all of the judgments confirmed the approach in *Rainy Sky* (Lord Neuberger paras 13-14; Lord Hodge para 76; and Lord Carnwath para108). Interpretation is, as Lord Clarke stated in *Rainy Sky* (para 21), a unitary exercise; where there are rival meanings, the court can give weight to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense. But, in striking a balance between the indications given by the language and the implications of the competing constructions the court must consider the quality of drafting of the clause (*Rainy Sky* para 26, citing Mance LJ in *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2)* [2001] 2 All ER (Comm) 299 paras 13 and 16); and it must also be alive to the possibility that one side may have agreed to something which with hindsight did not serve his interest: *Arnold* (paras 20 and 77). Similarly, the court must not lose sight of the possibility that a provision may be a negotiated compromise or that the negotiators were not able to agree more precise terms.

12. This unitary exercise involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated: *Arnold* para 77 citing *In re Sigma Finance Corpn* [2010] 1 All ER 571, para 10 per Lord Mance. To my mind once one has read the language in dispute and the relevant parts of the contract that provide its context, it does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language in the contract, so long as the court balances the indications given by each.

13. Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation. Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements. Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance. But negotiators of complex formal contracts may often not achieve a logical and coherent text because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement. There may often therefore be provisions in a detailed professionally drawn contract which lack clarity and the lawyer or judge in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type. The iterative process, of which Lord Mance spoke in *Sigma Finance Corpn* (above), assists the lawyer or judge to ascertain the objective meaning of disputed provisions.

14. On the approach to contractual interpretation, *Rainy Sky* and *Arnold* were saying the same thing.

15. The recent history of the common law of contractual interpretation is one of continuity rather than change. One of the attractions of English law as a legal system of choice in commercial matters is its stability and continuity, particularly in contractual interpretation.

On any view the Supreme Court must now be taken as rejecting any preference for a literalist approach to contractual interpretation.

As to the determination of the appeal before it, Lord Hodge observed[55] that "[c]lause 7.11 has not been drafted with precision and its meaning is avoidably opaque". He indicated that his preliminary view of the meaning of the clause was that which found favour in the Court of Appeal but that it was necessary to place the clause in the context of the contract as a whole, to examine the clause in more detail and to consider whether the wider factual matrix gives guidance as to its meaning in order to consider the implications of the rival interpretations.

Lord Hodge went on to describe the contractual context as "significant in this case". He referred to the detailed (time limited) warranties given by the Sellers and held that the scope of cl 7.11, breach of which gave rise to a liability unlimited in time, fell to be assessed in the context of those time limited warranties.

After adverting to the commercial sophistication of the parties to the SPA, Lord Hodge considered the business common sense of the provision from the point of view of each party and added this[56]:

> Business common sense is useful to ascertain the purpose of a provision and how it might operate in practice. But in the tug o' war of commercial negotiation, business common sense can rarely assist the court in ascertaining on which side of the line the centre line marking on the tug o' war rope lay, when the negotiations ended.

Consideration of the language used in the clause led Lord Hodge, for reasons substantially the same as Christopher Clarke LJ in the Court of Appeal, to prefer Mr Wood's proposed construction. He remained of that view after returning to a consideration of the commercial context and the practical consequences of the rival interpretations. Had clause 7.11 stood on its own, the requirement of a claim or complaint by a customer and the exclusion of loss caused by regulatory action which was otherwise prompted might have appeared anomalous. It was the inclusion in the SPA of the wide-ranging warranties which meant that cl 7.11 was not contrary to business common sense.

Conclusion

There is, following *Wood*, now no scope for contending that the decision in *Arnold* heralded a less purposive approach than was thought to prevail following *Rainy Sky*.

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55 At [26].

56 At [28].

SAAMCO revisited: a tale of two parables

It is probably wiser not to agree an investment in a property development with an old chum over two swift ones, and then a slow one, in a pub in Gloucestershire. It might result, some ten years later, in bankruptcy and an unsuccessful trip to the UK Supreme Court: *BPE Solicitors v Hughes-Holland*[57]. But that is what Mr Richard Gabriel, who was a semi-retired businessman, did with his then friend, Mr Peter Little, a builder and developer. Mr Little told Mr Gabriel that he wanted to borrow £200,000 for the proposed development of a disused heating tower on Kemble Airfield. Mr Gabriel agreed to lend the money on the assumption that it would be used to finance the project. In fact the building belonged to a company which was owned and controlled by Mr Little, and was subject to a bank charge for £150,000. Mr Little further intended to transfer the building to a special purpose vehicle which was to be used to carry out the development. The purchase by the SPV – which had no other funds – was to be funded from the £200,000.

An assistant solicitor at BPE acted for Mr Gabriel, but on the instructions of Mr Little, in a voicemail message. The solicitor drafted a facility letter and a charge by recycling a document from an earlier abortive deal, which contained statements that the loan moneys would be made available to assist with the costs of the development of the property. This unwittingly confirmed Mr Gabriel's misunderstanding of the arrangement. The project was a failure with no construction work ever carried out. Mr Gabriel lost all his money. The judge at first instance was not persuaded that the development was inevitably doomed, and awarded damages of £191,808.44, being the whole of Mr Gabriel's losses arising out of the transaction.[58] BPE appealed to the Court of Appeal. The Court of Appeal held that £200,000 of expenditure would not have increased the value of the property, that the project was never viable, and the loss had been attributable to Mr Gabriel's commercial misjudgements, and therefore reduced the damages to nil.[59] Mr Gabriel now bankrupt, his trustee in bankruptcy appealed to the Supreme Court, which dismissed the appeal.

The case is of interest in its reconsideration, in a careful judgment of Lord Sumption, of the issue of scope of the duty of care, most closely associated with the valuer's negligence case of *South Australia Asset Management Corp v York Montague Ltd (also known as Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd)*[60] (*'SAAMCO'*). Lord Sumption commenced:

'The issue on this appeal is, in summary, what damages are recoverable in a case where (i) but for the negligence of a professional adviser his client would not have embarked on some course of action, but (ii) part or all of the loss which he suffered by doing so arose from risks which it was no part of the adviser's duty to protect his client against. The problem may be illustrated by one of the most celebrated legal parables of modern times, the story of the mountaineer's knee devised by Lord Hoffmann in the course of argument in *South Australia Asset Management Corpn v York Montague Ltd* [1997] AC 191, at p 213:

"A mountaineer about to undertake a difficult climb is concerned about the fitness of his knee. He goes to a doctor who negligently makes a superficial examination and pronounces the knee fit. The climber goes on the expedition, which he would not have undertaken if the doctor had told him the true state of his knee. He suffers an injury which is an entirely foreseeable consequence of mountaineering but has nothing to do with his knee."

Like all parables, this one over-simplifies the issue and will not bear too much analysis. But it serves the purpose which its author intended, of introducing one of the main dilemmas of the law of damages.'

For Lord Sumption the central point was that judicial instinct filtered out certain elements of damages based on an assessment of the nature or extent of the duty which the wrongdoer had broken. Recognition of this limiting principle had been slow. It may be said that Lord Sumption's successful submissions in his mercenary guise as counsel in *SAAMCO*, and their acceptance and development by Lord Hoffmann, massively accelerated the modern prominence of this principle. The scope of the duty argument was explicitly linked to a dichotomy between advice cases and information by Lord Hoffmann (at 214):

'It is that a person under a duty to take reasonable care to provide information on which someone else will decide upon a course of action is, if negligent, not generally regarded as responsible for all the consequences of that course of action. He is responsible only for the consequences of the information being wrong. A duty of care which imposes upon the informant responsibility for losses which would have occurred even if the information which he gave had been correct is not in my view fair and reasonable as between the parties. It is therefore inappropriate either as an implied term of a contract or as a tortious duty arising from the relationship between them.

The principle thus stated distinguishes between a duty to *provide information* for the purpose of enabling someone else to decide upon a course of action and a duty to *advise* someone as to what course of action he should take. If the duty is to advise whether or not a course of action should be taken, the adviser must take reasonable care to consider all the potential consequences of that course of action. If he is negligent, he will therefore be responsible for all the foreseeable loss which is a consequence of that course of action having been taken. If his duty is only to supply information, he must take reasonable care

to ensure that the information is correct and, if he is negligent, will be responsible for all the foreseeable consequences of the information being wrong.'

As clarified in *Nykredit Mortgage Bank plc v Edward Erdman Group Ltd (No 2)* [1997] 1 WLR 1627, a party claiming damages has to satisfy a two-stage test: first, to prove that he had suffered a loss, and, secondly, to establish that the loss had fallen within the scope of the duty he had been owed.

Lord Sumption attempted to see off criticisms and misunderstandings of the *SAAMCO* principle. There were two key points. First, where the contribution of the defendant is to supply material which the client will take into account in making his own decision on the basis of a broader assessment of the risks, the defendant has no legal responsibility for his decision. Secondly, the principle has nothing to do with legal causation. Despite Lord Hoffmann's later more cautious extra-judicial thoughts ('Causation' (2005) 121 LQR 592), the scope or nature of the duty is the critical issue.

Glossing *SAAMCO* Lord Sumption rejected an advice/information dichotomy (at [39]): 'On the face of it they are neither distinct nor mutually exclusive categories. Information given by a professional man to his client is usually a specific form of advice, and most advice will involve conveying information. Neither label really corresponds to the contents of the bottle.' Less helpfully Lord Sumption was inclined to view the subsequent insurance broker 'advice' case of *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins*[61] as very much confined to its facts. The critical point here was that BPE had not assumed responsibility for Mr Gabriel's decision to lend money. Their instructions were confined to drawing up the facility agreement and the charge. Overall in place of a dichotomy between advice and information, Lord Sumption identified a spectrum of possibilities (at [44]):

'…because categorisation is inevitably fact-sensitive, I doubt whether it is helpful to describe either of Lord Hoffmann's categories as "normal" or "special". A valuer or a conveyancer, for example, will rarely supply more than a specific part of the material on which his client's decision is based. He is generally no more than a provider of what Lord Hoffmann called "information". At the opposite end of the spectrum, an investment adviser advising a client whether to buy a particular stock, or a financial adviser advising whether to invest self-invested pension fund in an annuity are likely, in Lord Hoffmann's terminology, to be regarded as giving "advice". Between these extremes, every case is likely to depend on the range of matters for which the defendant assumed responsibility and no more exact rule can be stated.'

Those of us who specialise in claims against investment advisers will appreciate the clarity provided by the last couple of sentences. In contrast, valuers and conveyancers will rarely undertake a duty extending beyond information-provision. Accordingly the Supreme Court over-ruled Chadwick J's reasoning in *Bristol and West Building Society v Fancy & Jackson (a firm)*[62] and the decision of the Court of Appeal in in *Portman Building Society v Bevan Ashford (a firm)*[63]. Hughes-Holland will now be the first, and probably last, port of call for questions of the scope of the duty of care, and identification of recoverable damages, in professional negligence cases. This is presumably of little comfort to Mr Gabriel.

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57 [2017] UKSC 21, [2017] 2 WLR 1029

58 [2013] BCLC 750

59 (2013) 16 ITELR 567

60 [1997] AC 191

Beyond *Bolam*: the standard of care in risk warning cases

It is well-established law that the standard of care in professional negligence claims is judged on the basis of the long-standing "Bolam" test (taken from *Bolam v Friern Barnet Hospital Management Committee*[64]), which requires the Court to ask the question *"whether the defendants, in acting in the way they did, were acting in accordance with a practice of competent respected professional opinion"*. In this way, deference has traditionally been shown to the knowledge and skill of the "professional" who should be judged only by the standards of his peers.

However, in recent years there has emerged a shift in judicial thinking away from the use of this test in cases where the duty of care encompasses a duty to explain risks. In such cases, it has begun to be recognised that leaving the extent of the explanation necessary to the judgment of the professionals involved could embody an overly paternalistic attitude to the person actually subjected to the risk, rather than giving them the opportunity to make their own, properly informed, decisions.

The Recent Authorities

This shift in thinking first emerged in the context of medical negligence, in *Montgomery v Lanarkshire Health Board*[65]. In *Montgomery*, the Supreme Court eschewed the Bolam test in the context of a doctor's duty to explain the risks associated with treatment to a patient. This, the Supreme Court concluded, was not a matter of purely professional judgment. The doctor's advisory role could not be regarded as solely an exercise of medical skill without leaving out of account the patient's entitlement to decide on the risks to her health which she is willing to run (a decision which may be influenced by non-medical considerations). Furthermore, because the extent to which a doctor may be inclined to discuss risks with a patient is not determined by medical learning or experience, the application of the Bolam test to this question was liable to result in the sanctioning of differences in practice which are attributable not to divergent schools of thought in medical science, but merely to divergent attitudes among doctors as to the degree of respect owed to their patients. The Supreme Court concluded therefore that a doctor is:

"under a duty to take reasonable care to ensure that the patient is aware of any material risks involved in any recommended treatment, and of any reasonable alternative or variant treatments. The test of materiality is whether, in the circumstances of the particular case, a reasonable person in the patient's position would be likely to attach significance to the risk, or the doctor is or should reasonably be aware that the particular patient would be likely to attach significance to it".[66]

While one can see the particular force of these arguments in the medical context, where bodily autonomy is of considerable importance, the same reasoning logically extends (and has been judicially extended) beyond risk warnings provided to patients. In *Baird v Hastings* [2015] NICA 22, the Court of Appeal of Northern Ireland, in dealing with a claim against a solicitor for allegedly negligent conduct of conveyancing transactions, noted the Supreme Court's decision in *Montgomery* and commented that:

"The doctor/patient relationship is not a full or true analogue of a solicitor/client relationship since the therapeutic duties owed by a doctor to a patient raises different questions from those arising between a solicitor and client. However, a solicitor is bound to take reasonable care to ensure that the client understands the material legal risks that arise in any transaction which the client has asked the solicitor to handle on his behalf. As in the doctor/patient relationship the test of materiality is whether a reasonable client would be likely to attach significance to the risks arising which should be reasonably foreseeable to the competent solicitor. As in the medical context, the advisory role of the solicitor must involve proper communication and dialogue with the client"[67]

Most recently, the applicability of the Bolam test has been considered in the context of the provision of financial services by Kerr J *O'Hare and anor v Coutts & Co*[68] The claimants in this case were a high net worth couple (their over-all wealth, including real property, was in the region of £38m), who had approached the defendant bank to provide them with investment advice. Relying upon that advice, they made various investments including £8m in three hedge fund products marketed by the bank in 2007-8, and a further £10m in two funds run by a subsidiary of the Royal Bank of Scotland (then mainly owned by the government) in 2010. The investments did not perform well, and the claimants issued proceedings alleging that all of these products were unsuitable for them, and were negligently recommended by the financial advisor for whom the bank was vicariously liable.

Kerr J dismissed the claim on the facts, but the most interesting part of the decision was his discussion on the applicable standard of care (found at paras 199 – 214 of his judgment).

He began with the uncontroversial statement that the law of tort imposed a duty (identical to the implied duty on contract) to use reasonable skill and care when recommending investments, and that, so far as the giving of advice is concerned, the standard is that of a reasonably competent practitioner in the relevant sector of the profession. The question for the court is therefore whether reasonable practitioners professing the

61 [2001] 2 All ER (Comm) 929, [2002] PNLR 8

62 [1997] 4 All ER 582

63 [2000] PNLR 344

expertise of the defendants could properly have given advice in the terms they did (standard Bolam fare)

However, he went on to cite the decisions in *Montgomery* and *Baird*, and noted that, in the context of investment advice too, there must be proper dialogue and communication between adviser and client. He concluded (at para. 204) that:

"I do not think the required extent of communication between financial adviser and client to ensure the client understands the advice and the risks attendant on a recommended investment, is governed by the Bolam test."

In drawing this conclusion, he pointed out that the relevant regulatory regime (here the Conduct of Business Rules Sourcebook, "COBS")) is strong evidence of what the common law requires (citing *Loosemore v Financial Concepts (a firm)*[69]; and *Green v Royal Bank of Scotland (Financial Conduct Authority intervening)*[70]), and that a duty to explain in terms not dissimilar to the *Montgomery* formulation is found in the COBS rules (in particular in rules 2.2.1(1) and 2.2.2(1)(b); rule 4.2.1(1); rule 9.2.1, 9.2.2, 9.2.3 and 9.2.6). He considered the content of those rules would be very difficult to square with the application of a conventional Bolam approach, as they do not include reference to a responsible body of opinion within the profession (see paras 208-9).

He was not swayed by the defendant's submission that there were differences between the medical and financial contexts. How much to say to a client was not a question to be decided according to whether the adviser acted in accordance with a practice accepted as proper by a responsible body of persons skilled in the giving of financial advice, because the expert evidence tended to indicate that there was little consensus in the financial services industry about how the treatment of risk appetite should be managed by an adviser, and, as in the medical context, the extent of required communication with the client should not depend on the attitude of the individual adviser (at paras 204-5). Instead he adopted the *Montgomery* formulation, essentially a test of the "materiality" of the risk which was unexplained.

In the writer's view, Kerr J's reasoning is to be welcomed. Financial advisors often use tools to assess the risk appetites of their clients in order to determine what financial products would suit them. *O'Hare* suggests that it is not enough for the advisor to aver that a product is suitable because he or she has "matched" his or her assessment of the risk profile of the investor with his or her perception of the risk category of the product, even where it can be established that that perception was shared by a reasonable body of professional opinion. The sorting of clients and products into risk into categories can be helpful to an extent (if only by narrowing the field – the utility is often more in excluding the unsuitable than selecting the suitable), but it cannot be the end of the story - just because a product is assessed as, for instance, "low risk" does not automatically mean it will suit a particular cautious client. The client must be informed of the actual material risks of the product so that they can make an informed decision whether to enter into it themselves.

O'Hare was cited in *Philip Thomas, Helen Thomas v Triodos Bank NV*[71], in which the Claimants sued the defendant bank for, inter alia, failing to explain to them the financial consequences which would flow if they entered into a 10 year fixed rate loan and subsequently tried to break it early. HHJ Havelock-Allan QC held that this was a non-advised transaction, but an intermediate duty of care had arisen requiring the bank to explain the financial implications of fixing the interest rate, in response to the claimants' enquiries (following *Crestsign Ltd v National Westminster Bank Plc [2014] EWHC 3043 (Ch)*[72]). *O'Hare* was not directly comparable, because it dealt with an advised transaction and the expert evidence indicated a lack of consensus in the financial services industry about how the treatment of risk appetite should be managed by an advisor (whereas in *Thomas*, there was a measure of agreement between the experts as to what information a bank would be expected to give in response to a customer's questions). However, HHJ Havelock Allan QC stated (albeit obiter) that :

"in case of doubt as to how far a bank should go in providing information in response to questions from the customer about a product in a non-advised transaction, I would resort to the test of materiality in the Montgomery case. The question to be asked is: would a reasonable person, in the position of the customer, be likely to attach significance to that piece of information?"[73]

The future for Bolam?

It is clear that the materiality test in *Montgomery* is finding a real foothold in other contexts, especially in the financial services field.

It is perhaps unsurprising that, in cases where there are comprehensive regulations which prescribe in detail what is required when undertaking particular tasks, a professional who fails to comply with these regulations should be held to have failed to exercise reasonable skill and care without reference to the general body of professional opinion. The editors of *Jackson and Powell on Professional Liability* (8th ed.) point out (at para 2-012) that *"In this way regulations and codes of conduct and guidelines can require a profession to achieve a higher standard than is currently being achieved and so effect a change in the required standard."* With a growing trend amongst professional bodies to publish written standards which reflect the best practices of the profession, it is an open question how far in the future the "codification" of professional standards wmight overtake the Bolam test in other contexts.

Certainly, there is every possibility that in the near future we will see a full review of the application of Bolam in the case of solicitors as well as IFAs who, in common with doctors, often undertake an advisory role in assessing risk with clients.

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64 [1957] 1 WLR 582

65 [2015] AC 1430

65 at para. 87, per Lord Kerr and Lord Reed JJSC

67 at para 34, per Girvan LJ delivering the judgment of the court

68 [2016] EWHC 2224 (QB).

Case note: *Jackson v Leslie & Nuding*[74]

On 30 May 2017, the Court handed down judgment in *Jackson v Leslie & Nuding*[75] – in which Mr Jackson sought damages for the loss of virtually the entire value of his pension fund of c£1.7m.

Leslie & Nuding, an authorised firm, had been asked to review the investment profile of the pension fund in 2008 and failed to recognise that it was unsuitably invested in a single asset class i.e. traded life policies (TLPs) in the (inaptly named "Utopia Fund") and in the Secure Capital Fund (another TLP fund). The adviser – Mr Swallow - had advised Mr Jackson to invest his pension fund in the Utopia (TLP) fund in 2005 when working for a different authorised firm. Shortly after joining Leslie & Nuding he advised further investment in Secure Capita.

TLPs as an asset class are unregulated collective scheme investments (UCIS). They attracted the attention of the Financial Services (now Conduct) Authority (FSA) between 2010 and 2012 resulting in the publication in January 2012 of *Finalised Guidance on TLP Investments*. The FCA strongly recommended that TLPs "*should not reach the vast majority of retail clients*" because they were unsuitable by reason of key risks to which they were exposed, among them:

- the Longevity risk (that the life insured might live longer than expected, so the Fund needs to fund premiums for longer than expected which *"could negatively affect the return on investment and liquidity on an on-going basis"*);
- the Liquidity risk (because TLPs are in their nature illiquid until maturity and there is only a limited secondary market for them);
- the Counterparty risk (that the insurer becomes insolvent or declines to pay e.g. for reasons of non-disclosure);
- the Structural risk (arising from the fact that in some models *"yields are promised to previous investors, which can only be sustained by using new investors"* money, so the model in effect 'borrows' from itself");
- the Governance Risk (because the vast majority of TLP investments are based off-shore and are not covered by the Financial Services Compensation Scheme); and
- the Cross Subsidy risk (present in funds where investors' monies and the assets purchased with those funds are pooled with the result that investors redeeming early may get a fuller return than those remaining invested).

The FCA's view was that TLP investments *"are complex and high risk, and are unsuitable for the vast majority of retail clients"*.

By the date of the trial the Utopia Fund was in lock-down and of no certain value. The case is important for a number of reasons. In particular:

- the Judge rejected the defendant's argument that the FCA concerns were being applied retrospectively. HHJ Havelock-Allan QC concluded [88]: *"Whilst the FSA's intervention came long after the sale to Mr Jackson in the autumn of 2005, the risks described in its Finalised Guidance were all risks to which the Utopia TLP Fund was exposed and would have been obvious to any financial adviser taking reasonable care in carrying out due diligence"*;
- although the value of the Utopia Fund was uncertain – in that it's illiquid nature made it impossible to conclude whether in the long run it may provide a return to Mr Jackson – the Court was prepared to assume it had no value (subject to Mr Jackson agreeing to assign his interest in the fund to the defendant); and
- the Court decided that although it is permissible to recommend and arrange investments in unregulated collective investment schemes in certain circumstances, such as where the investor is already invested in a UCIS, this did not apply where the adviser had previously mis-advised the investor he was a suitable candidate for a UCIS investment.

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69 [2001] Lloyds Rep PN 235, at page 241 per HHJ Jack QC

70 [2014] Bus LR 168, at para 18 per Tomlinson LJ

71 [2017] EWHC 314 (QB)

72 [2015] 2 All E.R. (Comm) 133

73 at para. 89

Illegality: what is left of *Stone v Rolls*?

Practitioners will be aware of the troublesome decision of the House of Lords in *Moore Stephens (a firm) v Stone & Rolls Limited (in Liquidation)*[76], where auditors successfully deployed a defence of illegality to stop in its tracks a professional negligence claim brought by a liquidator. That decision followed the earlier House of Lords decision in *Tinsley v Milligan*[77] to the effect that a claimant cannot rely on his own illegal act to bring a claim. However, two recent Supreme Court decisions (*Bilta v Nazir*[78] and *Patel v Mirza*[79]) require reconsideration of what *Stone & Rolls* now establishes, if anything.

Stone & Rolls

Moore Stephens (MS) acted for Stone & Rolls Limited (SR) as its auditors. SR went into insolvent liquidation and the Liquidators started a recovery action against MS in the name of SR for breach of its duty of care and skill. The case was an appeal by the Liquidator against a decision to strike out his claim.

Mr Stojevic was the *'sole directing mind and will'* (and sole shareholder) of SR. He worked with a company (BCL Ltd) to generate fraudulent documentation relating to the delivery of goods from SR to BCL Ltd. This documentation was then used by BCL Ltd to obtain letters of credit from banks in SR's favour. The banks were given deceitful assurances by SR that it held invoiced goods when no goods in fact existed. The claim brought by the Liquidator was based on 30 such letters which were used to draw $90m from one particular bank (Komercni Banka SA). $80m of the money was paid to BCL Ltd and related companies and then 'disappeared'. Claims were successfully brought by Komercni against Stojevic & SR, which then resulted in SR going into liquidation.

The Liquidator then brought a claim in the name of SR against MS on the basis that they had failed to perform even basic checks that the goods existed as part of the annual audit. As the detection of fraud was *'the very thing'* MS were retained to do, SR argued that as auditors they should be found liable for the losses suffered by SR.

For the purposes of the appeal, MS accepted that they owed a duty to SR and accepted that they were in breach of that duty. However, it was argued that MS was not liable on the following grounds: SR was a company that had a sole director and shareholder (Mr Stojevic) and as such he was the sole directing mind and will of SR and the only person interested in it. The acts and knowledge of the company and that sole director could not therefore be separated. Mr Stojevic was a fraudster using SR as a vehicle through which he could defraud banks. As a result, MS defended the claim primarily on the basis of *ex turpi causa non oritur actio*.

The maxim was historically viewed as working in such a way as to prevent a claim succeeding if a claimant has to rely upon his own illegal conduct. Its effect was viewed as effectively procedural in nature and requiring an assessment of the essential averments of the particulars of claim to ascertain whether its effect is triggered; Lord Phillips in *Stone & Rolls* observed that illegality had not to be pleaded, lead in evidence or relied upon for the rule to be avoided.

It is worth having in mind that on the facts of the case, MR, as SR's auditors, failed to identify the fraudulent operations. However, Lord Phillips found with the majority (with Lord Scott and Lord Mance dissenting) that the claim did necessarily involve the allegation that its directing will and mind infected SR with turpitude and *ex turpi causa* applied in those circumstances. Likewise, Lord Brown found that SR was in no better position than Mr Stojevic due to the fact that he was the *'sole actor'* and Lord Walker opined that Mr Stojevic's state of mind was imputed to that of the company, also on the basis that it was a *'one man'* company.

To recover damages, SR would have had to establish that the scope of duty owed by MS extended to taking reasonable care to ensure that SR was not used as a vehicle for fraud, and that the duty was owed for the benefit of those that the company might defraud. The House of Lords found that such a duty would be an untenable extension of *Caparo v Dickman*[80], which is a case which is authority for the proposition that auditors do not owe an independent duty of care to shareholders. It was reasoned if auditors do not owe a duty of care to shareholders they should not owe a duty to creditors of an insolvent company. In his dissenting judgment, Lord Mance disagreed and concluded that when a company became insolvent different considerations applied so as to justify the conclusion that the illegality defence should not be permitted to succeed.

Accordingly, on one analysis, *Stone & Rolls* stood as authority for the proposition that a company claim brought by a Liquidator against a third party professional will not succeed if the company has a *'sole directing mind and will'* and a sole shareholder and has to rely on its own illegal act to found the cause of action. But over the years the decision has been heavily criticised. The majority speeches each contain different reasoning and Lord Walker subsequently recanted from the speech he gave.

74 John Virgo acted for Mr Jackson

75 (2017 [EWHC] 1308)

Bilta

The ambit of the defence was given further consideration in the context of a claim against former company directors. The defendants were the sole directors of the claimant company and owed fiduciary duties to the company. The company's Liquidators claimed that a conspiracy existed to injure and defraud the company by trading in carbon credits and dealing with the resulting proceeds in such a way as to deprive the company of its ability to meet its VAT obligations on such trades. It was claimed that the defendants were knowingly parties to the business of the company with intent to defraud creditors and for other fraudulent purposes, and should therefore be ordered under s.213 of the Insolvency Act 1986 to contribute to the company's assets. The defendants, whom it was claimed had dishonestly assisted the conspiracy, applied for summary judgment on the grounds, among others, that the claim by the company was precluded by application of the maxim *ex turpi causa non oritur actio* on the basis that the pleaded conspiracy disclosed the use of the company to carry out a VAT carousel fraud, the only victim of which was HMRC. Since the company was a party to the fraud, the defendants argued that it could not claim against the other conspirators for losses which it had suffered as a result of the fraud.

The application was refused on the grounds, among others, that the defence of *ex turpi causa non oritur actio* was not available to the defendants. The Court of Appeal upheld that decision, and the defendants appealed to the Supreme Court who dismissed the appeal. The Supreme Court considered attribution principles and stated that in most circumstances the acts and state of mind of its directors and agents could be attributed to a company by applying agency principles, but ultimately the key to any question of attribution was always to be found in considerations of context and the purpose for which the attribution was relevant. So, where the purpose of the attribution was to apportion responsibility between a company and its agents so as to determine their rights and liabilities to each other, the result would not necessarily be the same as it would be in a case where the purpose was to apportion responsibility between the company and a third party. Where a company had been the victim of wrongdoing by its directors, or of which its directors had notice, that wrongdoing or knowledge of the directors could not be attributed to the company as a defence to a claim brought against the directors by the company's liquidators, even if it might be in other types of proceedings.

The decision in *Bilta* is particularly of note however for the doubt it cast on the decision in *Stone & Rolls*. Lord Neuberger (with whom two other Lordships concurred) had the following to say[81] when referring to the third proposition identified by Lord Sumption (namely *"as between a "one-man" company and a third party, the latter could raise the illegality defence on account of the agent's dishonesty, at any rate where it was not itself involved in the dishonesty"*):

'While it appears that the third proposition, as extracted from three judgments in Stone & Rolls, would so apply, I have come to the conclusion that, on this appeal at least, we should not purport definitively to confirm that it has that effect. I am of the view that we ought not shut the point out, in the light of (a) our conclusion that attribution is highly context-specific..., (b) Lord Walker's change of mind..., (c) the fact that the three judgments in Stone & Rolls which support the third proposition are not in harmony..., and (d) the fact that the third proposition is in any event not an absolute rule...'

Lord Neuberger also stated agreement with the second proposition identified by Lord Sumption (namely that the defence did not apply where there were innocent shareholders), but beyond qualified support for the third proposition (as above), and approval of the second proposition, he (and two other Lordships) were unwilling to go beyond, stating[82]:

'Subject to these points, the time has come in my view for us to hold that the decision in Stone & Rolls should, as Lord Denning MR graphically put it in relation to another case...be put "on one side in a pile and marked 'not to be looked at again' ". Without disrespect to the thinking and research that went into the reasoning of the five Law Lords in that case, and although persuasive points and observations may be found from each of the individual opinions, it is not in the interests of the future clarity of the law for it to be treated as authoritative or of assistance save as already indicated.'

So, even ignoring the decision in *Patel*, the question of whether a claim may be brought against a third party professional firm, even in a 'one-man' company scenario, where that company is insolvent, is now an open one, and the prevailing mood in the Supreme Court appears to recognise that different considerations may, or should, prevail where the company is insolvent.

Patel

That conclusion is reinforced by *Patel*, where the Supreme Court has jettisoned the *Tinsley* approach to illegality in favour of a more nuanced public policy approach. In *Patel*, the respondent transferred sums totalling £620,000 to the appellant for the purpose of betting on the price of shares, using advance insider information which the appellant expected to obtain from contacts regarding an anticipated government announcement which would affect the price of the shares. The appellant's expectation proved to be mistaken and so the intended betting did not take place, but the appellant failed to repay the money to the respondent despite promises to do so. The respondent brought a claim for the recovery of the sums which he had paid on various grounds, including breach of contract and unjust enrichment. The agreement between the parties amounted to a conspiracy to commit an offence of insider dealing and, in order to establish his claim for the return of his money, it was necessary for the respondent to explain the nature of the agreement.

Applying the 'reliance principle' stated in *Tinsley*, the judge at first instance held that the respondent's claim to recover the sum paid was unenforceable because he had to rely on his own illegality to establish it and he could not bring himself within the *locus poenitentiae* exception, since he had not voluntarily withdrawn from the illegal scheme. In the Court of Appeal, the majority agreed with the judge on the reliance issue, but disagreed with him on the application of the *locus poenitentiae* exception. They held that it was enough for the claim to succeed that the scheme had not been executed. The appellant appealed to the Supreme

76 [2009] UKHL 39
77 [1994] 1 AC 340
78 [2015] UKSC 23
79 [2016] UKSC 42
80 [1990] 2 AC 605

Court, and the issue for determination was whether the illegality defence precluded a party to a contract tainted by illegality from recovering, under the law of unjust enrichment, money paid under the contract.

The appeal was dismissed by the Supreme Court, who held that the essential rationale of the illegality doctrine was that it would be contrary to the public interest to enforce a claim if to do so would be harmful to the integrity of the legal system. In assessing whether the public interest would be harmed in that way, it was necessary to consider: (i) the underlying purpose of the prohibition which had been transgressed and whether that purpose would be enhanced by denial of the claim; (ii) any other relevant public policy on which the denial of the claim might have an impact; and (iii) whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment was a matter for the criminal courts. Accordingly, the reliance rule as laid down in *Tinsley* should no longer be followed. The public interest was best served by a principled and transparent assessment of the considerations identified, rather than by the application of a formal approach capable of producing results which might appear arbitrary, unjust and disproportionate. Accordingly, a person who satisfied the ordinary requirements of a claim in unjust enrichment would not, *prima facie*, be debarred from recovering money paid or property transferred by reason of the fact that the consideration which had failed was an unlawful consideration.

Conclusions

So, returning to the question posed in the title to this article, what is left of *Stone & Rolls*? It would appear not much, but until a claim is brought by a liquidator of an insolvent company against an auditor or other third party professional it remains to be seen whether any remnants of it can be revived, perhaps under the guise of scope of duty and a rigid application of Caparo.

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81 At [28]

82 At [30]. See also Lord Mance's criticism of Stone & Rolls at [46], and Lords Toulson and Hodge's relegation of its authoritative status at [154]: "*We conclude that Stone & Rolls should be regarded as a case which has no majority ratio decidendi. It stands as authority for the point which it decided, namely that on the facts of that case no claim lay against the auditors, but nothing more*". Lords Toulson and Hodge were also keen to emphasise (at [123]-[130]) that different principles apply when a company is insolvent, and that it would be contradictory and contrary to the public interests if in such circumstances fraudulent directors could shield themselves behind their control of the company on the ground that their illegality tainted the liquidators' claim.

Equal partners: what does the equality act have to say?

Picture the scene: a partnership is adopting a new and innovative business model (purely paperless, entirely cloud-based and even utilising AI to perform certain tasks undertaken by lawyers). I hate to break the news, but this is not the script of some dystopian, post-apocalyptic sci-fi movie, but a not-to-distant reality (although I quickly digress). The partnership anticipates opposition from one of its number. The individual is resistant to change and in addition to philosophical differences, the partnership has developed performance concerns. The individual is below target and showing visible signs of buckling from work-related pressure. More importantly, the partner is widely perceived as *"abrasive"*. After much soul-searching, the partnership has decided upon expulsion and is therefore seeking advice.

There would likely be several pertinent questions at the top of any lawyer's list: what does the partnership agreement say; does it contain an expulsion clause; how wide is the clause; do all the partners agree? Perhaps less likely are questions such as: how old is the partner; what sex are they and has a recent health assessment been obtained? Based on the facts above, each of these questions are potentially relevant to how the Equality Act 2010 may interact with the partnership agreement and the intention to expel.

Within the confines of the limited column inches available to me, I could not hope to embark upon a thorough dissection of the EqA nor is that necessary. Instead, this article provides an overview intended to signpost to the busy practitioner those aspects of the EqA which might intersect with their partnership practice. It is possible there exists a lacuna within the legal market. The EqA is bread and butter for an employment lawyer, but they may infrequently deal with partnership disputes. Conversely, those whose practice includes partnership disputes, may seldom encounter the EqA. This article hopes to ameliorate that possible gap. We will therefore consider the following topics in turn:

a How to navigating the EqA;

b Key concepts of the EqA;

c Applying the EqA to partnerships; and

d Enforcement under the EqA.

Navigating the EqA

The most useful point to observe is the EqA's helpful structure. Whilst it consists of 16 parts and a shade over 200 sections, it is far less daunting that it might at first appear. In any given situation, one typically has regard to no more than 3 parts:

a Part 2: Key Concepts;

b Part 3-7: Application to various circumstances (only 1 will apply); and

c Part 9: Enforcement.

Part 2 deals with the concepts used elsewhere. It defines the various protected characteristics, obligations and restrictions. Parts 3 – 7 deal with the application of part 2 to various specific areas (services and public functions, premises, work, education and associations). In the context of a partnership it is to part 5 (work) that we would turn. Part 9 deals with what happens when things go wrong.

It is however, worth briefly mentioning parts 8 and 10. Part 8 is a short area (5 sections) dealing with ancillary matters relevant to prohibited conduct (relationships that have ended, vicarious liability and claims of inducement). In practice, these sections would have been at home within part 2. Part 10 deals with contractual agreements which seek to frustrate the effect of the EqA (in short, it cannot).

This hopefully provides a useful, albeit brief whistle-stop tour of the EqA and demonstrates one need only be closely familiar with 3 of its parts (and associated schedules). One might even argue, that in truth it is only part 2 (consisting of a mere 23 short sections) which is likely to exercise the grey matter to any great extent.

Key concepts (Part 2)

The key concept provisions are divided by 2 chapters, *"Protected characteristics"* and *"Prohibited Conduct"*, which largely do what they say on the tin. The latter may however, appear to be somewhat of a misnomer as it encompasses not only prohibited but mandatory conduct (such as the duty to make reasonable adjustments).

There are 8 protected characteristics, which are listed alphabetically in s.3 and then each separately defined in ss.4-12. These are:

a Age;

b Disability;

c Gender reassignment;

d Marriage and civil partnership;

e Race;

f Religion or belief;

g Sex; and

h Sexual orientation.

In most cases, the definitions will prove relatively straightforward and would be as one might broadly expect. Disability however, has a specific definition which is set out in s.6 and supplemented in Schedule 1. Disability is perhaps one of the more common characteristics to arise in partnership disputes and has a definition which is not necessarily intuitive. It can be broken down as requiring the following:

a That P has a mental or physical impairment;

b That impairment has an adverse effect on P's ability to carry out normal day-to-day activities and where that effect is both:

- Substantial (read not minor or trivial); and
- Long-term (read likely to last for 12 months or more).

There is no longer a prescribed list of day-to-day activities, instead adopting a broad common-sense approach. The long-term requirement can however, prove tricky as the test is forward looking (having regard to likelihood). It might - for example – apply to someone who has suffered with anxiety for 2 months, if it is likely to last for a further 10. This will depend upon the evidence and information available, but by its nature it can be predicative. Of course, the shorter the duration, the less likely the test will be met. The inherent uncertainty however, is naturally problematic.

Having identified the scope of who is protected, one must turn to consider what is required and prohibited. There are 6 main provisions, which are frequently encountered. These are as follows

a Direct discrimination (s.13);

b Discrimination arising from Disability (s.15);

c Indirect Discrimination (s.19);

d Failure to make reasonable adjustments (s.21);

e Harassment (s.26);

f Victimisation (27).

Each of these requires consideration which is beyond the scope of this article. It is however, worth briefly mentioning s.15 (a new cause of action introduced by the EqA). Unlike other forms of discrimination, one is not concerned with whether the disability itself sits behind any conduct, but whether it is because of something arising in consequence of that disability. For example, reprimanding a partner for falling asleep at their desk, might engage s.15 if sudden sleep onset were a side effect of their medication. Falling asleep is not the disability but it is caused by it. There is however a defence of justification (unlike with direct discrimination). As the discrimination is a step (or 2) removed from the disability, s.15 is not one that would naturally spring to mind unless one is familiar with the EqA. It can however, have significant implications for partnerships and their agreements.

In addition to the above there are other specific provisions in relation to the following:

a Gender reassignment absences (s.16); and

b Pregnancy and maternity cases (s.17 and 18).

With these few paragraphs, one can see that part 2 is easy to follow.

Application to Partnership Disputes (Part 5)

By virtue of part 5, (and in particular ss.44 and 45), the concepts in part 2 apply to both partnerships and LLPs. Notably, it also applies to *"prospective"* firms and LLPs. Moreover, it applies not only to existing partners and members but to those who have applied for partnership and indeed others (such as those refused partnership – whether or not they applied).

Unlike other parts (which permit various exceptions), part 2 applies in full to part 5. Accordingly, s.44 (as to partnerships) and s.45 (as to LLPs) set out the application of part 2. In respect of both models the formulation is materially the same. This prohibits the following:

a Discrimination (of all kinds);

b Harassment;

c Victimisation; and

d A failure to make reasonable adjustments.

In relation to those who are not partners or members, the EqA prohibits discrimination:

a in the arrangements made for deciding to whom to offer partnership;

b as to the terms of any such offer; or

c by not making an offer.

In relation to existing partners/ members it prohibits discrimination:

a as to the terms on which X is a partner;

b in the way the partnership affords access, (or by not affording access) to opportunities for promotion, transfer or training or for receiving any other benefit, facility or service;

c by expelling X; and

d by subjecting X to any other detriment.

The word *"detriment"* is especially (and intentionally) wide and covers any treatment which a reasonable person would consider to be to their disadvantage.

Returning then to our opening scenario it is possible to see how the EqA might affect any attempt to expel the partner. For example:

a Has age played a part in the perception X is resistant to change? Is this part of a stereotypical view that *"You cannot teach an old dog, new tricks"*? If so, this might constitute direct age discrimination;

b Has the move towards a paperless, cloud-based, AI driven system caused partners in an older age group to be placed at a particular disadvantage compared to those who are younger? If so, can the partnership objectively justify its move? Could it, for example, have instead provided greater training or allowed a greater transitional phase? If not, it is possible X might succeed in a claim of indirect age discrimination;

c What about the visible signs X is not coping with pressure? Is this a symptom of X suffering from an underlying mental health impairment, such as anxiety or depression? Have these observations put the partnership on notice X is disabled? If so, has the partnership made proper enquiries or made reasonable adjustments? Any omission could lead to a claim for direct discrimination, discrimination arising from disability and failure to make reasonable adjustments; and

d What about the perception X is *"abrasive"*? Are other partners guilty of the same tone and manner? If so, why has this partner been perceived differently? Is it based on any protected characteristic? Research has suggested strong female characters are viewed more negatively than strong male characters. Is this the source of that perception? If so, there might be a claim for direct sex discrimination.

This article does not seek to convey the message that partnerships should be afraid of the EqA. Its application, whilst seeking to prevent all forms of discrimination, recognises that companies, firms and LLPs have a business to conduct. What is however, important, is that partnerships and LLPs are aware of the context in which their agreements and decisions might operate and to accordingly be alive to the implications of the EqA. This is especially so given the enforcement provisions, to which we shall now turn.

Enforcement and Jurisdictional Issues (Part 9)

One need only say a little about enforcement, but what is said is worthy of note. Part 9 comprehensively deals with the enforcement of claims under the EqA. The single most important matter to observe is that under s.120, the employment tribunal has exclusive jurisdiction to determine EqA claims involving partnerships and LLPs. This provides a very different regime to that which is provided by the civil courts. For example:

a Claims must be filed within 3 months (s.123), subject to ACAS early conciliation;

b The claim will be heard by an Employment Judge, most likely sitting with two lay members. Although the Judge will conduct the proceedings, a majority verdict is all that is required;

c Strict rules of evidence do not apply; and

d The tribunal operates within a no-costs regime. Unless one of the exceptions apply (such as vexatious or unreasonable conduct is found) the successful party will bear their own costs. Discrimination trials can be lengthy!

Conclusion

It is hoped that by this conclusion the following points have been established:

a The EqA, with good signposting, is easy to navigate;

b The key concepts are clearly set out and easily ascertainable;

c The EqA can significantly impact upon a partnership; and

d The different enforcement regime is worthy of particular note.

It is further, hoped this article has helped put the EqA firmly on the practitioner's radar with sufficient information to spot early warning signs. Later in this year, we will be providing seminars on the EqA in the context of partnerships, for those looking to deepen their understanding. Hopefully the appetite has been sufficiently whetted.

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Data Subject Access: improper motive means invalid request?

Data subject access requests

Under s.7 Data Protection Act 1998, (the "DPA") an individual who is a data subject is entitled to request from an organisation (the data controller) which processes and holds personal data about him copies of that personal data. The request must be made in writing and is referred to as a data subject access request, ("DSAR").

The data controller organisation must respond to the DSAR promptly and in any event within 40 days, (s.7(8) and s.7(10) DPA). The data controller can charge the data subject a maximum fee of £10 for responding to the DSAR. If a data controller fails to respond to a DSAR, then upon application to the Court by the data subject, the Court has a discretionary power pursuant to s.7(9) DPA to order compliance by the data controller.

Over the years, there has been much debate about the extent of the duty to respond to a DSAR; the meaning and parameters of the 'personal data' which must be provided in response to a DSAR; and whether or not a data controller can decline to respond to a DSAR where it considers that the DSAR is made with a view to obtaining information to assist with litigation or complaints against the data controller.

What has happened?

The Court of Appeal has recently considered certain issues relating to DSARs in two separate appeals: *Dawson – Damer v Taylor Wessing LLP*[83]; and in the joined appeals of *Deer v University of Oxford* and *Ittihadieh v 5-11 Cheyne Gardens*[84] (which were heard together by a differently constituted Court of Appeal).

Why is it important?

In handing down judgment in the above appeals, the Court of Appeal has provided valuable authority on a range of important issues including:

- the extent of the legal professional privilege exception which allows a data controller to refuse to provide copies of documents containing personal data which are subject to legal professional privilege;
- the extent of the obligation imposed upon a data controller to undertake a reasonable and proportionate search for data in response to a DSAR;
- the motive of the data subject in making the DSAR and whether it is relevant to the question of compliance by the data controller with the DSAR; and
- the exercise of discretion by the Court to order compliance with a DSAR pursuant to s.7(9) DPA.

Relevance of the motive of the data subject in making the DSAR

It is worth highlighting in particular the issue of the relevance of the motive of the data subject in submitting a DSAR and whether the existence of a collateral motive can provide grounds upon which the data controller lawfully can refuse to respond to the DSAR and/or grounds for the Court to refuse to make an order for compliance pursuant to s.7(9) DPA.

The submission of a DSAR in order to obtain copy documents and data has long been a useful tool in litigation, both at the pre-action stage and following issuance of proceedings. The regulatory regime and applicable criteria for compliance with a DSAR are of course entirely distinct from the disclosure regime pursuant to the Civil Procedure Rules.

There have been several differing decisions at first instance, but based on a particular paragraph in the judgment of the Court of Appeal in *Durant v Financial Services Authority*[85], frequently it has been argued that the purpose of the data subject access right at s.7 DPA is to enable a data subject to check the accuracy of the personal data held about him and to check that it is not being processed unlawfully and that the purpose of the data subject access right is not to *'assist [the data subject] to obtain discovery of documents that may assist him in litigation or complaints against third parties'*.[86]

However, in *Dawson-Damer* the Court of Appeal held that *Durant* did not establish a rule that a data subject should not exercise his subject access rights for purposes outside the DPA and that the above passage from the judgment in *Durant* did not establish that a DSAR would be invalid if made for the collateral purpose of assisting in litigation.[87]

Hence, even if a DSAR was made with a view to obtaining documents to assist in litigation or otherwise to assist with a complaint that would not invalidate the request and nor would it present a barrier to the order by the Court of relief pursuant to s.7(9) DPA. The Court noted that the right contained at s.7 DPA is not expressed to be subject to any purpose or motive test. Notably, the conclusion of the Court chimes with the views consistently expressed by the Office of the Information Commissioner.

The issue was further explained by the Court in the appeals of *Deer* and *Ittihadieh*. The Court expressed agreement with the judgment in *Dawson-*

83 [2017] EWCA Civ 74
84 [2017] EWCA Civ 121
85 [2003] EWCA Civ 1746
86 *Durant*, per Auld LJ, at [27]
87 *Dawson-Damer*, per Arden LJ, at [108] and [110] – [112]
88 per Lewison, LJ at [86] and [110]
89 per Lewison, LJ at [110]

Damer, but went on to clarify that whilst having a collateral purpose for making the DSAR would be no barrier to relief, the motive underlying the DSAR is still relevant to the extent that the data subject lacked a legitimate reason for making the DSAR, or the DSAR and/or application for relief amounted to an abuse of process.[88]

Further, the Court analysed the factors to be taken into account by a Court when exercising its discretion in respect of an application for relief pursuant to s.7(9) DPA and held that the Court should take into account the following[89]

- whether there is a more appropriate route to obtaining the requested data;
- the reason for the DSAR;
- whether the DSAR is an abuse of rights or procedure;
- whether the DSAR amounts to a request for documents rather than personal data; and
- the potential benefit to the data subject of granting relief.

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