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Brexit and its Implication for Restructuring and Corporate Insolvency in the UK

Gerard McCormack[*]
University of Leeds

Hamish Anderson[**]
Norton Rose Fulbright

Brexit; Business restructuring; Cross-border insolvency; EU law

Introduction

The UK Prime Minister, Theresa May, has famously said that "Brexit means Brexit", but the precise implications of this pronouncement are as yet uncertain. Certainly, this is the case in the cross-border insolvency and corporate restructuring fields. Essentially, the effect of Brexit depends on:

- the outcome of negotiations under art.50 of the Treaty on European Union for Britain's withdrawal from the EU;
- the terms of the so-called "Great Repeal" Bill that will repeal the European Communities Act 1972, which gave effect to the UK's membership of the European Economic Community (EEC), which later became the EU, as well as incorporating certain aspects of EU law into domestic UK law[1];
- the terms of any replacement arrangements between the UK and the EU (the remaining 27 EU Member States).

This article addresses the likely scenarios for cross-border insolvency and corporate restructuring in a post-Brexit world from a UK perspective. It consists of six sections and a conclusion. The first section reviews the current cross-border insolvency landscape and the influence of European law in this area. The second does the same for corporate restructuring law, particularly in the form of schemes

[*] Professor of International Business Law

[**] Consultant. This article reflects the personal views of the authors and none of the opinions expressed therein can be attributed in particular to Norton Rose Fulbright or any of its affiliates. Nor can the views expressed in the article be attributed to INSOL International. The authors have completed this article as part of a larger project for INSOL International on the effect of Brexit on corporate restructuring and insolvency and the assistance of INSOL International is gratefully acknowledged.

[1] On the "Great Repeal Bill", see further the House of Commons Library Briefing Paper, "Legislating for Brexit" (02 May 2017), available at *http://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7793#fullreport* [Accessed 08 August 2017]. The Bill is officially titled the European Communities (Withdrawal Bill) and was published on 13 July 2017—see *https://www.publications.parliament.uk/pa/bills/cbill/2017-2019/0005/18005.pdf* [Accessed 07 August 2017]. It is not clear what will be the final form of the Bill, given that it is subject to a lengthy process of parliamentary debate and scrutiny.

of arrangement under the Companies Act 2006. The third section focuses on the issue of how the current law deals with foreign insolvency proceedings insofar as they purport to discharge or modify English law governed obligations. The fourth section considers the effect of a "hard" Brexit on the existing corporate restructuring and insolvency landscape in the UK. A "hard" Brexit in this area is understood to mean leaving the EU and the European Insolvency Regulation (EIR) regime without there being any replacement agreement in place to mirror the effect of the EIR. The section expressly concludes that the absence of any alternative or replacement regime would be detrimental to both the UK and the EU. The fifth section considers what the UK and the EU might each do unilaterally to fill the gap.[2] The sixth and final section considers the terms of a possible alternative or replacement regime between the UK and the EU 27.

Cross-border insolvency landscape—pre-Brexit

The UK has three main statutory vehicles for international/cross-border co-operation in insolvency matters—the EU Regulation on Insolvency Proceedings (supplemented by sector-specific instruments[3]), the UNCITRAL Model Law and s.426 of the Insolvency Act 1986. Additionally, there is the common law to the extent that it has not been superseded in relation to particular matters. The common law had been in a state of arrested development, but in recent years there have been a series of decisions from both the House of Lords/UK Supreme Court and Privy Council on cross-border insolvency at common law and, in particular, on the limits of common law judicial assistance in respect of foreign insolvency proceedings.

But the most significant change over the past 20 or so years has come with the promulgation and coming into force of the European Insolvency Regulation (EIR), Regulation 1346/2000. The provisions of this regulation have been amended somewhat or "recast" with the recast Regulation—Regulation 2015/848—applying to proceedings opened on or after 26 June 2017.[4] The Regulation only applies, however, where a debtor that is the focus of the insolvency proceedings has its centre of main interests (COMI) in the EU. If the debtor has its COMI outside the EU, then the EIR does not apply.

[2] The term "English" is used here and elsewhere in this article to mean England and Wales. England and Wales as a jurisdiction form the focus of this article, but most of the points made in relation to England and Wales are also likely to be relevant for Northern Ireland and Scotland (and reference is made the UK and UK law without attempting to differentiate the constituent jurisdictions).

[3] For these sector-specific instruments, see Directive 2001/24 [2001] OJ L125/15 on the reorganisation and winding-up of credit institutions as amended by the Bank Resolution and Recovery Directive—Directive 2014/59 [2014] OJ L173/190; and now Directive 2009/138 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) [2009] OJ L335/1.

[4] For the original European Commission recommendations for reform of the Regulation, see Proposal for a new Regulation COM(2012) 744, and see also *Report from the Commission on the application of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings*, COM(2012) 743 and the Hess-Oberhammer-Pfeiffer external evaluation of the Regulation commissioned by the European Commission: see JUST/2011/JCIV/PR/0049/A4.

European Insolvency Regulation (EIR)[5]

The EIR is directly applicable law and constrains the jurisdiction of the UK courts (and other national courts) to open insolvency proceedings in respect of a debtor. The EIR establishes uniform rules on both jurisdictions to open insolvency proceedings and the choice of which law applies in respect of those proceedings. "Main" insolvency proceedings may be opened where the debtor has its centre of main interests (COMI) and secondary proceedings may be opened where the debtor has an "establishment".[6]

The EIR implements a philosophy of modified or mitigated universalism.[7] In theory, main insolvency proceedings apply to all the debtor's assets irrespective of location, though the possibility of opening secondary proceedings in a state where the debtor has an establishment qualifies the universal scope of the main insolvency proceedings. Secondary proceedings operate in respect of assets located in the state where the debtor has an establishment.[8] As well as establishing express jurisdictional rules, the EIR also has conflicts of law rules with the law of the state that opens insolvency proceedings, whether main or secondary, applying generally to those proceedings, subject to certain exceptions.[9]

The EIR establishes a mutual recognition mandate based on the principle of mutual trust and co-operation between different states and judicial authorities. Insolvency proceedings opened in one Member State[10]—as well as judgments handed down in the course of insolvency proceedings[11]—should automatically be recognised in other Member States subject only to a limited public policy exception.[12] If a party is dissatisfied with the decision to open insolvency proceedings in a particular state, then it should appeal the decision to a higher judicial authority in that state, rather than moving off to another Member State and seeking to open rival proceedings there. If a party attempts this tactic, then the courts in the second Member State have to defer to the courts in the first Member State.[13]

The underlying motivation behind the EIR appears to be one of fostering and deepening market integration. The EU is based on the idea of a single market, and this suggests that there should be a single insolvency law applying to that single market.[14] The EIR, however, falls short in that regard. Essentially it is a conflict

[5] The substantive changes made by the recast Regulation are not directly relevant to the issue considered in this article and references to the "EIR" and the "Regulation" are therefore intended as references to either or both versions, as appropriate. More specific footnote references, unless expressly indicated otherwise, are references to the relevant provisions in the recast Regulation.

[6] EIR art.3.

[7] EIR, Recital 23 of the Preamble; and *Schmid v Hertel* (C-328/12) EU:C:2014:6; [2014] 1 W.L.R. 633. For the universalism/territorialism debate, see G. McCormack, "Universalism in Insolvency Proceedings and the Common Law" (2012) 32 *Oxford Journal of Legal Studies* 325; J. L. Westbrook, "Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum" (1991) 65 *American Bankruptcy Law Journal* 457; L. LoPucki, "Cooperation in International Bankruptcy: A Post-Universalist Approach" (1999) 84 *Cornell Law Review* 696; S. Franken, "Three Principles of Transnational Corporate Bankruptcy Law: A Review" (2005) 11 *European Law Journal* 232.

[8] EIR art.3(2).

[9] For the general rule see art.7 of the recast Regulation and for the exceptions see arts 8–18. See also art.35 on the limited effect of secondary proceedings.

[10] EIR art.19.

[11] EIR art.32.

[12] EIR art.33.

[13] *Re Eurofood IFSC Ltd* (C-341/04) EU:C:2006:281; [2006] Ch. 508.

[14] Opinion of A.G. Bobek in *ENEFI v DGRFP* (C-212/15) EU:C:2016:841; [2017] I.L.Pr. 10 at [AG67] suggested that the Insolvency Regulation "aims at assembling the totality of the debtor's assets into one insolvency estate, thus

of laws instrument with rules on jurisdiction and choice of law, though there are also some substantive law provisions providing for minimum levels of treatment for foreign creditors.[15] The EIR tries to remove frictions between national insolvency laws, and the Preamble sets out is mission.[16] It speaks of the activities of undertakings having more and more cross-border effects and the insolvency of such undertakings affecting the proper functioning of the internal market, with a corresponding need for co-ordination measures at a European level. It also speaks of trying to stamp out forum-shopping—the movement of assets or legal proceedings from one jurisdiction to another to take advantage of a more favourable legal position. The enactment of the EIR may have done more, however, to enhance rather than reduce forum-shopping.[17] In its mutual recognition mandate, it creates incentives for parties to move assets to another country with a view to having the case resolved under the better designed or more advantageous insolvency law of the second state.

German and Irish individual debtors have moved their COMI to the UK to take advantage of shorter bankruptcy discharge periods,[18] and corporates have also moved their COMI, largely, it seems, to take advantage of better restructuring opportunities in other countries, most notably the UK.[19] London has become the insolvency and debt restructuring capital of Europe. Certainly, there is evidence from the cases that certain ostensibly European companies have moved operations to the UK immediately prior to a formal insolvency process so as to claim a UK COMI and the consequent application of UK law. *Re Hellas Telecommunications (Luxembourg) II SCA*[20] is a case in point, where a Luxembourg holding company shifted its COMI to England. The main asset of the holding company was a shareholding in a Greek operating company, which carried on business as one of the main telecom companies in Greece.

More recently, it seems that more corporate restructurings in respect of "European" companies have been done by means of schemes of arrangement under the UK Companies Act, and the courts have also distinguished between "good" and "bad" forum-shopping.[21] For instance, Newey J has said in *Re Codere Finance (UK) Ltd*[22]:

> "Plainly forum shopping can be undesirable. That can potentially be so, for example, where a debtor seeks to move his COMI with a view to taking advantage of a more favourable bankruptcy regime and so escaping his debts.

preserving the system of the collective resolution of insolvency proceedings and the equal treatment of all creditors which underpins any insolvency proceeding".

[15] EIR arts 48 and 49.

[16] See generally EIR, Recitals 2–5 of the Preamble.

[17] See generally M. Szydlo, "Prevention of Forum Shopping in European Insolvency Law" (2010) 11 *European Business Organization Law Review* 253; W.-G. Ringe, "Forum Shopping Under the EU Insolvency Regulation" (2008) 9 *European Business Organization Law Review* 579; G. McCormack, "Jurisdictional competition and forum shopping in insolvency proceedings" (2009) 68 *Cambridge Law Journal* 213.

[18] On mobile Irish debtors attempting to shift COMI to the UK, see also *O'Donnell v Bank of Ireland* [2012] EWHC 3749 (Ch); [2013] I.L.Pr. 16. On a German debtor attempting likewise, see *Schrade v Sparkasse Ludencheid* [2014] EWHC 1049 (Ch); [2014] B.P.I.R. 1058.

[19] See generally A. Walters and A. Smith, "'Bankruptcy tourism' under the EC Regulation on Insolvency Proceedings: A View from England and Wales" (2010) 19 *International Insolvency Review* 181.

[20] *Re Hellas Telecommunications (Luxembourg) II SCA* [2009] EWHC 3199 (Ch); [2010] B.C.C. 295.

[21] See the Opinion of A.G. Colomer in *Proceedings Brought by Staubitz-Schreiber* (C-1/04) EU:C:2005:500 at [71] and [72], to be contrasted with the more general comments of Lord Simon in *The Atlantic Star* [1974] A.C. 436 HL at 471 that "'Forum-shopping' is a dirty word".

[22] *Re Codere Finance (UK) Ltd* [2015] EWHC 3778 (Ch) at [18].

> In cases such as the present, however, what is being attempted is to achieve a position where resort can be had to the law of a particular jurisdiction, not in order to evade debts but rather with a view to achieving the best possible outcome for creditors. If in those circumstances it is appropriate to speak of forum shopping at all, it must be on the basis that there can sometimes be good forum shopping."

It is to be observed that the EIR is an inward-facing measure; it seeks to regulate issues as between the Member States but it does not purport to provide a framework for the resolution of cross-border insolvency issues where proceedings are opened outside the EU, which require recognition or assistance within one or more Member States.[23] This is, of course, a highly material consideration in the context of Brexit.

Cross-Border Insolvency Regulations (CBIR)

The Cross-Border Insolvency Regulations (CBIR)[24] implement the United Nations Commission on International Trade Law (UNCITRAL) 1997 Model Law on Cross-Border Insolvency in the UK. The Model Law has also been implemented in other major common law jurisdictions such as the US, Canada, Australia and New Zealand, as well as in some other major economies such as Japan and Korea, but not by China or Russia. It has been adopted by four EU Member States apart from the UK—Greece, Poland, Romania and Slovenia—but it has not been implemented directly in any of the EU founder members, though it may have had an indirect influence on the law in Germany and the Netherlands. The Model Law is international "soft" law which countries have implemented in somewhat different ways.[25]

Under the Model Law there is provision for the recognition of foreign insolvency proceedings and for the extension of co-operation to foreign courts and foreign insolvency representatives. This principle of recognition and co-operation applies in respect of both traditional liquidation-type procedures and restructuring proceedings. The foreign proceedings may be either "main" or "non-main", and these proceedings are defined in substantially the same way as "main" and "secondary" proceedings under the EIR.[26] If foreign main proceedings are recognised, generally there is a "stay" or moratorium on proceedings against the debtor or its assets. Execution proceedings against the debtor's assets are also barred and the debtor's right to dispose of assets is suspended.[27] The court granting recognition may also authorise additional "appropriate" relief as a matter of discretion.[28] In relation to foreign non-main proceedings, the recognising court may in the exercise of a discretion grant the types of relief that could have been granted in relation to foreign main proceedings. There are no quasi-automatic consequences of recognition.

[23] If the debtor has its centre of main interests outside the EU, then the Regulation does not apply: see Recital 25 of the Preamble to EIR, and Recital 14 of the Preamble to Regulation 1346/2000.

[24] Cross-Border Insolvency Regulations (SI 2006/1030).

[25] See generally G. McCormack, "US exceptionalism and UK localism? Cross Border insolvency law in comparative perspective" (2016) 36 *Legal Studies* 136; G. McCormack, "Bankruptcy Forum Shopping: The UK and US as venues of choice for foreign companies" (2014) 63 *International and Comparative Law Quarterly* 815; G. McCormack and A. Hargovan, "Australia and the International Insolvency Paradigm" (2015) 37 *Sydney Law Review* 389.

[26] EIR art.2 (the definition of an "establishment" is slightly different).

[27] EIR art.20.

[28] EIR art.21.

In contrast to the EIR, the Model Law is an outward-facing measure which is principally concerned with the response of the enacting jurisdiction to insolvency proceedings commenced elsewhere in the world. Adoption of the Model Law is not, however, merely an expression of comity, because the enactment of insolvency laws making proper provision for such matters is seen to be part of the process of making a jurisdiction "business friendly" and thereby stimulating external investment.[29]

Section 426 Insolvency Act

Section 426 of the Insolvency Act 1986 empowers a UK court having jurisdiction in relation to insolvency law to give effect to a request for assistance from a foreign court or tribunal in a designated country that has the corresponding jurisdiction.

Section 426 may be used in preference to the CBIR in a particular case, the major advantage being that it allows the application of foreign insolvency law, whereas this does not seem to be possible under the CBIR. The UK court, in responding to a request for assistance, may apply:

- its general equitable and statutory jurisdiction;
- UK insolvency law; or
- the insolvency law of the requesting court.

Section 426 contains some major limitations, however. First, the statutory duty of assistance applies only as between courts, and therefore the UK court must have received a request from a foreign court before it can act. Secondly, the duty to provide assistance only operates in respect of requests from designated countries, and the list of countries that have been designated is confined to "friendly" common law countries with historic links to the UK—a sort of "cricket-playing club". The list excludes the US and all EU Member States with the exception of Ireland.

Although the list of designated jurisdictions was founded on expectations of reciprocity, the s.426 jurisdiction is a free-standing, outward-facing measure.[30]

Common law

In recent years, the courts in England, both at first instance and at appellate level, have given extensive consideration to the common law principles governing judicial assistance in insolvency matters and the recognition of foreign insolvency judgments. The cases have originated largely, but not exclusively, from offshore jurisdictions such as the Isle of Man, the Cayman Islands and the British Virgin Islands (BVI).

Initially, the flow of the tide was strongly in the direction of a more expansive interpretation of the relevant principles, but this tide has now ebbed and the courts have rowed back. The more expansive view is associated with Lord Hoffmann,

[29] See generally in this connection "Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring" (2016), paras 3.26 to 3.31, *https://www.mlaw.gov.sg/content/dam/minlaw/corp/News/Report%20of%20the%20Committee.pdf* [Accessed 17 July 2017].

[30] For the background to s.426 see the Cork Committee *Report on Insolvency Law and Practice* (1982), Cmnd.8558, Ch.49. Essentially, s.426 is a more comprehensive version of s.122 Bankruptcy Act 1914, which dealt with co-operation between UK courts and those in colonial territories.

who, in *Re HIH Casualty and General Insurance Ltd*,[31] referred to the principle of modified universalism as the "golden thread" running through English cross-border insolvency law since the 18th century. The universality or otherwise of insolvency proceedings was discussed by the Privy Council in *Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings Plc*,[32] where Lord Hoffmann said:

> "The English common law has traditionally taken the view that fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated."

From the *Cambridge Gas* case it seemed that, at common law, the courts had a wide discretion to provide assistance to a foreign insolvency proceeding by doing whatever was considered to be just and appropriate in all the circumstances of the particular case, to the extent they could do so in a domestic insolvency.

Lord Collins has come to be associated with a more restrictive view of the limits of common law judicial power, and in *Singularis Holdings v PricewaterhouseCoopers*[33] the Privy Council, including Lord Collins, held that it did not have a common law power to assist foreign liquidators by exercising powers analogous to those that would have been exercisable in a domestic insolvency, but which did not apply to a cross-border insolvency. Lord Collins said that the notion of legislation by analogy was wholly inconsistent with established principles governing the relationship between the judiciary and the legislature. It was therefore profoundly unconstitutional.

Two further points warrant mention in connection with the common law jurisdiction:

- The judicial retreat concerning the extent to which the courts can act in aid of foreign proceedings will have limited practical implications in the UK[34] so long as the CBIR remain in force.
- The presently restrained approach to judicial innovation is likely to continue. As Lord Neuberger PSC acknowledged in *Singularis*,[35] the courts "have not been conspicuously successful" in developing the jurisprudence of cross-border insolvency. He concluded that major developments should be a matter for the legislature and not the courts.[36]

[31] *Re HIH Casualty and General Insurance Ltd* [2008] I W.L.R. 852 HL at [30].

[32] *Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings Plc* [2007] 1 A.C. 508 PC (Isle of Man) at [16].

[33] *Singularis Holdings v PricewaterhouseCoopers* [2014] UKPC 36; [2015] A.C. 1675 at [108].

[34] As opposed to other jurisdictions where decisions of the UK Supreme Court/Privy Council are followed and which have not enacted the Model Law.

[35] *Singularis* [2014] UKPC 36; [2015] A.C. 1675 at [154].

[36] *Singularis* [2014] UKPC 36; [2015] A.C. 1675 at [161]. Lord Neuberger amplified his thinking on this subject in his keynote speech on 19 June 2017 to the International Insolvency Institute Annual Conference in London.

Cross-border restructuring landscape—pre-Brexit

In recent years, many corporate restructurings in respect of EU registered companies have been accomplished by means of schemes of arrangement under the UK Companies Act.[37] Snowden J in *Re Van Gansewinkel Groep BV*[38] commented as follows:

> "In recent years schemes of arrangement have been increasingly used to restructure the financial obligations of overseas companies that do not have their COMI or an establishment or any significant assets in England … The use of schemes of arrangement in this way has been prompted by an understandable desire to save the companies in question from formal insolvency proceedings which would be destructive of value for creditors and lead to substantial loss of jobs. The inherent flexibility of a scheme of arrangement has proved particularly valuable in such cases where the existing financing agreements do not contain provisions permitting voluntary modification of their terms by an achievable majority of creditors, or in cases of pan-European groups of companies where co-ordination of rescue procedures or formal insolvency proceedings across more than one country would prove impossible or very difficult to achieve without substantial difficulty, delay and expense."

The law on schemes of arrangement is contained in Pt 26 of the Companies Act 2006 and has been developed substantially by judicial interpretation. The scheme involves an arrangement between a company and its creditors and/or members with some element of "give and take" on both sides, and the sanctioning of a scheme is a three-stage procedure. First, there is an application to the court to convene relevant meetings of creditors or members of a company. Secondly, the relevant class meetings are held and the scheme must be approved by 75 per cent in value and a majority in number of creditors within each class. Thirdly, the scheme comes before the court for approval and it must be satisfied that the scheme proposed is a reasonable one such that a reasonable member of the class concerned and acting in respect of its own interests could have voted for it.[39] The court is not a rubber stamp but, on the other hand, it need not be satisfied that the scheme proposed is the only fair one.[40]

It has been held by the Court of Justice of the EU (CJEU) in *Ulf Kazimierz Radziejewski* (C-461/11) EU:C:2012:704[41] that the EIR applies only to those

[37] See generally G. O'Dea, J. Long and A. Smyth, *Schemes of Arrangement Law and Practice* (Oxford: Oxford University Press, 2012); J. Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge: Cambridge University Press, 2014). See also L.C. Ho, "Making and enforcing international schemes of arrangement" (2011) 26 J.I.B.L.R. 434; J. Payne, "Cross-Border Schemes of Arrangement and Forum Shopping" (2013) 14 E.B.O.R. 563.

[38] *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch); [2015] Bus. L.R. 1046 at [4]–[5].

[39] See *Anglo-Continental Supply Co Ltd* [1922] 2 Ch. 723 Ch D at 736.

[40] It has been pointed out that the test is not whether the opposing creditors have reasonable objections to the scheme, since a creditor might be acting equally reasonably in voting either for or against the scheme. In these circumstances, the English courts consider that creditor democracy should prevail—see *Re British Aviation Insurance Co Ltd* [2005] EWHC 1621 (Ch); [2006] B.C.C. 14 at [75].

[41] *Ulf Kazimierz Radziejewski v Kronofogdemyndigheten i Stockholm* (C-461/11) EU:C:2012:704. Recital 9 of the recast Regulation provides that the insolvency proceedings to which the Regulation applies are listed exhaustively in Annex A. It goes on to say that when a procedure appears in the Annex, the Regulation applies without any further examination by national courts regardless of whether the definition is in fact satisfied. It adds that where a procedure is not listed, it is not covered by the Regulation. See also Recital 16, stating that "proceedings that are based on general company law not designed exclusively for insolvency situations should not be considered to be based on a law relating to insolvency".

proceedings listed in Annex A to the Regulation. Schemes of arrangement are not only not listed under the EIR; they are also not necessarily a collective procedure or an insolvency procedure. They may only involve a few creditors rather than creditors or bondholders as a whole and, moreover, they may be used as a takeover mechanism in respect of solvent companies. The fact that schemes of arrangement are not listed means that they are not entitled to the benefits of automatic EU-wide recognition under the EIR but, on the other hand, the jurisdiction of the UK courts to sanction a scheme is not subject to the constraints of the EIR, i.e. the relevant company need not have its COMI or even an "establishment" within the UK.

Under Pt 26 Companies Act 2006 the courts have jurisdiction to sanction a scheme in respect of a company that is "liable to be wound up" under the Companies Act. In *Re Rodenstock GmbH*[42] Briggs J held that the Insolvency Regulation had not narrowed the court's jurisdiction in relation to schemes. It was improbable on a purposive interpretation of the Regulation that any such narrowing of the jurisdiction was intended.

Section 221 of the Act confers jurisdiction on the courts to wind up a foreign registered company in a broad range of circumstances, but there has been a judicial concern that the jurisdiction conferred by the section is potentially "exorbitant" in that it may interfere with the disposition by foreign sovereign powers of matters within their own territories. Briggs J in *Re Rodenstock GmbH* referred to the jurisdiction in this way and also spoke of the practical purpose of ensuring that the court only made orders where some useful purpose would be served.[43]

A "sufficient connection" test has been used as the overriding criterion for determining whether the court should exercise its discretion to make a winding-up order in respect of a foreign company,[44] and the same "sufficient connection" test has been used in relation to exercising the jurisdiction to sanction schemes of arrangement. The UK courts may sanction schemes where the relevant foreign company has a "sufficient connection" with the UK, even though its COMI may not be in the UK.

UK courts have also considered the potential application of the recast Jurisdiction and Judgments Regulation (Brussels I Regulation)[45] to schemes. The overall objective of this Regulation is to secure the simplification of formalities that govern the reciprocal recognition and enforcement of judgments within the EU and to strengthen the legal protection of persons. The Preamble makes clear the need, in the interests of the harmonious administration of justice, to ensure that irreconcilable judgments will not be given in two EU states. Under art.4 of Brussels I, persons domiciled in a Member State must be sued in the courts of that Member State though there are rules of special jurisdiction allowing proceedings to be brought

[42] *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); [2011] Bus. L.R. 1245 at [52].

[43] *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); [2011] Bus. L.R. 1245 at [21].

[44] In *Re Real Estate Development Co* [1991] 1 B.C.L.C. 210 Ch D, Knox J referred to a sufficient connection that would justify the court in setting in motion its winding-up procedures over a body that was prima facie beyond the limits of territoriality. The test can be criticised for being somewhat circular but it does enable a wide range of factors to be brought into the reckoning, including benefit to the petitioner whether through the presence of corporate assets in the UK or otherwise— [1991] 1 B.C.L.C. 210 at 217. Knox J also talked about a reasonable possibility of benefit accruing to the applicants for a winding up and a person or persons interested in the distribution of the assets being persons over whom the court can exercise jurisdiction.

[45] Regulation 1215/2012, which came into force in January 2015 and "recasting" Council Regulation 44/2001, which in turn replaced the earlier similar, but not identical, Brussels Convention on jurisdiction and the enforcement of judgments in civil and commercial matters 1968. See generally A. Dickinson, "The Revision of the Brussels I Regulation" (2010) 12 *Yearbook of Private International Law* 248.

in other Member States in certain circumstances. Article 31 provides that if proceedings involving the same cause of action between the same parties are brought in the courts of different Member States, then any court, other than the court first seised, must stay its proceedings until the jurisdiction of the court first seised is established and, when it is, decline its jurisdiction in favour of that court.[46]

Brussels I applies in civil and commercial matters, but according to art.1(2)(b) it does not apply to "bankruptcy, proceedings relating to the winding up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings". There is somewhat conflicting case law at both the European and UK levels as to whether Brussels I and the Insolvency Regulation were intended to provide mutually exclusive codes in relation to jurisdiction, and this issue is very relevant in relation to whether UK schemes of arrangement are within Brussels I. This question has been considered in a number of cases, although there has not yet been an appellate court decision that reviews all the relevant authorities. As one commentator remarks[47]:

> "The outcome of these cases is uniform: in each case the English courts were found to have jurisdiction to sanction the scheme provided a sufficient connection was found, i.e. the jurisdiction of the English courts to convene scheme meetings and to sanction these schemes was unaffected by the EU Regulation. However, in reaching this conclusion the reasoning in these cases varies and is often inconsistent."

In *Re DAP Holding NV*,[48] for example, it was suggested that applications to sanction schemes of arrangement in respect of solvent companies fell outside Brussels I, but in *Re Rodenstock GmbH*[49] Briggs J took a different view. The *Rodenstock* analysis was adopted by David Richards J in *Re Magyar Telecom BV*,[50] who decided that an order sanctioning a scheme between an insolvent company and its creditors was also subject to Brussels I, at least if the company was not subject to insolvency proceedings under the Insolvency Regulation. Moreover, David Richards J suggested that an application to sanction a scheme may involve persons being "sued" for the purpose of art.4 of Brussels I.[51] In those circumstances, the courts of the Member State where a defendant is domiciled had jurisdiction.[52] Where some of the creditors whose rights were being affected by the scheme were domiciled in England, the English courts could sanction the scheme. Article 8 enabled a person domiciled in a Member State to be sued, where he was one of a number of defendants, in the national courts where any of the defendants were domiciled, provided that the claims were so closely connected that it was expedient

[46] Under art.31(2) of Brussels I recast, if the parties have given a particular court exclusive jurisdiction, this court may go on to hear the case even if it was not first "seised".

[47] See Payne, *Schemes of Arrangement* (2014), p.292.

[48] *Re DAP Holding NV* [2005] EWHC 2092 (Ch); [2006] B.C.C. 48 at [14].

[49] *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); [2011] Bus. L.R. 1245.

[50] *Re Magyar Telecom BV* [2013] EWHC 3800 (Ch); [2014] B.C.C. 448.

[51] But for a different view see Warren J in *Re Sovereign Marine and General Insurance Co Ltd* [2006] EWHC 1335 (Ch); [2007] 1 B.C.L.C. 228 at [62] that none of the jurisdictional rules in Brussels I was wide enough to encompass schemes of arrangement.

[52] But see *Primacom Holding GmbH v A Group of the Senior Lenders & Credit Agricole* [2012] EWHC 164 (Ch), [2013] BCC 201, where Hildyard J at [13] suggested that it was a "stretch" to consider company creditors, though they were integral to the scheme process and had a right to attend the court hearing, as being defendants for the purpose of Brussels I.

to hear and determine them together to avoid the risk of irreconcilable judgments resulting from separate proceedings.

The authorities were reviewed recently by Snowden J in *Re Global Garden Products SpA*[53] who said that

> "on the assumption that the recast Judgments Regulation applies to schemes, and treating the company as a claimant which is suing the scheme creditors, provided that at least one such creditor is domiciled in the United Kingdom, Article 8 is potentially engaged. The question will then be whether it would be expedient to hear and determine the application for sanction of the scheme as regards the other creditors to avoid inconsistent judgments from separate proceedings. On one view, this question will necessarily be answered in the affirmative because of the desirability of binding all scheme creditors to the same restructuring: see *Re Metinvest BV* [2016] EWHC 79 at paragraph 33. Alternatively, the answer may depend upon a consideration of the number and value of the creditors domiciled in the United Kingdom: see *Re Van Gansewinkel Groep BV* at paragraphs 41 to 45".

There are also suggestions in some of the cases that UK courts may have jurisdiction over scheme creditors by virtue of art.25 of Brussels I, which confers jurisdiction on the courts of a Member States if parties, regardless of their domicile, agree that the courts of a particular state have jurisdiction to settle any disputes which may arise in connection with a particular legal relationship. The argument is that, where the parties to a lending agreement agree to submit their disputes to the jurisdiction of the UK courts, then the latter will have jurisdiction if a scheme purports to modify rights governed by that particular lending agreement.

It is not clear, however, whether an "asymmetric" jurisdiction agreement falls within art.25. An example of such an agreement would be where borrowers submitted to the exclusive jurisdiction of the UK courts, but the lenders were entitled to take action in any available forum that was convenient for them.[54]

By way of conclusion to this brief review of the position in respect of schemes of arrangement, it will be noted that, in contrast to the position in respect of insolvency proceedings and the application of the EIR, there is considerable uncertainty as to the application of Brussels I to determine jurisdiction and, by extension, recognition of approved schemes. In practice, the courts look for reassurance as to recognition when sanctioning schemes and the recognition of approved schemes is therefore less of an issue than might be supposed.

[53] *Re Global Garden Products SpA* [2016] EWHC 1884 (Ch) at [25]. But see further *Re DTEK Finance Plc* [2016] EWHC 3562 (Ch); [2017] B.C.C. 165 at [10]–[15].

[54] Snowden J expressed the provisional view in *Re Global Garden Products* [2016] EWHC 1884 (Ch) at [31]) that art.25 would not be satisfied by an asymmetric jurisdiction clause under which borrowers submitted to the exclusive jurisdiction of the English courts but the lenders were entitled to take action in any available and convenient forum. In *Re Hibu Group Ltd and Re HY Ltd* [2016] EWHC 1921 (Ch), however, Warren J took a different view and suggested that art.25 applied to an asymmetric jurisdiction clause. This view also commended itself to Cranston J in *Commerzbank AG v Liquimar Tankers Management Inc* [2017] EWHC 161 (Comm); [2017] 1 Lloyd's Rep. 273, who held decisively that an asymmetric clause is "exclusive" for the purposes of the Regulation despite allowing one party to sue in courts other than the court named.

Discharge or modification of English law governed obligations in foreign insolvency proceedings

The common law

There is a long-established principle of the common law that the discharge of a debt under foreign insolvency law will not be given effect in the UK where the contract creating the debt is governed by English law. This doctrine is reflected in *Gibbs v La Société Industrielle et Commerciale des Métaux*,[55] where it was held that the foreign bankruptcy law was irrelevant because it was

> "not a law of the country to which the contract belongs, or one by which the contracting parties can be taken to have agreed to be bound; it is the law of another country by which they have not agreed to be bound".

Most recently, the *Gibbs* principle has been approved by Lord Hope in *Joint Administrators of Heritable Bank Plc v Winding Up Board of Landsbanki Islands HF*.[56] There is also a statement by Lord Hoffmann in *Wight v Eckhardt Marine GmbH*[57] that the question whether an obligation has been extinguished is governed by its proper law.

In *Global Distressed Alpha Fund 1 Ltd Partnership v PT Bakrie*,[58] for instance, it was held that the movement towards "universalism" in insolvency proceedings did not allow a first instance judge to disregard the established doctrine. In that case, the question was whether the discharge of a debt under foreign (Indonesian) bankruptcy law would be given effect in the UK where the contract creating the debt was subject to English law. It was argued that recognition of the discharge under Indonesian law would be consistent with the principle of universality because the debtor was an Indonesian company with its business operations centred in Indonesia. While the court rejected this argument, it referred with apparent approval to various criticisms that had been levelled against *Gibbs*. That decision generates anomalies. For example, while a debt governed by English law will not be discharged by a foreign bankruptcy, the debtor's movable assets situated in England are taken to have vested in the foreign trustee in bankruptcy. The debtor remains liable to pay its debts but has been deprived of the means that enable this to be done. Moreover, it was likely that the debtor's creditors would have foreseen the possibility that the restructuring of the Indonesian debts might take place in Indonesia. This suggested that recognition of the Indonesian debt discharge would not be unjust.

The criticisms of *Gibbs* have been taken a stage further in certain foreign jurisdictions, including Singapore. For instance, in *Re Pacific Andes Resources Development*[59] the Singapore High Court suggested that upon recognising foreign insolvency proceedings, it may give effect to a compromise or discharge of debts

[55] *Gibbs v La Société Industrielle et Commerciale des Métaux* (1890) 25 Q.B.D. 399 CA.

[56] *Joint Administrators of Heritable Bank Plc v Winding up Board of Landsbanki Islands HF* [2013] UKSC 13; [2013] 1 W.L.R. 725 at [44].

[57] *Wight v Eckhardt Marine GmbH* [2003] UKPC 37; [2004] 1 A.C. 147 at [11].

[58] *Global Distressed Alpha Fund 1 Ltd Partnership v PT Bakrie* [2011] EWHC 256 (Comm); [2011] 1 W.L.R. 2038.

[59] *Re Pacific Andes Resources Development* [2016] SGHC 210.

governed by Singapore law that were purportedly effected by the foreign insolvency law.

In England, the *Gibbs* principle was considered in passing by the Court of Appeal in *Erste Group Bank AG v JSC VMZ Red October*,[60] but the court declined to re-evaluate the correctness of the decision. It referred to the fact that the principle said to spring from the case "has been the subject of what many regard as justifiable criticism",[61] and entered an important caveat in relation to the *Gibbs* line of cases, observing that those cases did not address, and could have no application to, the situation where a creditor had submitted to a foreign jurisdiction by actively participating in insolvency proceedings in that jurisdiction.[62] The prospects of judicial reversal of the *Gibbs* principle should nonetheless be viewed with caution. *Gibbs* itself is longstanding Court of Appeal authority binding on that court and all lower courts. It would be open to the Supreme Court to reverse it, notwithstanding its recent approval in *Heritable Bank* but it is questionable whether the Supreme Court feel that to do so would stray beyond the proper limits of judicial law-making.[63] The future of the *Gibbs* principle is likely to be an important dynamic in shaping a successful post-Brexit solution to European cross-border insolvency.

Effect of the EIR

Under the EIR the applicable law is the law governing insolvency in the state where the proceedings are opened. This rule is laid down in art.7 of the new Regulation, which is equivalent to art.4 in the original Regulation 1346/2000. Article 7(2) states that the law of the state of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure,[64] and then sets out a non-exhaustive list of matters that are specifically referred to the law governing the opening of the proceedings. These matters are both substantive and procedural in nature and include:

- the effects of insolvency proceedings on current contracts to which the debtor is party;
- the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending;
- the claims which are to be lodged against the debtor's estate and the treatment of claims arising after the opening of insolvency proceedings;
- the rules governing the lodging, verification and admission of claims;
- the rules governing the distribution of proceeds from the realisation of assets, the ranking of claims and the rights of creditors who have

[60] *Erste Group Bank AG v JSC VMZ Red October* [2015] EWCA Civ 379; [2015] 1 C.L.C. 706.

[61] *Erste Group Bank v JSC VMZ Red October* [2015] EWCA Civ 379; [2015] 1 C.L.C. 706 at [75].

[62] See generally on what constitutes "submission" to a particular jurisdiction the Privy Council decisions in *Stichting Shell Pensioenfonds v Krys* [2014] UKPC 41, [2015] A.C. 616; and *Vizcaya Partners Ltd v Picard* [2016] UKPC 5, [2016] 3 All E.R. 181.

[63] See above in relation to the common law power to act in aid of foreign insolvency proceedings. In his keynote speech to the International Insolvency Institute Annual Conference 2017, London, para.30, Lord Neuberger expressly identified the future of the *Gibbs* principle as an example of the sort of issue which is problematic for judges.

[64] The concept of closure of insolvency proceedings must be interpreted according to national law. There is no autonomous Community-wide interpretation—see *Bank Handlowy w Warszawie SA v Christianapol sp z oo* (C-116/11) EU:C:2012:739; [2013] Bus. L.R. 956 at [52].

obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right in rem or through a set off;
- the conditions for and the effects of closure of insolvency proceedings, in particular by composition;
- creditors' rights after the closure of insolvency proceedings;
- who is to bear the costs and expenses incurred in the insolvency proceedings;
- the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors.

The most straightforward interpretation of art.7 suggests that if insolvency proceedings are opened under the Regulation in another EU Member State, then the law of that state will determine whether English law-governed obligations of the debtor are abrogated or modified by those insolvency proceedings.[65]

In *Edgeworth Capital Luxembourg Sàrl v Maud*[66] Knowles J, however, seemed inclined to accept a more restricted interpretation, though it was not necessary to reach a definitive conclusion in the case. Nevertheless, he seemed sympathetic to the notion that a third-party debt arising under a contract governed by English law was not capable of being discharged by insolvency proceedings under the EIR in a foreign jurisdiction. The case concerned a loan made to a company with its COMI in Spain and which entered into a formal insolvency process in Spain. The debtor's obligations under the loan agreement had been guaranteed, and it was argued by the guarantor that its liability under the guarantee had been discharged by the Spanish insolvency proceedings. The court held that the relevant Spanish law did not have this effect but it was suggested that, even if it did, it did not produce any extraterritorial effects by virtue of the EIR.[67]

This suggestion is difficult to square with the European Court decisions in *Kornhaas v Dithmar*[68] and *ENEFI v DGRFP*[69] which give an expansive interpretation to what is now art.7. Moreover, if a guarantor accepts liability under the guarantee and pays the principal debt, then normally it is entitled to be indemnified by the debtor and has a right of reimbursement from the debtor's estate. This enlarges the scope of the claims against the estate. Articles 7(2)(g) and (h) provide that the courts of the state where insolvency proceedings are opened shall determine the claims that may be lodged against the debtor's estate, as well as the rules governing the lodging, verification and admission of claims.

In conclusion, the better view is that one of the reciprocal benefits of the EIR is that insolvency proceedings commenced in accordance with its jurisdictional requirements can have the effect of discharging obligations governed by a foreign law and that in consequence the *Gibbs* principle has no application to EIR cases.

[65] The application of the law of the insolvency forum, even in respect of matters not specifically referred to in art.7(2), was addressed in *Re Hellas Telecommunications (Luxembourg) II SCA* [2013] B.P.I.R. 756 Ch D—a case that concerned the scope of the doctrine of legal professional privilege. The court held that English law, as the law of the forum, applied in deciding whether a document was protected from inspection by reason of legal professional privilege.

[66] *Edgeworth Capital Luxembourg Sàrl v Maud* [2015] EWHC 3464 (Comm).

[67] See *Edgeworth Capital* [2015] EWHC 3464 (Comm) at [43]–[45] of the judgment.

[68] *Kornhaas v Dithmar* (C-594/14) EU:C:2015:806; [2016] B.C.C. 116.

[69] *ENEFI v DGRFP* (C-212/15) EU:C:2016:841; [2017] I.L.Pr. 10.

Effect of the CBIR/Model Law

The CBIR/Model Law regime is intended to facilitate the recognition of foreign insolvency proceedings and authorises the grant of certain relief consequent on such recognition. Article 21, which refers to such discretionary relief, is drafted in broad terms, but it was held by Morgan J in *Re Pan Ocean Co Ltd*[70] that it does not permit the application of foreign law. Only domestic law may be applied. Morgan J rejected the argument for a broad interpretation of the expression "appropriate relief" in art.21 that would permit the application of foreign insolvency law. *Re Pan Ocean Co* concerned a contract of carriage which a Brazilian company had entered into with a Korean shipper. The contract was governed by English law and contained a clause allowing the Brazilian party to terminate the contract in certain events, including if the shipper entered insolvency proceedings. The shipper entered insolvency proceedings in Korea and the Brazilian party wished to activate the termination provision. The shipper's insolvency administrator, on the other hand, sought to keep the contract alive because it was quite profitable for the shipper. It appeared that under Korean insolvency law, unlike UK insolvency law, termination clauses of this type could be overridden. Morgan J concluded that, even if he had the power to do so, it would not be appropriate in this particular case to give effect to the provisions of Korean insolvency law. He said:

> "In some cases, it can be argued that anyone who does business with a foreign company which might thereafter enter a process of insolvency, governed by the insolvency law of its country of registration, should expect that the insolvency will be governed by that law … However, in the present case, the parties had deliberately chosen English law as the law of the contract. Whereas the parties might have expected that a Korean court would apply Korean insolvency law to the insolvency of the Company, they might have been very surprised to find that an English court would apply Korean insolvency law to the substantive rights of the parties under a contract which they had agreed should be governed by English law."[71]

These comments suggest that the CBIR/Model Law Regime does not have any direct effect on the *Gibbs* principle.

Corporate insolvency and restructuring consequences of Brexit

Insolvency proceedings

The EIR is a much more comprehensive and extensive legal instrument than either the UNCITRAL Model Law on Cross-Border Insolvency or the Cross-Border Insolvency Regulations (CBIR) which implement the Model Law in the UK. The following points emphasise why this is the case:

- Recognition of insolvency proceedings opened in another EU Member State is automatic under the EIR, whereas under the

[70] *Re Pan Ocean Co Ltd* [2014] EWHC 2124 (Ch); [2014] Bus. L.R. 1041.
[71] *Re Pan Ocean Co Ltd* [2014] EWHC 2124 (Ch); [2014] Bus. L.R. 1041 at [112].

CBIR/Model Law regime it is dependent upon an application to the court.

- While the assumption under the CBIR is that main insolvency proceedings should take place where the debtor has its COMI and "non-main" proceedings in a state or states where the debtor has an establishment, the CBIR does not directly allocate jurisdiction to open insolvency proceedings, and existing national jurisdictional rules remain in place. The mere fact that a debtor may have assets, or even its COMI, in a particular state does not of itself confer jurisdiction on the courts of that state to open insolvency proceedings. Whether the courts have jurisdiction depends on the relevant national law as it applies to that case.
- The CBIR do not purport to say which law should govern insolvency proceedings that are opened in a particular jurisdiction.
- Under the EIR, insolvency proceedings have the same effect in other EU states as they have in the law of the insolvency forum, whereas under the CBIR the consequences of recognition depend on the law of the recognising state.
- There are many other differences of detail between the EIR and CBIR/Model Law, such as in the definition of an "establishment".

In some respects, however, the Model Law/CBIR regime is potentially wider than the EIR. It applies:

1. to insolvency proceedings throughout the world;
2. to a broader range of procedures than the EIR; and
3. a wider stay than can catch the enforcement of security.

As regards (1), the Model Law provides for recognition and relief in respect of a foreign insolvency proceeding. The term "foreign proceeding" is defined in art.2(a) of the Model Law as meaning a

> "collective judicial or administrative proceeding in a foreign state, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation".

The relevant definition in art.2(i) of Sch.1 to the CBIR is in substantially similar terms. The EIR, on the other hand, only applies to those proceedings listed in Annex A to the Regulation. If national proceedings are listed, they come within the scope of the Regulation, but this is not the case if they are not listed.

As regards (2), it has been held in *Re Bud-Bank Leasing SP*[72] that the CBIR definition may enable the recognition of insolvency proceedings taking place in other EU Member States, even though they have not been listed in EIR Annex A. In this particular case, Polish proceedings were held to fall within the CBIR definition—even though they were not listed in Annex A—since they had the

[72] *Re Bud-Bank Leasing SP* [2010] B.C.C. 255 Ch D.

characteristics of insolvency proceedings and specifically incorporated provisions of the general Polish insolvency law.

As regards (3), once foreign main proceedings are recognised, then CBIR art.20 provides that a stay/moratorium comes into effect, precluding certain proceedings against the debtor. It is specifically stated, however, that the stay does not affect rights to enforce security, rights to repossess goods under hire-purchase and retention of title agreements, rights of set off and rights in respect of financial market transactions to the extent that all these rights would be exercisable in a domestic UK context. However, the foreign representative, at the time of applying for recognition, can apply for the effects of the stay to be modified—such as where the foreign proceedings are restructuring or "rescue" rather than liquidation proceedings—and more appropriate relief to be granted under the discretionary provisions of art.21.

The relevant discretion was exercised in *Re Pan Oceanic Maritime Inc*,[73] where an "administration stay" along the lines of para.43 of Sch.B1 to the Insolvency Act 1986 was granted, rather than the more limited "liquidation stay". The more extensive stay may bar the enforcement of security. Under the EIR, a stay will be the automatic consequence of the recognition of foreign insolvency proceedings if such a stay is a feature of the law of the state that opens insolvency proceedings. Article 8 of the recast Regulation, which is equivalent to art.5 in the original Regulation, however, provides that this stay does not affect rights in rem (security rights) over property in another Member State. This means that while the EIR will bar general legal proceedings against the debtor in other EU Member States, it will not bar the enforcement of security rights over the debtor's property.[74]

Notwithstanding these qualifications, the general point remains that the EIR is a much more comprehensive legal instrument than the CBIR/Model Law. To this extent, the UK legal landscape would be impoverished by a "hard" Brexit and withdrawal from the mutual recognition and co-operation mandate under the EIR. Other EU states are also likely to be disadvantaged because their insolvency proceedings will not automatically be recognised in the UK and, in view of the *Gibbs* principle, will not have the effect of discharging debts governed by UK law. The predictable consequence of this would be an increased need for parallel proceedings with attendant cost and complexity implications.

Restructuring proceedings

In theory, some corporate restructuring professionals might see Brexit as a business opportunity—an opportunity to break free of jurisdictional shackles imposed by the EIR or the Jurisdiction and Judgments (Brussels I) Regulation—and to present the UK more openly as the forum in which to do restructuring business. Another view, however, sees Brexit as presenting a distinct risk—a risk that UK-sanctioned schemes of arrangement in respect of EU registered companies will not be

[73] *Re Pan Oceanic Maritime Inc* [2010] EWHC 1734 (Comm).

[74] In *Lutz v Bäuerle* (C-557/13) EU:C:2015:227; [2015] Bus. L.R. 855 at [38]–[40] the European Court said that the provision enables a creditor to assert effectively, and even after the opening of insolvency proceedings, a right in rem that was established before the opening of those proceedings. Moreover, in order to enable the creditor to assert its right in rem effectively, in principle that creditor must be able to exercise the right under the *lex causae* after the opening of the insolvency proceedings. The particular conditions under the *lex causae*, i.e. the law of the state where the assets are located, would apply rather than the law of the state of the opening of proceedings.

recognised in other EU countries. The greater possibility of non-recognition is likely to militate against the attractiveness of the UK as a forum-shopping venue in corporate restructuring cases. It may also be disadvantageous as far as jobs and growth in other EU countries are concerned. The domestic laws of these countries may lack the favourable corporate restructuring possibilities presented by the UK scheme of arrangement. It should be added, however, that the European Commission has recently published a proposal for a Restructuring Directive[75] suggesting innovative new restructuring possibilities on a pan-European basis which enhances the chances that foreign companies will "shop locally" for restructuring procedures rather than in the UK.

It seems reasonably clear that the jurisdiction of the UK courts to sanction a scheme of arrangement in respect of a foreign registered company is not negatively impacted by the EIR, and the UK courts may sanction a scheme even if the relevant company does not have its COMI or even an "establishment" in the UK. This is most obviously exemplified by the use of UK schemes to restructure financial obligations governed by English law where the enactment of new domestic procedures in other Member States may not be capable of rendering the same benefits as a UK scheme. Further, it must be borne in mind that the enactment of black-letter law is merely the starting point in establishing a viable restructuring forum—much also depends on the professional, financial and judicial infrastructure to make such laws work in practice.[76]

But, as we have seen, the position of schemes vis-à-vis Brussels I is much less clear. On one view, they are outside Brussels I since they are not strictly speaking adversarial proceedings and it is hard to see creditors whose rights are being "schemed" as "defendants". More recent cases, however, have tended to proceed on the basis that schemes are subject to Brussels I and then go on to consider whether the jurisdictional tests of the Regulation have been satisfied and whether the court should exercise jurisdiction. There has been some criticism on the basis that the matter is not one of discretion. The argument based on *Owusu v Jackson*[77] is that if the jurisdiction exists, it cannot be declined. According to the CJEU in *Owusu v Jackson*[78]:

> "Application of the *forum non conveniens* doctrine, which allows the court seized a wide discretion as regards the question whether a foreign court would be a more appropriate forum for the trial of an action, is liable to undermine the predictability of the rules of jurisdiction laid … and consequently to undermine the principle of legal certainty, which is the basis of the [Regulation]."

[75] Proposal for a Restructuring Directive, COM(2016) 723 final 2016/0359 (COD); and see also European Commission Staff Working Document accompanying the proposal, SWD(2016) 357 final. On the reform process in Europe in this area see generally G. McCormack, "Business restructuring law in Europe: making a fresh start" (2017) 17 *Journal of Corporate Law Studies* 1; S. Madaus, "The EU Recommendation on Business Rescue: Only Another Statement or a Cause for Legislative Action across Europe?" (2014) 27 *Insolvency Intelligence* 81; H. Eidenmuller and K. van Zweiten, "Restructuring the European Business Enterprise: The EU Commission Recommendation on a New Approach to Business Failure and Insolvency" (2015) 16 E.B.O.R. 625.

[76] See, in this connection, *Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring* (2016), *https://www.mlaw.gov.sg/content/dam/minlaw/corp/News/Report%20of%20the%20Committee.pdf* [Accessed 17 July 2017], which refers to the development of a financial "ecosystem".

[77] *Owusu v Jackson* (C281/02) EU:C:2005:120; [2005] Q.B. 801.

[78] *Owusu v Jackson* (C281/02) EU:C:2005:120; [2005] Q.B. 801 at [41].

Nevertheless, some element of discretion, or at least balancing, is an inbuilt feature of the jurisdictional rules under Brussels I. According to Snowden J in *Re Global Garden Products SpA*,[79] one may treat the company as a claimant that is suing the scheme creditors. If at least one such creditor has a UK domicile, the question then is whether it would be *expedient* to hear and determine the scheme application with respect to the other creditors so as to avoid inconsistent judgments from separate proceedings. The answer, he said, may depend upon the number and value of the creditors domiciled in the UK.

If schemes are subject to Brussels I, then they benefit from the recognition machinery provided under that instrument. If they are outside Brussels I, then recognition in other EU states is more difficult because recognition depends on the national private international law rules in the individual Member States. In a post-Brexit situation, if there is little or no evidence that a scheme will be recognised in a relevant foreign country, it may be hard to argue that the UK courts should sanction a scheme in respect of the foreign registered company.

There may be a chink of daylight, however, if the scheme purports to modify obligations governed by UK law, for example if the scheme modifies debt obligations that are subject to English law. It is a generally accepted principle of private international law that the modification or termination of a contract is governed by the proper law of the contract. This principle is also reflected in the Rome I Regulation,[80] which provides in art.12(1) that the law applicable to a contract shall govern in particular: (a) interpretation; (b) performance; (c) the consequences of a total or partial breach of obligations and "(d) the various ways of extinguishing obligations, and prescription and limitation of actions". On the other hand, art.1(2)(f) excludes from the scope of Rome I "questions governed by the law of companies … internal organisation or winding-up of companies". This exclusion is not very clear, but it has been suggested that the effect of a scheme of arrangement is one of the questions governed by the law of companies, and therefore it falls outside Rome I.[81] On this latter view, there would be no scope for the recognition of schemes in EU Member States pursuant to Rome I. There is, however, no decisive authority on this point.

Unilateral options for the UK and the EU post-Brexit

The EIR is directly applicable EU law and it will therefore cease to apply as such when the UK withdraws from the EU. The Cross-Border Insolvency Regulations, s.426 of the 1986 Act and the common law will be unaffected. It is necessary to consider each of these tools in turn.

In fashioning any unilateral response of the UK to a "hard" Brexit, it is suggested that there are two policy imperatives:

- the UK courts must be accessible to all those with a legitimate need for relief under UK law; and
- the UK courts must have a wide-ranging jurisdiction to recognise and act in aid of foreign insolvency proceedings (in particular, for

[79] *Re Global Garden Products* [2016] EWHC 1884 (Ch).
[80] Regulation 593/2008.
[81] See R. Sheldon (ed.), *Cross Border Insolvency*, 4th edn (London: Bloomsbury, 2015), p.507.

these purposes, proceedings taking place in Member States of the EU).

The unilateral options in respect of the EIR are limited. The UK Government's White Paper on exiting the EU[82] speaks of its intention to covert the "*acquis*" into UK law "wherever practical and sensible" so as to provide a seamless transition on day one. In the present context, such an approach would be neither sensible nor practical (unless matched by corresponding action on the part of the EU) because it would ignore the essential and defining characteristic of the EIR, which is the reciprocal surrender of jurisdiction in return for recognition. Any unilateral enactment of the inward effects of the EIR would tie the hands of the UK courts in dealing with foreign companies (and UK companies with their COMI in the EU) while achieving nothing as regards the recognition of UK proceedings.

On the contrary, the more pressing need for unilateral action is to provide a means by which debtors with UK law obligations can obtain relief and, where necessary, restructure those obligations. This suggests that a better option, in the absence of any bilateral solution, would be to remove the jurisdictional restrictions on the ability of foreign companies to access UK procedures under the 1986 Act. This could be done by making the "sufficient connection" test applicable not only to liquidation (and schemes of arrangement) but also to administration and voluntary arrangements.[83] The prospects of recognition elsewhere are an important consideration in this respect but one which should go to the exercise of discretion rather than the existence of jurisdiction.

As stated, the Cross-Border Insolvency Regulations will remain in place regardless and will be available in support of EU insolvency proceedings. There are legitimate arguments for the expansion of the relief available under the Regulations (for example, in relation to the enforcement of insolvency judgments[84] and the application of foreign law[85]), but those arguments do not arise because of Brexit. Although there is much to be said for a greater degree of international uniformity in the interpretation of provisions enacting the Model Law, there is a powerful argument that close adherence to the Model Law itself is desirable in that it promotes a more readily understood international standard. The unilateral solution, from the UK point of view, does not appear to lie in departing from the terms of the Model Law.

On the other hand, enactment of the Model Law is unilateral action which is available to either the EU or to those Member States that have not already adopted it, and would be a welcome development. This may prompt a question as to why

[82] Repeal Bill: White Paper, "Legislating for the United Kingdom's Withdrawal from the European Union" (March 2017), Cm.9446.

[83] Before the coming into force of the EIR the general view was that only companies formed and registered under the Companies Act could be the subject of UK administration proceedings. There was a minority view, however, that this limitation did not make sense and that foreign registered companies which could be wound up the Insolvency Act 1986 were also covered but a statutory amendment clearly dispels the minority view—Insolvency Act 1986 (Amendment) Regulations 2005 (SI 2005/879). See generally G. Moss "Salvage sunk" (2005) 18 *Insolvency Intelligence* 92. The jurisdiction in respect of CVAs is limited in the same way—see now s.1(4) Insolvency Act 1986 as amended.

[84] In *Rubin v Eurofinance SA* [2012] UKSC 46; [2013] 1 A.C. 236, it was held that the provisions of the Model Law authorising the grant of discretionary relief in respect of foreign insolvency proceedings did not provide a basis for overturning long-established common law principles governing the enforcement of foreign monetary judgments.

[85] This would deal with some of the issues thrown up by *Re Pan Ocean Co Ltd* [2014] EWHC 2124 (Ch); [2014] Bus. L.R. 1041. It should be noted that in the US version of the Model Law—Ch.15 of the US Bankruptcy Code—it has been held permissible to apply foreign law: see *Re Condor Insurance Co Ltd* (2010) F. 3d 319 (2010), which concerns the application of foreign avoidance proceedings.

the Member States should adopt a measure in the context of Brexit that would facilitate recognition and acting in aid of (among others) UK proceedings. There are two answers to this potential objection. First, adoption of the Model Law is a progressive step in the jurisprudence of cross-border insolvency and it is a step which has usually been undertaken by other enacting states, notably the US, without any requirement for reciprocity. Secondly, the terms of the Model Law make relief wholly discretionary where the proceedings are not "main proceedings", which would ensure that there was no question of Member States being required to act in aid of any UK proceedings which might be stigmatised as being the product of an exorbitant jurisdiction in respect of foreign companies.

A third and more promising possibility for the UK would lie in amendment of s.426 of the Insolvency Act 1986. This uniquely UK provision could be amended in response to Brexit in a number of ways. The UK could add EU Member States to the list of designated jurisdictions which could seek s.426 relief or, even more radically, the UK could dispense with requirement for designation altogether. If taking this step, it would probably be sensible to dilute the "duty" to act in response to a s.426 request (which is far from being an absolute duty in any event[86]) and make relief discretionary—particularly if dispensing with designation and thus admitting the possibility of requests for relief coming from jurisdictions (outside the EU) which have few shared values with the UK. Further updating of s.426 might also include an express discretionary power to discharge UK law debts where that is necessary to give effect to foreign proceedings. Such a solution would lack the automaticity of the EIR but would, in other respects, go a long way towards replicating its benefits for EU Member States—albeit in a more controlled manner.

Further development of the common law would, of course, be another form of possible unilateral action, but it is unlikely to be significant in this context for a number of reasons: first, the significantly weakened judicial appetite for common law development, and secondly, the fact already noted that the scope for common law assistance in the UK has been marginalised by the Cross-Border Insolvency Regulations. Thirdly, although common law developments might theoretically arise out of problems created by Brexit, the common law would have nothing to do with Brexit as such.

In conclusion, there are unilateral measures open to both the UK and the EU to mitigate the potential disadvantages of a "hard" Brexit. Those disadvantages are principally the loss of automatic recognition which will occur as a natural result of the EIR falling away. In the absence of a bilateral agreement to replicate the effects of the EIR, the EU, or its Member States, could consider adopting the Model Law. The UK has already enacted the CBIR to give effect to the Model Law but could consider further amendment of s.426 to give itself even greater powers to act in aid of foreign proceedings and thereby to promote its status as a business-friendly jurisdiction in a post-Brexit environment.

[86] See *Hughes v Hannover Rucksversicherungs AG* [1997] B.C.C. 921 CA (Civ Div), where the Court of Appeal said that the court enjoys a continued discretion and may reject the request for assistance although "[t]he particular assistance requested should be given unless there is some good reason for not doing so" (at 935) In the *Hughes* case itself the request was actually turned down because the circumstances had changed materially since the date of the request. For a general discussion on the discretion of the court, see I. Fletcher, *Insolvency in Private International Law*, 2nd edn (Oxford: Oxford University Press, 2005), pp.239–240.

However, such unilateral measures would inevitably fall short of what could be achieved, in the interests of both sides, through a new bilateral treaty between the UK and EU or, at the very least, a transitional fall-back regime in the corporate insolvency space. The suggestions made by the Commercial Bar Association (COMBAR) in respect of the Jurisdiction and Judgments (Brussels I) regime provide a possible model to follow in relation to corporate insolvency and restructuring.

A new bilateral framework?

There is a scope for a new bilateral agreement between the UK and EU post-Brexit in respect of insolvency and related matters. This would sit alongside the EIR, which would continue to apply as between the 27 remaining EU Member States.

There is a broad consensus that the EIR has been successful and that its effects should be replicated, if possible.[87] Obviously, this could be achieved by a bilateral treaty between the EU and the UK if the necessary political will exists and the matter is considered as meriting sufficient priority. In that connection, as a matter of practicality, it would probably be easier to provide for a seamless continuation of the status quo rather than to attempt to resurrect the effects of the EIR some years later, after all concerned have become used to living without it. There are, however, two obvious difficulties with a simplistic approach to maintaining the status quo: first, the EIR is not a static measure; and, secondly, the Court of Justice is the ultimate authority on the meaning of its provisions. Quite apart from periodic review and revision, the EIR is amended from time to time to accommodate new procedures and new Member States and, as regards the second of these difficulties, the Court of Justice's jurisdiction in UK affairs is politically controversial in the UK. That is not to suggest that either difficulty could not be finessed—merely to recognise the obstacles.

The bare bones of such an agreement could be as follows:

- The UK would recognise EU insolvency procedures, etc. in line with the EIR, and the EU 27 would recognise UK procedures, etc. on a similar basis.
- In their interpretations, UK courts would "take account" of CJEU decisions but not be obliged necessarily to follow them, nor would UK courts be required or even entitled to make references to the CJEU.
- There would be provision for the UK to update the list of EU insolvency procedures that are automatically recognised in the UK in line with revisions to Annex A of the EIR.
- The UK would not be subject to any of the reporting requirements under the EIR.

[87] It should be noted that the UK had to "opt in" to the recast Regulation, which it did because of the perceived benefits to the UK—see written ministerial statement of 15 April 2013: "Government consider that it is in the UK's interest to opt in to the proposal because it will be of general benefit to creditors and businesses in the UK and EU." The statement is available at *http://www.publications.parliament.uk/pa/cm201213/cmhansrd/cm130415/wmstext/130415m0001.htm* [Accessed 17 July 2017].

The Commercial Bar Association (COMBAR) and the London Solicitors Litigation association group have advocated such an approach for the Judgments (Brussels I) Regulation.[88] This article has highlighted the relevance of the Brussels I regime in respect of restructuring proceedings and given the obvious overlaps between insolvency and restructuring proceedings, a similar approach appears apposite in relation to the Insolvency Regulation. Moreover, the EIR in art.31 provides for the recognition and enforcement of insolvency judgments and insolvency related judgments in line with the Brussels I regime.

Certainly, the points made by COMBAR about the inadequacies of a unilateral as distinct from a bilateral approach are equally appropriate in an insolvency context. COMBAR states that[89]

> "these issues cannot be addressed solely through domestic action, for example through the Government's stated policy of incorporating certain aspects of EU law into domestic law. Whilst domestic action could be taken to address the establishment of jurisdiction in the UK, it would fail to ensure reciprocity with other States such that they would not be obligated to enforce UK judgments or allocate jurisdiction with respect to UK nationals or domiciled corporations as is required at present. Given the vital importance of enforcement and a mutually respected system for the allocation of jurisdiction, a domestic solution is entirely inadequate".

It also argues that the portability of judgments and the predictable allocation of jurisdiction are not intrinsically linked to the free movement of goods, services or persons.[90]

COMBAR has suggested that the UK should enter into a treaty with the EU to remain bound by the Brussels I regime. COMBAR points to the 2005 Denmark/EU agreement[91] on the Brussels I Regulation. Denmark was part of the former Brussels Convention—which was outside the framework of the EU treaties—but the Brussels Convention then became a Regulation on largely similar terms. Denmark could not sign up to the Regulation because it came under the Justice and Home Affairs domain in the EU treaties in respect of which Denmark had exercised an "opt out". Denmark then negotiated this bilateral replacement agreement to cover the jurisdictional certainties that it would otherwise lose.

The proposed UK-EU agreement would be an international instrument construed in accordance with public international law. It would ensure continuity with the present regime and avoid the need for the unanimous agreement of EU Member States in the future. COMBAR suggests that in a stand-alone UK-EU agreement, provision is likely to be made for the continued role of the Court of Justice of the EU (CJEU) such that UK courts would "take due account" of relevant CJEU judgments. COMBAR, however, notes that such a treaty would be an international

[88] Commercial Bar Association (COMBAR), *Brexit Report, Conflict of Laws Sub-Group* (January 2017), p.14, *https://app.pelorous.com/media_manager/public/260/COMBAR%20Brexit%20Conflict%20of%20Laws%20%20Jurisdiction%20Report%20as%20sent%20to%20MoJ%2011.1.17%20(002).pdf*. See also Bar Council Brexit Working Group, "The Brexit Papers" (December 2016), p.14, *http://www.barcouncil.org.uk/media/508513/the_brexit_papers.pdf* [Both accessed 17 July 2017], stating similar views from the General Council of the Bar.

[89] COMBAR, *Brexit Report* (January 2017), para.17.

[90] COMBAR, *Brexit Report* (January 2017), paras 28–29.

[91] Agreement between the European Community and the Kingdom of Denmark on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2005] OJ L299/62.

law instrument and not an EU instrument. It would need UK implementing legislation, but, in accordance with generally accepted public international law principles and to ensure a harmonious and uniform interpretation, due account would have to be taken of relevant CJEU decisions in any event:

> "Clarification of issues of interpretation by the CJEU therefore should be seen in this light as adding to the certainty and efficacy of the system across all participating States. It is inherently undesirable that each country should reach its own interpretation … In our view, such an obligation is therefore highly unlikely to change the approach of the English courts and agreeing to such an express proviso should not be seen as a cause for concern."[92]

Conclusion

Brexit gives rise to uncertainty in the insolvency space. It should be remembered, however, that the EIR and other EU instruments in this area are relatively recent phenomena. The original version of the EIR only came into force in 2002, and for the UK essentially to have to fall back on the Model Law regime is not like returning to the legal dark ages, though recognition of UK insolvency proceedings in other EU states may become more problematic.

Brexit is also problematic in the corporate restructuring space since it is likely to mean that the recognition in post-Brexit Europe of UK-sanctioned schemes of arrangement for EU registered companies is more precarious and uncertain. This, in turn, may have a knock-on effect on the willingness of foreign companies to use the UK as a venue for corporate restructurings, with a consequent loss of business for UK-based legal and other professionals. It may also result in a loss of value for EU businesses, as a well-established restructuring venue becomes more troublesome to use. It is only in the last 20 years or less, however, that the scheme jurisdiction has taken off as a vehicle of choice for foreign companies and there remain a relatively small number of such cases. As one door, and one business opportunity, closes, others may appear on the horizon. There is no reason to suppose that the same results cannot be achieved through parallel proceedings where such are necessary in order to fill the gaps left by the disapplication of the EIR to the UK—albeit at greater cost.

While the future may be cloudy, the sunlight can break through; and this article has suggested possible ways forward. First and foremost, we conclude that continued co-operation is in the best interests of both the UK and the EU and that co-operation is in no way incompatible with UK ceasing to be a Member State. Time is, however, short when considering not only the possibility of a new bilateral treaty, but also the various steps which might be taken unilaterally to fill the void.

[92] COMBAR, *Brexit Report* (January 2017), paras 22–23.

Subrogation Against a Contractual Beneficiary: A New Limitation to Insurers' Subrogation?

Özlem Gürses*
Kings College London

Co-insurance; Contract terms; Implied terms; Insurers; Subrogation; Waiver

Introduction

It is not uncommon to see insurance provisions in contractual relationships where the parties' interests are distinct from each other. Such terms are varied; that is, some may require a co-insurance for all the parties involved,[1] while others include an undertaking by one party to insure his interest in the subject-matter of the contract. The issue that derives from such insurance provisions, however, is the same: if one of the contracting parties suffers loss as a result of the other contracting party's negligence, and if the insurer indemnifies the loss, will the insurer have a subrogation right towards the party who caused it? The two reference points which can be used to answer this question are the underlying contractual relationship between the parties and the terms of the insurance contract. The following points have been taken into account by the courts that have discussed this issue: the subrogation waiver clause in the insurance contract; the underlying contract which either requires a co-insurance or contains an undertaking by one party about insurance; and a circumstance in which neither the insurance contract contains an express waiver of subrogation, nor does the underlying contract provide any insurance provision.

This issue is complex, as will be seen throughout this article. The objective of this article is to explore the route of such a complexity and, after analysing the various different opinions presented by the courts, to discuss a solution which fits easily within the established principles of the law on insurers' subrogation.

Subrogation

An insurer confers a contractual right on the assured by a contract of indemnity, with the effect of putting the assured in the same position in which the assured

* Reader of Insurance and Commercial Law.

[1] Insurance contracts are divided into two different categories when more than one party's interests are insured by an insurance contract. A joint insurance is where the co-assured parties' interests are identical. A typical example of this is insurance of their house by a husband and wife. In a composite insurance, the parties' interests are distinct: for instance, insurance of the employers' and the contractors' interests which arise from a construction contract. While, in theory, the difference between a joint and a composite insurance is clear-cut, in practice it is seen that joint insurance is referred to where the contract is composite in its nature. In this work, we will use "joint names insurance" to express the situation where the co-assured parties' interests are distinct from each other.

would have been had the event not occurred, but in no better a position.[2] This contractual right, prima facie, comes into existence immediately when loss is suffered by the happening of an event insured against.[3] In addition to the insurance contract, if the assured has a right to claim the same loss from a third party, upon indemnifying the assured for the insured loss, the insurer stands in the place of the assured[4] and can claim against the third party to the extent that he has paid the loss. The person originally sustaining the loss was the assured; but after he is indemnified, the insurer steps into the assured's shoes.[5] The source of this principle was stated to be "the plainest equity" that could be.[6] Subrogation does not create a fresh right but transfers a right of action.[7] As a result, unless the assured assigns his rights against the third party to the insurer, the insurer has to use the name of the assured.[8] Consequently, the rights and defences that would be available between the assured and the insurer will be available without change between the third party and the insurer.[9]

The court cases have established some limitations to subrogation.[10] The question that this article addresses is, as noted above, whether the insurer can exercise his subrogation right against the co-assured who caused the loss insured against. Various cases in which the interpretation of the insurance and the underlying contracts was at the heart of the matter are discussed in the following sections.

Reference 1: insurance contract—express waiver of subrogation

The first reference point is the contract of insurance. By an express waiver of subrogation, the insurer agrees at the outset of the contract that it will not exercise its subrogation right against the parties who are covered by the waiver clause. A company may be named as the principal assured, and its affiliated and associated companies may appear under the "additional assured" section of the policy. The reason for such an arrangement is usually that the additional assureds have a business relationship with the principal assured.[11] For example, the principal assured is a commodity trader and an associated company is the carrier of the commodity that belonged to the principal assured. The additional assured's reliance on the insurer's express waiver of subrogation may be challenged by the insurer on the

[2] *Callaghan v Dominion Insurance Co Ltd* [1997] 2 Lloyd's Rep. 541 QBD at 544, Sir Peter Webster. The principle of indemnity in insurance may differ in some respects from other types of indemnity. For a very detailed analysis of indemnity, see W. Courtney *Contractual Indemnities* (Oxford: Hart Publishing, 2014); *MacGillivray on Insurance Law*, 13th edn, edited by J. Birds, B. Lynch and S. Paul (London: Sweet and Maxwell, 2015), para.24-002.

[3] *Callaghan v Dominion Insurance* [1997] 2 Lloyd's Rep. 541 at 544.

[4] *Mason v Sainsbury* (1782) 3 Doug. K.B. 61; *Randal v Cockran* (1748) 1 Ves. Sen. 98; *Castellain v Preston* (1883) 11 Q.B.D. 380 CA.

[5] *Randal v Cockran* (1748) 1 Ves. Sen. 98; see also *Colinvaux's Law of Insurance*, 11th edn, edited by R.M. Merkin (London: Sweet & Maxwell, 2016), para.12-001.

[6] *Randal v Cockran* (1748) 1 Ves. Sen. 98l; *Lord Napier and Ettrick v RF Kershaw Ltd (No.1)* [1993] A.C. 71 HL. For the other doctrines that tried to justify subrogation see M.A. Clarke, *The Law of Insurance Contracts* (Abingdon/New York: Informa, last update December 2016), para.31-2; *Colinvaux's Law of Insurance* (2016), paras 12-004, 12-005; *MacGillivray on Insurance Law* (2015) paras 24-015 et seq.

[7] *Simpson & Co v Thomson* (1877) 3 App. Cas. 279 HL.

[8] *Mason v Sainsbury* (1782) 3 Doug. K.B. 61; *Dickenson v Jardine* (1867–68) L.R. 3 C.P. 639.

[9] *London Assurance Co v Sainsbury* (1783) 3 Doug. K.B. 244; *Simpson v Thomson* (1877) 3 App. Cas. 279.

[10] For instance, the assured cannot sue himself and, as a result, where the assured caused a loss to himself, there is no third party against whom the insurer may exercise a subrogation right: *Simpson v Thomson* (1877) 3 App. Cas. 279; Further, the insurer may only subrogate up to the amount that the insurer paid to the assured: *Yorkshire Insurance Co Ltd v Nisbet Shipping Co Ltd* [1962] 2 Q.B. 330 QBD. For a list of "Limits on the Insurer's Rights" see Clarke, *The Law of Insurance Contracts* (2016), paras 31-5 et seq.

[11] See e.g. *The Surf City* [1993] 2 Lloyd's Rep. 582 QBD (referred to below).

basis that the additional assured is not covered by the waiver clause.[12] However, third-party rights under a contract are such that a co-assured may benefit from the waiver clause if the insurance contract either expressly states this or confers a benefit on the co-assured.[13] The co-assured may expressly be named[14] in the contract or may be stated as a group of people.[15]

Further, a subrogation waiver clause is not a blanket abandonment of all claims against the co-assured.[16] If the policy provides co-assured A with cover of a narrower scope than the cover provided by it to the principal assured B, it will only be in respect of loss and damage falling within that narrower scope of cover that subrogated claims are excluded with respect to A. Moreover, the benefits of a clause which provides waiver of subrogation "against any Assured and any person, company or corporation whose interests are covered by this policy …" are confined to insured losses.[17] In *National Oilwell (UK) Ltd v Davy Offshore Ltd*,[18] the cover provided to the co-assured contractor was limited in scope to the period of time before delivery to the principal assured of the item of equipment in relation to which the subrogated claim was advanced. Consequently, that claim was to be excluded only if, and to the extent that, the cover provided to the contractor under the terms of the policy would protect it against such loss, damage or expense relating to its own equipment arising in the circumstances in which such loss, damage and expense actually occurred.[19]

A conflict between *National Oilwell* and *The Surf City*[20] is worth mentioning here, although it was resolved by the Contracts (Rights of Third Parties) Act 1999. In *National Oilwell*, Colman J held[21] that the clause confined the effect of the waiver to claims for losses that are insured for the benefit of the party claimed against under the policy. In *The Surf City*, Clarke J rejected the argument that the express waiver of subrogation clause did not operate against the owner of *the Surf City* because the insurer indemnified a third party but not one of the assureds. In *The Surf City*, the policy insured the named assured as well as "their affiliated and/or subsidiary companies as their respective interests may appear." The insured ship, which was owned by a subsidiary of the principal assured, exploded while loaded with a cargo of naphtha and gas oil. The insurer paid out to the cargo owner and brought a subrogation action against the shipowner. Clarke J rejected the insurer's argument to the effect that the subrogation waiver clause did not operate where it had paid, not the original assured, but the consignee buyer as the assignees of the contract. Clarke J held that the purpose of the clause was to protect the assured. The assured would naturally wish to ensure that if cargo was lost in circumstances in which the buyer rejected the documents, he would be able to recover from his insurers without the insurer being able to claim the money back

[12] C. Mitchell, "Defences to an insurer's subrogated action" [1996] L.M.C.L.Q. 343, 351–352.
[13] Contracts Rights of Third Parties Act 1999 s.1(1).
[14] *Nisshin Shipping Co Ltd v Cleaves & Co Ltd* [2003] 2 C.L.C. 1097 QBD.
[15] *Crowson v HSBC Insurance Brokers* [2010] Lloyd's Rep. I.R. 441 Ch D: company appointed insurance broker to obtain policy insuring directors of the company against liability. Broker failed to do so. Held: that directors had an action against the broker under the 1999 Act, because the term was for their benefit under s.1(1)(b) and they had been identified by class under s.1(3).
[16] J. Henley, "Subrogation, Contribution and Reinstatement", Ch.6 in R. Merkin (ed.), *Insurance Law: An Introduction* (Abingdon/New York: Informa, 2007).
[17] *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep. 582 QBD.
[18] *National Oilwell* [1993] 2 Lloyd's Rep. 582 QBD.
[19] *National Oilwell* [1993] 2 Lloyd's Rep. 582 at 615.
[20] *The Surf City* [1995] 2 Lloyd's Rep. 242 QBD.

from his subsidiary as owner of the carrying ship. The fact that the assured's subsidiary would be protected where the assured was paid under the policy did not mean that it was not to be protected where the insurer paid the c.i.f. buyer and not the original assured.

If the express waiver clause does not operate because, for instance, the claim falls outside the scope of the waiver clause, it does not always follow that the insurer can exercise his right of subrogation against the person who has a contractual relationship with the assured (and who caused the loss indemnified by the insurer). Underlying contract terms are varied, and the matter is ultimately resolved by construing such terms to find out the parties' objective intention under the contract.

Reference 2: construction of the underlying contract terms

Once the insurer steps into the assured's shoes, the insurer and the assured are regarded as one. The insurer can exercise his right of subrogation only if a third party is liable for the loss that the assured suffered. In a co-insurance context, liability of an assured towards the other co-assured is determined in reference to the underlying contract between them.[21] The key issue with regard to the reference to the underlying contract is whether or not the contracting parties' liability is excluded or retained by the terms of the contract. This will also require consideration of whether or not the underlying contract provides that one party will take out insurance in the name or for the benefit of all the contracting parties.

The underlying contract requires co-insurance—construction of terms

The aim of construing contractual terms is to identify the parties' intention objectively. One of the main principles of contractual construction is that the underlying contact should be construed as a whole. The basis of subrogation is that a third party is liable for the loss insured and the insurer's payment does not discharge the third party's liability. The clause at the heart of the matter is the co-insurance provision. Two different questions are raised here: (a) is a co-insurance provision in the underlying contract sufficient to construe that the defendant's liability is excluded, so long as the matter is covered by the insurance policy? (b) alternatively, is the co-insurance provision not to extinguish but only to satisfy the co-assured's liability under the underlying contract? The natural outcome of (a), if the answer is affirmative, is that there will be no liability that may be argued in a subrogation action. If an affirmative answer to (b) is preferred, the liability would exist, and the function of insurance is to satisfy such liability which would then entitle the insurer to a subrogation action against the co-assured who caused the loss.

The above-mentioned questions basically derived from Rix LJ's analysis of the matter in *Tyco Fire & Integrated Solutions (UK) Ltd v Rolls-Royce Motor Cars*

[21] *Cooperative Retail Services Ltd v Taylor Young Partnership Ltd* [2002] Lloyd's Rep. I.R. 555 HL at [65]; *Rathbone Brothers Plc v Novae Corporate Underwriting Ltd* [2015] Lloyd's Rep. I.R. 95 CA (Civ Div) at [89]. Beatson LJ agreed. Sharp LJ was in favour of implying a term in the policy to this effect: see [124]; *Gard Marine & Energy Ltd v China National Chartering Co Ltd* [2017] 1 Lloyd's Rep. 521 SC.

Ltd,[22] which involved the construction of a new green-field site manufacturing plant in West Sussex. Tyco Fire & Integrated Solutions (UK) Ltd, one of the contractors at the site, provided fire protection services, including a sprinkler system. One of the mains supply pipes burst and caused an escape of water, damaging both the works carried out by Tyco and other parts of the plant. Tyco has repaired the damage to the works but as for the damage to other parts of the development, Tyco argued non-liability since the contract between Tyco and Rolls Royce provided for joint names insurance, which relieved Tyco of liability for its negligence. The contract between Rolls Royce and Tyco on the one hand provided that Rolls Royce was to maintain, in the joint names of Rolls and Tyco, insurance of existing structures.[23] On the other hand, it also required Tyco to indemnify Rolls Royce against

> "any damage, expense, or loss whatsoever suffered by Rolls Royce or incurred to any third party to the extent that the same arises out of or in connection with any breach of the contract or any negligence or breach of statutory duty on the part of Tyco".

Rix LJ[24] distinguished the following two circumstances: (1) the underlying contract clearly provides that there is to be no liability of a contractor to his employer in the area of the regime for joint names insurance; (2) there is no such clarity in that direction, but, on the contrary, if anything there is, or appears to be, clarity in another direction, namely in favour of the contractor's continued liability to his employer for his negligence. In case (1), Rix LJ found that "the true basis of the rule is the contract between the parties" works in a straightforward way, but his Lordship was of the view that in (2) it was not the case. *Cooperative Retail Services v Taylor Young Partnership*[25] illustrates case 1 in the way that the contract between the employer and the contractors required the contractor to take out a joint names policy for all risks insurance for the full reinstatement value of the works and to maintain that policy until practical completion. The contract expressly precluded any liability in negligence on the part of the main contractor to the employer for loss and damage to the works which might have been caused by fire prior to the date of practical completion. Instead, the funds necessary to pay for the restoration of the physical damage caused to the works by fire, including the associated professional fees, were to be provided by means of insurance under the joint names policy. Lord Bingham interpreted the contract to the effect that the employer would be effectively indemnified by the insurers' provision of a fund enabling it to pay contractors for repairing the fire damage. The insurers could not then make a subrogated claim against the contractor because he was a party co-insured with the employer under the policy, and the insurers would be obliged to indemnify the contractor against any liability which might be established—an obvious absurdity.[26]

[22] *Tyco Fire & Integrated Solutions (UK) Ltd v Rolls-Royce Motor Cars Ltd* [2008] 1 C.L.C. 625 CA (Civ Div).

[23] Rolls-Royce had not, in fact, taken out any insurance in the joint names of Tyco and itself, but it was common ground that the issue between the parties had to be resolved just as if it had.

[24] *Tyco Fire* [2008] 1 C.L.C. 625 at [76].

[25] *Cooperative Retail Services* [2002] Lloyd's Rep. I.R. 555.

[26] See also *Scottish & Newcastle Plc v GD Construction (St Albans) Ltd* [2003] Lloyd's Rep. I.R. 809 CA (Civ Div) at [27]. The employer was required to take out a joint names policy for the employer and the contractors and the contract also explained that "'Joint Names Policy' means a policy of insurance which includes the Employer and the Contractor as the insured and under which the insurers have no right of recourse against any person named as an insured, or pursuant to clause 6.3.3 recognised as an insured thereunder". In this case *CRS* was approved and the

On the other hand, in *Tyco*, Rix LJ distinguished *CRS* and held that the liability provision must not be ignored in assessing a claim by one co-assured (or by the insurer in the assured's name in subrogation) against another.

There are other English cases which have discussed the insurer's subrogation against either a co-assured or a party who may be a contractual beneficiary to the insurance, and all those cases will be mentioned in the following sections with respect to the classification of the principle adopted in them. Most recent to the writing of this piece, in *Gard Marine & Energy Ltd v China National Chartering Co Ltd*,[27] the Supreme Court, in obiter, discussed extensively the two questions set out under (a) and (b) above. The facts of the case are as follows: the *Ocean Victory* was a bulk carrier built in China in 2005 and demise chartered to Ocean Line Holdings Ltd (OLH) in the same year. The owners and demise charterers were associated companies in the same group. There were then time charterparties entered into between OLH and China National Chartering Co Ltd (Sinochart), and Sinochart and Daiichi Chuo Kisen Kaisha (Daiichi). All the charterparties provided an undertaking to trade the vessel between safe ports. After completing her voyage from Saldanha Bay in South Africa to Kashima, the *Ocean Victory* grounded at Kashima and eventually broke into two.

Gard Marine & Energy Ltd (Gard), one of the vessel's hull insurers at the time of her loss, took assignments of the rights of OLH and OVM in respect of the grounding and total loss of the vessel. Gard subsequently brought a claim against Sinochart (which Sinochart passed on to Daiichi) in its capacity as assignee of those rights and claimed damages for breach of the charterers' undertaking to trade only between safe ports.

At first instance, Teare J held in favour of Gard: the charterer had breached the safe port provision and Gard was awarded substantial damages. The Court of Appeal allowed the appeal on the grounds that there was no breach of the safe port undertaking on the part of the charterers. Obiter, the Court of Appeal also held that Gard's action would not be sustainable given the insurance provisions of the demise charterparty.

The Supreme Court unanimously dismissed the appeal on the safe port issue. This ruling rendered it unnecessary to discuss whether Gard has a right of action against the time charterers but, "because the question is of some general importance",[28] the Supreme Court discussed it in detail, with their Lordships' view being divided 3/2 in favour of the charterer. The issue was whether the joint names insurance requirement in cl.12[29] of the Barecon 89 form precluded rights of subrogation of hull insurers against the demise charterers for breach of the express safe port undertaking.

Their Lordships, including the minority view,[30] acknowledged that, in the case of co-insurance where the insurance is taken out for the wrongdoer assured as well

express "no right of recourse" provision in the underlying contract was found even stronger than CRS to express subrogation immunity.

[27] *Gard Marine & Energy Ltd v China National Chartering Co Ltd* [2017] 1 Lloyd's Rep. 521 SC.

[28] See *Gard Marine* [2017] 1 Lloyd's Rep. 521, Lord Sumption at [93]; Lord Toulson at [129].

[29] Clause 12 of the demise charter provided for the demise charterers to procure insurance for the vessel at their own expense against marine, war and protection and indemnity risks, for the joint interests of themselves and the head owners.

[30] *Gard Marine* [2017] 1 Lloyd's Rep. 521, Lord Sumption at [98]–[99]; Lord Clarke agreed with Lord Sumption at [57].

as the assured who suffered loss, the insurer's subrogation right is not exercised. The co-insurance of employer, contractor and subcontractors under standard forms of building contract is one of the obvious examples of this case. The Supreme Court was then divided in choosing whether reason (a) or (b) above was the ground for not allowing the insurer's subrogation action against a co-assured. The questions raised in the two cases, *Tyco* and *Gard Marine*, are identical; however, in the latter, each of their Lordships discussed the above-mentioned questions from different angles.

It should first be noted that the basis of Gard's claim, on which the demise charterer was in a position to claim damages from a sub-charterer for the loss of a ship of which he was the bailee but not the owner, was that he is himself liable to the head owner under the demise charter.[31] If the demise charterers are not so liable, then they have suffered no loss in respect of the vessel and have no claim to pass on to the intermediate charterers. This then led to the discussion of the questions which are at the heart of the matter.

Lord Clarke and Lord Sumption represented the minority views. Lord Clarke emphasised the rules of contractual construction: that is, the demise charterparty must be given the meaning which, taking into account the background known to both parties, it would reasonably be understood to bear. This led his Lordship to conclude that, in circumstances where the demise charterparty contains a clear safe port warranty, any exemption of the demise charterers from liability in damages for breach of the safe port warranty is expected to be clearly expressed.[32] Interpreting cl.12 in the present context as an exhaustive code of the rights and liabilities of the parties would render cl.29, which contains a safe port undertaking, nugatory.[33] Teare J was influenced by *Tyco* in permitting Gard's cause of action. At the Supreme Court, only Lord Clarke referred to *Tyco* (through a reference to Teare J), and his Lordship agreed that it was intended that the demise charterer would be liable to the owner for breach of the safe port warranty, notwithstanding that they were joint assured. Lord Sumption, who agreed with Lord Clarke, expressed further analysis of the matter.

Lord Sumption adopted (b) above.[34] His Lordship relied on the general rule that insurance recoveries are ignored in the assessment of damages arising from a breach of duty.[35] As a result, based on public policy, insurance recoveries are intended to inure to the assured's benefit alone in consideration of the premium paid. Moreover, protecting insurers' subrogation rights is necessary as an important part of the economics of insurance. Lord Sumption concluded that, against the third party wrongdoer, the insurance payment is *res inter alios acta*—in the words of his Lordship (loosely translated), none of his business.

Lord Mance's analysis was very concise and straightforward, and stated that the absence of an express subrogation waiver in cl.12 meant that it never occurred to the parties that there could be such claims as those disputed in the present case. Payments made under marine and the war risks insurances go to owners (or their

[31] Lord Sumption referred to two more possibilities (a bailee's possessory title and the principle of transferred loss); however, these two were not discussed in detail as the insurer confined their case to the above.

[32] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [49].

[33] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [52].

[34] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [102].

[35] His Lordship named this as the collateral payments exception and referred to *Bradburn v Great Western Railway Co* (1874) L.R. 10 Ex. 1; *Parry v Cleaver* [1970] A.C. 1 HL.

mortgagees) and charterers for their respective interests in the hull. Permitting a claim against the charterer would mean satisfying and at the same time imposing liability on the charterers against the owners. Taking into account the scheme in the present context, his Lordship was persuaded that that is clearly not what the parties intended. Lord Toulson, with whom Lord Hodge agreed, emphasised another purpose of maintaining a joint names insurance, which is to avoid litigation between the co-assureds, and cl.29 did not subvert that intention.[36]

The underlying contract contains a co-insurance provision—implied term

It has been observed through the different court cases that another aspect from which the underlying contract may be analysed is finding an implied term in the contract to the effect that, owing to the joint names insurance provision, the parties impliedly agreed that they would look to the insurer for their loss but not to each other. The result is the same as interpreting the contract in the manner explained above, but the addition here is that a term is implied in the contract. In *Rathbone Brothers Plc v Novae Corporate Underwriting Ltd*,[37] Elias LJ applied Lord Hoffmann's speech in *Attorney General of Belize v Belize Telecom Ltd*,[38] where he said that

> "the implied term must 'go without saying', it must be 'necessary to give business efficacy to the contract' and so on … There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean …?".

Some other views, on the other hand, expressed the necessity of implying a term for "officious bystander" or "business efficacy" reasons. In *Hopewell Project Management Ltd v Ewbank Preece Ltd*,[39] Mr Recorder Jackson QC, obiter, stated that it would be nonsensical if those parties who were jointly insured under a contractors all-risks policy could make claims against one another in respect of damage to the contract works. The deputy judge was prepared to imply a term in the underlying contract to this effect because such a result could not possibly have been intended by those parties.[40] In *Rathbone Brothers v Novae Corporate Underwriting*, Elias LJ explained that the question of how risks have been allocated between insurers and assured has to be construed by reference to the terms which the parties have agreed.[41] It could not have been the intention of the parties that the insurers should be able to enforce rights of indemnity against a co-assured

[36] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [142].

[37] *Rathbone Brothers Plc v Novae Corporate Underwriting Ltd* [2015] Lloyd's Rep. I.R. 95 CA (Civ Div). Elias LJ proceeded on the basis that the present case did not raise an issue of co-insurance at all in the strict sense. The parties settled after the trial and the judgment was delivered by the Court of Appeal only because of a request by *Rathbone* and the Court of Appeal's view that the points were of some importance.

[38] *Attorney General of Belize v Belize Telecom Ltd* [2009] 2 All E.R. 1127 PC (Belize).

[39] *Hopewell Project Management Ltd v Ewbank Preece Ltd* [1998] 1 Lloyd's Rep. 448 QBD at 458. Approved by *Co-operative Retail Services v Taylor Young Partnership* [2002] Lloyd's Rep. I.R. 555 HL.

[40] *Hopewell Project Management* [1998] 1 Lloyd's Rep. 448 at 458; approved by *Co-operative Retail Services v Taylor Young* [2002] Lloyd's Rep. I.R. 555.

[41] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [85], Elias LJ.

where the co-assured was indemnifying the very same risk as the insurers.[42] Implying the term is simply making express what the parties must have intended.[43]

In *Tyco*, however, Rix LJ stated that, although a provision for joint names insurance may influence, perhaps even strongly, the construction of the contract in which it appears, an implied term cannot withstand express language to the contrary.[44] The judge pointed out that it is unusual for an insurer to sue his own insured to recover insurance proceeds due under his own policy, but it must be recalled that he does so in the name of and under the right of another party, namely the employer.[45] In *Gard Marine* the majority decision was not based on the implied term, although Lord Mance stated that the reason why owners have no claim against charterers for the loss of the vessel was that "it is understood implicitly that there will be no such claim".[46] On the other hand, Lord Clarke, in his dissenting view, rejected either to read cl.12 excusing the demise charterer's liability to the owner or to imply a term to that effect.[47]

The underlying contract contains a co-insurance provision—construction of insurance contracts

The construction of the insurance contract may reveal two different justifications for the insurer's inability to exercise his subrogation rights against a co-assured. The first is circuity of action, namely that insurers who have paid out to an assured for loss or damage cannot bring a subrogated claim against a co-assured who is himself insured in respect of the very same loss or damage, because he himself would make a claim under the policy. Lloyd J expressed on two different occasions that the reason for not permitting the right of subrogation in the present context was not a fundamental principle to this effect but rests on ordinary rules about circuity.[48] Lloyd J said[49]:

> "Whatever be the reason why an insurer cannot sue one co-insured in the name of another, and I am still inclined to think that the reason is circuity, it seems to me now that it must apply equally in every case of bailment, whether it is the goods which the bailee has insured, or his liability in respect of the goods. The same would also apply in the case of contractors and sub-contractors engaged on a common enterprise under a building or engineering contract. Even if I still had reservations of the kind which I tried to voice in *The Yasin*, I would feel obliged to bury them in the light of the decision of the Supreme Court of Canada in the *Commonwealth Construction Co.* case, a decision which was not cited in *The Yasin* … ."

The circuity principle was disfavoured in later cases and some other justifications have been developed as discussed above.

[42] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [85], Elias LJ.
[43] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [85], Elias LJ.
[44] *Tyco* [2008] 1 C.L.C. 625 at [76].
[45] *Tyco* [2008] 1 C.L.C. 625 at [77].
[46] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [122].
[47] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [53].
[48] *The Yasin* [1979] 2 Lloyd's Rep. 45 QBD; *Petrofina (UK) Ltd v Magnaload Ltd* [1984] Q.B. 127 QBD.
[49] *Petrofina* [1984] Q.B. 127 at 140.

The alternative rationale relies on an implied term (as opposed to the above, here the term is implied in the insurance contract) whereby insurers, having paid co-assured A, are precluded from suing co-assured B.[50] Business efficacy necessitates such an implication,[51] that is, that exercising subrogation rights against a co-assured would be completely inconsistent with the insurer's obligation to the co-assured under the policy.[52] Permitting otherwise would result in a situation where the insurer would claim from the co-assured the loss or damage to the very subject-matter of the insurance in which this co-assured has an insurable interest and a right of indemnity under the policy.[53] The insurer cannot at once promise to indemnify a person against loss or damage whether or not negligently caused—and obtain a premium on that footing—while reserving the right to recoup that loss from him if another insured makes a claim under the policy.[54]

No co-insurance provision, but the defendant is an intended beneficiary

Emphasis has been made on an insurance provision in the underlying contract which does not necessarily include a co-insurance but ultimately insurance of a contracting party.[55] Who will pay for the insurance premium is determined by the underlying contract. The non-insured party may be required to contribute to the insurance cost, and at the same time he may undertake some contractual liabilities.[56] If construing the contract leads to the conclusion that the parties truly intended that the insurance was for the joint benefit of the parties, this would be enough for the courts to determine the matter. In the context of tenancy agreements, the fact that the tenant was not an insured person has not precluded the courts from finding that the insurance was for the benefit of the landlord as well as the tenant.[57] The insurance provision, depending on the other terms of the underlying contract, is likely to be interpreted as leaving no liability on the defendant with regard to the matters that are covered by the insurance contract. Therefore, clear words of express exclusion of liability are not needed.[58] The insurer's subrogation right is not denied; however, such a right is bereft of content as there is no claim to which the insurers'

[50] Some views in the literature have supported that the implied term in insurance contract is the most convincing rationale in this respect as it arises out of the insurer's obligations to the co-insured parties. See D. Ward, "Joint names insurance and contracts to insure: untangling the threads" [2009] L.M.C.L.Q. 239, 240; N. Beresford and J. Turnbull found that the most convincing rationale is that of an implied term in the insurance contract. See *Insurance Disputes*, 3rd edn, edited by J. Mance et al. (Abingdon/New York: Informa, 2011), Ch.9, paras 9-45 and 9-55.

[51] *Stone Vickers v Appledore Ferguson Shipbuilders* [1991] 2 Lloyd's Rep. 288 at 302; *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep. 582 QBD at 613–614.

[52] *Stone Vickers* [1991] 2 Lloyd's Rep. 288 at 302. Colman J's judgment was reversed by the Court of Appeal, [1992] 2 Lloyd's Rep. 578, on the limited grounds that on the proper construction of the relevant documents, the suppliers had not proved that the head contractors had any intention to insure the suppliers. There was therefore no privity of contract between the suppliers and the head contractors. The Court of Appeal did not consider the rest of the judgment.

[53] *Stone Vickers* [1991] 2 Lloyd's Rep. 288 at 302.

[54] Ward, "Joint names insurance and contracts to insure: untangling the threads" [2009] L.M.C.L.Q. 239, 243.

[55] *Fresca-Judd v Golovina* [2016] EWHC 497 (QB); [2016] 4 W.L.R. 107.

[56] *Mark Rowlands Ltd v Berni Inns* [1986] Q.B. 211 CA (Civ Div); *Quirkco Investments Ltd v Aspray Transport Ltd* [2013] Lloyd's Rep. I.R. 55 Ch D.

[57] *Mark Rowlands* [1986] Q.B. 211; *Fresca-Judd* [2016] EWHC 497 (QB); [2016] 4 W.L.R. 107.

[58] *Fresca-Judd* [2016] EWHC 497 (QB); [2016] 4 W.L.R. 107. If the underlying contract provides that insurance is to be "in joint names as their interest may appear", the agreement is likely to be construed as being an agreement to insure for the parties' joint benefit. *Gard Marine & Energy Ltd v China National Chartering Co Ltd* [2015] 1 Lloyd's Rep. 381 CA (Civ Div) at [78].

right to subrogation can attach.[59] In other words, the underlying contract between the co-assureds denudes the subrogation right of any substance and thus precludes its exercise.[60] These principles also apply in the above-mentioned case where the underlying contract provides a co-insurance requirement.

The principle that "the insurance position must not be ignored" was applied in *The Evia (No.2)*,[61] where the underlying contract did not contain a joint insurance obligation, but it was clear that the defendant was the intended beneficiary. In this case, the charterparty war risks clause provided that, if the vessel was ordered into a war risk zone, the owners were entitled to insure against the risk of loss or damage to the vessel and recover the premiums from the charterer. The House of Lords was of the view that, on the assumption that there was a breach of the safe port obligation, the charterers, having paid for the extra war risk insurance, were freed from any liability that they had for breach of that obligation. This was the case although the charterer was not a co-assured. In *Gard Marine*, only Lord Clarke referred to *The Evia (No.2)* to distinguish it since Lord Clarke rejected that cl.12 was an exhaustive code of the rights and liabilities of the parties.[62] In *The Evia (No.2)*, the relevant consideration is not the conditions of any insurance policy but the fact that the underlying contract makes provision for the effecting of extra insurance at the charterer's expense. Similar considerations were applied in *Mark Rowlands v Berni Inns*,[63] in which the tenant was contractually required—in addition to the rent—to pay "insurance rent" equal to the sum paid by the landlord to insure the premises pursuant to a landlord's covenant to insure. The tenant's negligence caused a fire which damaged the premises. The court construed the tenancy agreement to the effect that the landlord's loss was to be recouped from the insurance moneys and that, in this event, the landlord was to have no further claim against the tenant for damages in negligence.[64] Holgate J applied the *Rowlands* principle in *Fresca-Judd v Golovina*,[65] where he held that the fact that the defendant pays for the premium might be a strong indication that the loss should not be claimed from the defendant, but the main determining issue is the insurance provision that the landlord agreed to insure the premises. In *Fresca-Judd*, the tenant was not under any obligation to contribute to the cost of the insurance. The contract provided that the rent would cease to be payable in case the premises were inhabitable, which persuaded the judge that the risk was transferred to the insurer, not to the tenant, for instance, if the premises were damaged by flood and became inhabitable until they were repaired.

Analysis

Owing to diverse opinions on the question addressed in this work, it was necessary to set out the various types of interpretation above. The author submits that the following considerations should be taken into account while investigating which

[59] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [115], Beatson LJ.
[60] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [67], Elias LJ.
[61] *The Evia (No.2)* [1983] 1 A.C. 736 HL.
[62] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [52].
[63] *Mark Rowlands* [1986] Q.B. 211.
[64] Approved obiter in *Quirkco Investments* [2013] Lloyd's Rep. I.R. 55 at [43]–[44].
[65] *Fresca-Judd* [2016] EWHC 497 (QB); [2016] 4 W.L.R. 107.

of the above-mentioned opinions fits best in the settled principles of insurance law.

Who is first liable?

When, in *Mason v Sainsbury*,[66] Lord Mansfield CJ asked "Who is first liable?", his question was directed not to any issue of chronology but to establishing where the primary responsibility lay to make good the loss.[67] This question should be the starting point in the interpretation of the underlying contract terms.[68] As Lord Toulson stated in *Gard Marine*, the question in each case is whether the parties are to be taken to have intended to create an insurance fund which would be the sole avenue for making good the relevant loss or damage, or whether the existence of the fund co-exists with an independent right of action for breach of a term of the contract which has caused that loss.

As opposed to the majority view, in *Gard Marine* Lord Sumption stated that the starting point should be the principle that insurance recoveries are ignored in the assessment of damages that the third party can claim from a third party. Indeed, this is one of the justifications of insurers' subrogation. However, the question of "who is first liable" is to be raised before discussing the collateral payment exception that Lord Sumption referred to. Subrogation allows the paying party to recover from the primary source of indemnity.[69] The question of "who is the primary indemnifier" is best addressed by reference to the parties' various relationships and the context of the liability concerned.[70] If the party who has the primary liability to pay the loss pays out in full, that discharges the obligation of any other indemnifier.[71] If, on the other hand, the paying party's liability is secondary, then the payment is *res inter alios acta* and does not discharge the liability of the primary party.[72] In principle, a recovery upon a contract with the insurers is no bar to a claim for damages against the wrongdoer as the insurer's payment does not extinguish the third party's liability.[73] However, for the reasons stated above, this principle does not apply when the defendant to the subrogation action is a co-assured or where the insurance is for the benefit of the parties to the underlying contract. It is not further required that the insurer must pay in order to have this outcome.[74] If the parties agreed to claim the loss from the insurer only and not from each other, there is no right to transfer to the insurer[75]; there are no shoes to borrow.[76] In *Mark Rowlands v Berni Inns*,[77] the insurance money was not *res inter alios acta* so far as the tenant was concerned. The terms of the tenancy agreement were that the property would be rebuilt from the proceeds of the insurance claim and, accordingly, there was no claim in negligence that could be brought against

[66] *Mason v Sainsbury* (1782) 3 Doug. K.B. 61 at 64.
[67] *Mason* (1782) 3 Doug. K.B. 61 at 64, Lord Mansfield CJ; *Caledonia North Sea Ltd v London Bridge Engineering Ltd* [2002] 1 Lloyd's Rep. 553 HL at [14], Lord Bingham.
[68] *Mason* (1782) 3 Doug. K.B. 61; *Yates v Whyte* (1838) 4 Bing. N.C. 272.
[69] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [91], Elias LJ.
[70] R. Merkin and J. Steele, *Insurance and the Law of Obligations* (Oxford: Oxford University Press, 2013), p.130.
[71] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [91], Elias LJ.
[72] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [91], Elias LJ.
[73] *Mason* (1782) 3 Doug. K.B. 61.
[74] *Gard Marine* [2017] 1 Lloyd's Rep. 521, Lord Mance at [122].
[75] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [67], Elias LJ
[76] P. James, "The Fallacies of Simpson v Thomson" (1971) 34 Mod. L. Rev. 149, 153.
[77] *Mark Rowlands* [1986] Q.B. 211.

the tenant. The contracting party whose negligence caused the loss may be liable, on the other hand, if the innocent party's loss is not covered by the insurance contract.[78]

Moreover, when an insurer subrogates into the assured's rights, insurer and assured are regarded as one.[79] The right of the insurers is merely to make such a claim for damages as the assured himself could have made.[80] In the co-insurance context, it is arguable that when the insurer pays one of the co-assureds, the insurer and all the co-assureds are regarded as one with respect to the claims that fall within the insurance contract. The assured cannot sue himself, as established by *Simpson & Co v Thomson*,[81] in which two ships that belonged to the same owner collided. The underwriters paid the insurance effected on the lost ship, and then claimed to rank pari passu, with the owners of cargo destroyed, in the distribution of the fund lodged in court by the owner as proprietor of the ship which did the damage. Having reiterated that the insurance was a contract of indemnity, it was held that it would be "little short of an absurdity" that the underwriters should, in the first place, indemnify the assured for the consequences of the negligent navigation according to their contract, and immediately afterwards recover the amount from the very same assured as damages occasioned by his negligent navigation. This, in fact, expresses the same principle that Lloyd J mentioned with respect to the circuity principle. Whether the reason is circuity or not, all the views which deny the insurer's subrogation agree that subrogation does not fit easily in this context. Subrogation becomes irrelevant for the lack of any shoes to borrow. Colman J stated in *National Oilwell*[82] that any attempt by an insurer after paying the claim of one assured to exercise rights of subrogation against another would, in effect, involve the insurer seeking to reimburse a loss caused by a peril (loss or damage even if caused by the assured's negligence) against which he had insured for the benefit of the very party against whom he now sought to exercise rights of subrogation.[83] In rejecting a subrogation action against a co-assured, Colman J said[84]:

> "As a matter of logic Lord Cairn's reasoning would lead to the same result, namely that there would be no available right of subrogation, if the owner of the guilty ship had been a co-assured under the policy on the innocent ship for the same perils."

If underwriters had attempted to sue him by subrogation he could also resist the claim on the grounds that he was as much the assured in respect of the relevant perils as if he were the same person as the owner of the innocent ship. As Lord Mance commented in *Gard Marine*, adopting option (b) would mean treating the present co-insurance as if it involved two separate and severable insurances, leaving charterers exposed, without liability cover, to claims for breach of charter or duty

[78] This may be expressed in the underlying contract. See *Fresca-Judd* [2016] EWHC 497 (QB); [2016] 4 W.L.R. 107.
[79] *Mason* (1782) 3 Doug. K.B. 61.
[80] *Simpson* (1877) 3 App. Cas. 279; *Caledonia North Sea Ltd v London Bridge Engineering Ltd* [2002] 1 Lloyd's Rep. 553 HL at [11], Lord Bingham.
[81] *Simpson v Thomson* (1877) 3 App. Cas. 279.
[82] *National Oilwell* [1993] 2 Lloyd's Rep. 582 at 613–614.
[83] *National Oilwell* [1993] 2 Lloyd's Rep. 582 at 613–614.
[84] *National Oilwell* [1993] 2 Lloyd's Rep. 582 at 614.

brought by owners in respect of loss of the hull. Clearly, that is not what the parties intended by including a co-insurance provision in the underlying contract. Further, the parties' must have also intended to avoid disputes between them, which becomes even clearer in a context such as that of *Gard Marine* where the owner and the demise charterers are associated companies in the same group. As a result, it becomes no answer that demise charterers might in turn have a back-to-back claim for damages against sub-charterers. Moreover, the demise charters may not have a claim against a sub-charterer in the case, for instance, that they were trading the vessel on their own account or the sub-charterer traded on different terms to the demise charterparty.[85]

A further response to the collateral payment exception which Lord Sumption referred to is that one of the main reasons why parties take out insurance is that they need to be covered for the consequences of their own negligence. The prima facie position where a contract requires a party to that contract to insure, should be that the parties have agreed to look to the insurers for indemnification rather than to each other. This was again stated to be the case—although obiter—in *Rathbone Brothers*, where the underlying contract consisted of an employer's indemnity granted to an employee.[86] In *Rathbone*, Elias LJ was prepared to imply a term in the underlying contract to the effect that it was intended to provide supplemental protection only once the claim against the insurance company had been exhausted.[87] Moreover, the fact that the guilty co-assured paid the premium, justified treating insurance as the primary liability.[88]

In *Gard Marine*, cl.13 of the charterparty provides an express waiver of subrogation by the owner against the charterer. Clause 13 was optional if it is voluntarily applied, and cl.12 was to be considered deleted. The parties did not expressly agree that cl.13 applied, and therefore cl.12 did. Lord Clarke found that by deleting cl.13, the demise charterers chose not to be bound by cl.13.[89] Lord Toulson referred to BIMCO's explanation for the optional alternative of cl.13, which was that sometimes a vessel is bareboat chartered for only a short period and it may make sense for the owners to carry on with the insurances which they are likely to have in place. For example, in insurance of passenger vessels bareboat chartered for a short cruise or ferries hired just for a short summer season, it is normal practice that the shipowners continue with the insurances for their own account. In such a case, cl.13 would be an obvious choice. Although dissenting in this case, Lord Sumption also recognised that cl.13 is designed for a very different kind of chartered service.[90]

It should be further noted that precluding insurers' subrogation rights in the circumstances stated above is not contrary to "justice, reasonableness and public

[85] *Gard Marine* [2017] 1 Lloyd's Rep. 521, Lord Mance at [119].

[86] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95. Rathbone Trustees granted to PEV, a solicitor and an employee of Rathbone, a joint and several indemnity of up to £40 million for liabilities arising from the performance of his services, other than liabilities arising from fraud or wilful misconduct. The consultancy agreement between PEV and Rathbone provided that Rathbone was to provide PEV with professional indemnity insurance for work done and services provided to clients. The beneficiaries of the Walker Trust commenced proceedings against the trustees, including PEV, alleging breach of professional and fiduciary duty from whether the insurers were entitled to recoup their payment from Rathbone by way of subrogation, i.e. in reliance upon the indemnity clause in the contract between PEV and Rathbone.

[87] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [104], Elias LJ.

[88] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [105], Elias LJ.

[89] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [53].

[90] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [105].

policy".[91] This was an additional support for the conclusion stated above.[92] Enforcing insurers' subrogation rights in those cases may lead the contracting parties to seek their own insurance to cover their liability for the same risks. This would introduce additional and unnecessary insurance costs. Moreover, the benefit conferred upon the contractor by the other contractor's undertaking to insure would, to that extent, be negated.[93] Further, one of the commercial purposes of maintaining a co-insurance is to avoid litigation between the parties to the underlying contract and the bringing of a subrogation claim in the name of one against the other.[94]

What if the insurers do not pay?

Does the outcome on the issue of insurer's subrogation in co-insurance (whether subrogation is prevented or granted) depend on whether or not the insurance moneys have yet been paid? The insurer may not pay, for instance, because the co-assured who claimed under the insurance contract was in breach of the insurance contract or the duty of fair presentation of the risk. A joint names insurance in the present context is composite in the nature that the parties' interests are separable; therefore, insurers' defences against one party leave intact another party's defence. Clearly, whether or not the insurer has a sustainable argument against the co-assured's claim is not a concern in analysing another co-assured's rights under the insurance. Alternatively, if the insurer rejects liability because the claim is excluded from the policy cover, and the underlying contract does not require co-insurance in that respect, this would be outside the scope of the co-insurance provision.

Another consideration, the effect of which was discussed in *Gard Marine*, is insurer's insolvency. If the insurer's insolvency occurs before a loss, the lack of insurance cover at that stage might be considered as breach of the underlying contract which should be remedied by the party who is responsible for arranging the insurance. On the other hand, insolvency after a loss raises separate problems. Breach of the underlying insurance term which requires co-insurance is not breached given that the insurance was in force at the time of the loss. If option (b) is adopted, the risk of the insurer's insolvency would fall back on the party who caused the loss given that the liability between the co-assureds was not satisfied by the insurer.[95] A link with the question "who is first liable" becomes clear. In *Gard Marine*, Lord Sumption proposed that option (b) ensures compensation of the damages by the party who caused the loss in the case that, for some reason, the insurer did not pay.[96] The demise charter terminates upon the total loss of the ship[97]: the demise charterer would be bound to pay damages, not because he was responsible for the lack of insurance but because he was liable for the destruction of the ship in breach of his contract. Lord Mance, on the other hand, found insurer's insolvency a remote eventuality which could not be a guide to the meaning of cl.12 (or 13).[98] Further, in the present context and its scheme, the risk lies where it falls.[99]

[91] *Mark Rowlands* [1986] Q.B. 211.
[92] *Fresca-Judd* [2016] EWHC 497 (QB); [2016] 4 W.L.R. 107.
[93] *Fresca-Judd* [2016] EWHC 497 (QB); [2016] 4 W.L.R. 107 at [77].
[94] *Gard Marine* [2017] 1 Lloyd's Rep. 521, Lord Toulson at [142].
[95] *Tyco* [2008] 1 C.L.C. 625 at [79], Rix LJ.
[96] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [103].
[97] Clause 12d.
[98] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [123].
[99] *Gard Marine* [2017] 1 Lloyd's Rep. 521 at [123].

Lord Mance considered as an alternative argument, although contractually the charter terminates as of the date of any total loss, that the risk lies by implication on the party responsible for maintaining the insurance during the charter period. His Lordship concluded, and Lord Hodge and Lord Toulson agreed, that it was unnecessary on this appeal to decide which of these two alternatives would apply given that the focus of the interpretation was quite different from insurer's insolvency.

Delay in payment raises a different question, to which the answer would be that either party is at liberty to sue the insurers to judgment.[100] Alternatively, the co-assured who caused the loss is not a co-assured in the absence or unavailability of insurance cover and will be liable for the loss.

It should be remembered that there may be circumstances where the insurance cover does not meet the full liability, in which case the co-assured can take advantage of that payment to the extent that the liability is discharged by the insurance moneys and treat it as discharging *pro tanto* its own obligations.[101] It is open to the parties to expressly agree at the outset that the contractor would be liable for the loss that the other contracting party suffered, in case the insured risk is not satisfied by the insurer.[102] Similarly, the insurer may exercise his subrogation right against a person co-assured where the co-assured defendant's breach of policy has (a) caused the policy to be avoided vis-à-vis himself, or (b) made it impermissible for the defendant to claim under the policy.[103]

Insurable interest

As established by the English courts, a sub-contractor involved in a construction project has a pervasive insurable interest in the entire contract works, although his involvement in the work may be limited to only some part of the work.[104] *Stone Vickers v Appledore Ferguson Shipbuilders* involved a contract in which the head contractor of a shipbuilding contract agreed with a sub-contractor who was going to supply a tailshaft for the vessel. It was argued that the supplier would not have an insurable interest in the whole contract works. The terms of the sub-contract holds the sub-contractor liable to the owner of the property for loss of or damage to such property caused by that sub-contractor's fault.[105] It was held that the supplier of a part to be installed into the vessel or contract works under construction might be materially adversely affected by loss of or damage to the vessel or other works by reason of the incidence of any of the perils insured against by the policy in question.[106] The view is that there is no reason in principle why such a sub-contractor should not also have sufficient interest in the whole contract works to be included

[100] *Gard Marine* [2015] 1 Lloyd's Rep. 381 at [91].

[101] *Rathbone Brothers* [2015] Lloyd's Rep. I.R. 95 at [103], Elias LJ.

[102] *Fresca-Judd* [2016] EWHC 497 (QB); [2016] 4 W.L.R. 107.

[103] *Board of Trustees of the Tate Gallery v Duffy Construction Ltd* [2007] Lloyd's Rep I.R. 758 QBD at 774.

[104] *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1976) 69 D.L.R. (3d) 558; *Petrofina* [1984] Q.B. 127; *Stone Vickers* [1991] 2 Lloyd's Rep. 288; *National Oilwell* [1993] 2 Lloyd's Rep. 582 at 611; the analysis on insurable interest in *National Oilwell* was obiter. For a detailed analysis of insurable interest see G. Meggitt, "Insurable interest — the doctrine that would not die" (2015) 35(2) *Legal Studies* 280.

[105] See cl.13.2 in *Talbot Underwriting Ltd v Nausch Hogan & Murray Inc (The Jascon 5)* [2006] 2 Lloyd's Rep. 195 CA (Civ Div). Clause 13 gave Sembawang an insurable interest in the vessel as a whole: see [56].

[106] *Commonwealth Construction* (1976) 69 D.L.R. (3d) 558; *Petrofina* [1984] Q.B. 127; *Stone Vickers* [1991] 2 Lloyd's Rep. 288; *National Oilwell* [1993] 2 Lloyd's Rep. 582.

as co-assured under the protection of the head contractor's policy.[107] In *Stone Vickers*, Colman J added that

> "If the risk insured against is loss of or damage to the subject-matter of the insurance and the co-assured is interested in the entire subject-matter, rights of subrogation cannot be exercised to sue him for causing tortiously or in breach of contract loss of or damage to that same subject-matter unless he does so wilfully or fraudulently".[108]

To come to this conclusion, it is sufficient that the policy insures the co-assured sub-contractor against such loss or damage to the subject-matter of the policy. It is not necessary to question whether the co-assured's liability is insured under the same policy.[109] Moreover, as mentioned above, when the sub-contractor's insurable interest has been found, the courts have been willing to imply a term in the insurance contract that for the insurer exercising subrogation rights would be in breach of the implied term. Additionally, as seen in *Mark Rowlands*, if a person such as the tenant had no more than a limited interest in the subject-matter of the insurance, there was no principle of law which precluded him from asserting that an insurance effected by another person was intended to enure for his benefit to the extent of that interest. This outcome does not depend on whether the insurable interest of the person concerned was in the whole of the subject-matter or part of it.

In the practice of cargo insurance, the usual target of a recovery action will be the bailee of the cargo.[110] A bailee has sufficient insurable interest to insure the cargo in his own name.[111] A haulier or a carrier may be co-assured under the contract insuring the cargo. In such a case, if he negligently damages the cargo, when the insurer indemnifies, the cargo interest cannot recover from the haulier as he is insured under the same contract. This is the case even though his liability is not insured under the insurance policy.[112] Commercial convenience justifies the insurable interest point, i.e. that the assured bailee insures the goods as it would be very inconvenient if they were not permitted to insure the goods they are entrusted.[113] Lloyd J emphasised in *Petrofina* that in the case of a building or engineering contract, where numerous different sub-contractors may be engaged, there can be no doubt about the convenience from everybody's point of view, including the insurers, of allowing the head contractor to take out a single policy covering the whole risk; that is to say, covering all contractors and sub-contractors in respect of loss of or damage to the entire contract works. Otherwise each sub-contractor would be compelled to take out his own separate policy. This would mean, at the very least, extra paperwork; at worst it could lead to overlapping claims and cross-claims in the event of an accident. Furthermore, the cost of

[107] *Stone Vickers* [1991] 2 Lloyd's Rep. 288. Colman J's judgment was reversed by the Court of Appeal on the limited grounds that on the proper construction of the relevant documents, the suppliers had not proved that the head contractors had any intention to insure the suppliers. There was, therefore, no privity of contract between the suppliers and the head contractors. The Court of Appeal did not consider the rest of the judgment.

[108] *Stone Vickers* [1991] 2 Lloyd's Rep. 288 at 302.

[109] *Stone Vickers* [1991] 2 Lloyd's Rep. 288 at 302.

[110] J. Dunt, *Marine Cargo Insurance*, 2nd edn (Abingdon/New York: Informa, 2015), para.16-09.

[111] *Waters v Monarch Fire & Life Assurance Co* (1856) 5 E. & B. 870 QBD; *Hepburn v A. Tomlinson (Hauliers) Ltd* [1966] 1 Lloyd's Rep. 309 HL.

[112] *National Oilwell* [1993] 2 Lloyd's Rep. 582.

[113] *Waters* (1856) 5 E. & B. 870; *Tomlinson* [1966] 1 Lloyd's Rep. 309; *Petrofina* [1984] Q.B. 127.

insuring his liability might, in the case of a small sub-contractor, be uneconomic. The premium might be out of all proportion to the value of the sub-contract. If the sub-contractor had to insure his liability in respect of the entire works, he might well have to decline the contract. The purpose of this arrangement was to keep to a minimum the difficulties that are bound to arise where several different parties are working on a construction site. It had the obvious advantage of making it unnecessary for any investigation to be carried out into the duties owed to each other by the various parties under their respective contracts in the event of loss or damage to the works from a cause such as fire.[114]

Lord Sumption recognised that the demise charterer could be entitled to insure on the same basis as the owner. In line with the principles stated above, his Lordship held that the demise charterer has insurable interest, although it is not a liability but a property insurance. The demise charterers stood in a legal or equitable relation to the insurable property owing to their liability to the head owner as a bailee and time charterer. The measure of any liability of the demise charterer, in the case of the ship being lost or damaged, would be the same as the measure of the owner's loss. This ruling, although Lord Sumption supported the opposite, reinforces option (a) for the reasons stated above, i.e. where the demise charterers are entitled to insure on the same basis as owners, this leaves no room to treat the co-insurance as if it provides covers, which entitles the owner to claim only and leaves the charterer with liability, i.e. with no insurance cover. Further, it was held in *Cruise and Maritime Services International Ltd v Navigators Underwriting Agency Ltd*[115] that a party whose name is inserted in the insurance contract as a co-assured is not entitled to claim under the contract unless they have insurable interest. Accepting option (b) would mean treating the co-assured demise charterer as if his name only appears there with no benefit of the insurance contract. On the other hand, the fact is exactly the opposite.

Conclusion

Why does equity allow insurers to subrogate into the assured's rights against the party who is liable for the insured loss? One way of explaining this is that equity is a right of restitution based upon unjust enrichment or the reaping of an unfair advantage.[116] The objective is to prevent the wrongdoer from escaping from liability after the right holder has received a payment from the claimant.[117] By precluding the insurer's subrogation in the above-mentioned cases, does the law contradict these basic principles of subrogation? The answer should take into account the following: there should be an enforceable claim in the first place from which the guilty party has arguably escaped.[118]

[114] *Cooperative Retail Services* [2002] Lloyd's Rep. I.R. 555 at [14], Lord Hope.

[115] *Cruise and Maritime Services International Ltd v Navigators Underwriting Agency Ltd* [2017] 1 Lloyd's Rep. 575 QBD.

[116] James, "The Fallacies of Simpson v Thomson" (1971) 34 Mod. L. Rev. 149, 152; C. Mitchell, "The law of subrogation" [1992] L.M.C.L.Q. 483, 486; some scepticism has been expressed as to whether this has helped in any way to explain insurance subrogation: see Merkin and Steele, *Insurance and the Law of Obligations* (2013), p.100; see also *Colinvaux's Law of Insurance* (2016), para.12-003.

[117] Mitchell, "The law of subrogation" [1992] L.M.C.L.Q. 483, 486.

[118] *Gard Marine* [2015] 1 Lloyd's Rep. 381 at [93].

Moreover, subrogation aims to prevent over-compensation of the assured.[119] In the case of indemnity policies, the assured is not permitted to make a profit and this is a very common justification for subrogation.[120] If the assured is not permitted to bring a subrogation action against a co-assured, this objective of subrogation will not be defeated. There is no possibility of double recovery as the insurance provision in the underlying contract will exempt the liability of a contracting party so long as the matter is covered by the insurance.

It is concluded that the methodology to interpret the insurance and underlying insurance to determine whether the insurer can exercise a subrogation right is as follows:

1. Does the insurance contract contain a subrogation waiver clause?
   (a) Yes—no subrogation against contractual beneficiary (who may or may not be co-assured).
   (b) No—refer to the underlying contract.
2. Does the underlying contract provide a joint insurance clause?
   (a) Yes—subrogation right cannot be exercised against the co-assured.
   (b) No—refer to the underlying contract as it may still contain an insurance provision albeit not expressly a joint names insurance.
3. Does one party to the underlying contract agree to insure his interest?
   (a) Yes—depending on the interpretation of the party's intention, it is likely that this insurance will be interpreted for the benefit of the defendant as well as the assured.
   (b) No, the contract is silent—it will ultimately be the interpretation of the underlying contract but it is likely in this case that there is nothing in the contract precluding the insurer from exercising his rights of subrogation.
4. In 2(a) and 3(a) above, if the defendant to a subrogation action paid the premium, it may be taken as an indication that the parties agreed to claim the loss from the insurer but not from each other.[121] However, the premium payment clause is a persuasive matter but not determinative on its own.

[119] See Clarke, *The Law of Insurance Contracts* (2016), para.31-7A: "The Case for Subrogation".

[120] Merkin and Steele, *Insurance and the Law of Obligations* (2013), p.111; see *MacGillivray on Insurance Law* (2015), para.24-001.

[121] Approved obiter in *Cape Distribution Ltd v Cape Intermediate Holdings Plc* [2016] EWHC 1119 (QB); [2016] Lloyd's Rep. I.R. 499.

Reforming Additional Damages in Copyright Law

Dr Deming Liu[*]
Newcastle University

Additional damages; Aggravated damages; Copyright; EU law; Exemplary damages; Infringement

Introduction

When copyright as private property is infringed, the copyright owner can claim either damages compensating for the loss suffered by him, or an account of profits disgorging the profits made by the infringer.[1] It is possible to claim additional damages when damages are claimed for infringement of the economic rights of copyright and performers' property rights.[2] The question is, what purpose do additional damages serve? Are they to punish the infringer or are they to compensate for the loss suffered by the copyright owner, or something else? Fundamentally, are additional damages an element of criminal law inserted into civil law and, if so, is it appropriate that civil law undertakes the business of criminal law to punish in the case of infringement of copyright, irrespective of the view of Lord Nicholls that "punishment is a function par excellence of the criminal law, rather than the civil law"?[3] Those questions are important not least because the answers provide guidance to the judiciary in adjudicating cases and people using copyright law.

With those questions in mind, we review the law of additional damages. First, we examine the history of additional damages. We aim to find out about the nature of additional damages in the light of legislative background and judicial interpretation. Next, we discuss whether, with statutory additional damages, the copyright owner can claim other damages such as exemplary damages or aggravated damages at common law. This pursuit is related to our later evaluation of the doctrine of additional damages, projecting ways for its amendment. Then, we delve into the law of additional damages to see what factors are relevant in awarding additional damages. Further on, we discuss the proposed reform as well as the indicative change brought about by EU law. As will be seen, despite the law "crying aloud for reform", Parliament has failed to intervene. Rather, it has decided to leave the matter to further judicial development. As respects the Directive of 2004/Regulations of 2006 concerning the law of damages for infringement of intellectual property and their impact,[4] the law of additional damages is not believed

[*] Lecturer in Law, Newcastle Law School.
[1] Copyright, Designs and Patents Act 1988 (CDPA 1988) s.96.
[2] CDPA 1988 ss.97(2) and 191J(2).
[3] *Kuddus (AP) v Chief Constable of Leicestershire* [2001] 2 W.L.R. 1789 HL at [52], per Lord Nicholls.
[4] Namely, Directive 2004/48 on the enforcement of intellectual property rights. The Directive is implemented through the Intellectual Property (Enforcement, etc.) Regulations 2006.

to have been made redundant. Rather, it has been preserved, operating in parallel with the Directive. However, it is unclear whether the Directive, in operating alongside the law, would provide any clear answers to some of the issues with the law of additional damages. The law of additional damages is confusing and clear guidance is lacking. We argue that clear guidance is necessary for the judiciary to further develop the law; leaving the confusing law to the judiciary to develop without clear guidance would be likely to add to further confusion rather than lead to clarification. In concluding the article, we advocate the earliest reform to bring sanity to the functioning of the law.

History of additional damages

Additional damages first appeared in the Copyright Act of 1956.[5]Section 17(3) empowers the court to award additional damages where "effective relief would not otherwise be available to the plaintiff" and where it is appropriate to do so after considering the flagrancy of the infringement and any benefit accrued to the defendant by reason of the infringement.[6] The statutory provision for additional damages resulted from the recommendation made by the Gregory Committee Report

> "[t]hat the court should be given discretionary power to impose something equivalent to exemplary damages in cases where the existing remedies give inadequate relief".[7]

Despite the explicit reference to exemplary damages in the Report, the nature of additional damages is uncertain. The Copyright Act of 1956 preceded *Rookes v Barnard* (1964),[8] wherein the House of Lords intervened for the first time to clarify the distinction between aggravated and exemplary damages. As such, the reference to exemplary damages in the Gregory Report and the passage of the Copyright Act 1956, based on the Report, would not definitively determine the nature of additional damages.

Williams v Settle,[9] an interesting Court of Appeal case decided under the Act of 1956, provided some exposition of the nature of additional damages. In this case, a photographer was commissioned to take wedding photographs in which the couple's family owned copyright under the Act. When the father-in-law of the family appearing in the photographs was murdered, the photographer sold the photographs to the defendant newspapers, which published them several days after the wife gave birth. In suing for infringement, the claimant was awarded £15 damages. In addition, Blagden J awarded £400 additional damages. The judge condemned the infringement in the strongest possible terms, pointing out that "it is difficult to find language strong enough to describe this grossly offensive behaviour on the part of the two newspapers".[10] On appeal, the award of additional damages to the amount was affirmed. In agreeing with the trial judge over the award of additional damages, Sellers LJ focused on the flagrancy of the

[5] Copyright Act of 1956 s.17(3).
[6] Copyright Act of 1956 s.17(3).
[7] *Gregory Report* (1952), Cmnd 8662, para.294.
[8] *Rookes v Barnard* [1964] A.C. 1129 HL. See Lord Reid in *Cassell & Co Ltd v Broome* [1972] 2 W.L.R. 645 HL.
[9] *Williams v Settle* [1960] 1 W.L.R. 1072 CA.
[10] *Williams* [1960] 1 W.L.R. 1072 at 1075.

infringement and the resultant "intrusion into his life, deeper and graver than an intrusion into a man's property" and the injury to the claimant's "feelings and sense of family dignity and pride".[11] Together, they justified heavy punitive damages.[12] Sellers LJ made it clear that additional damages were exemplary and were awarded to serve as an example to deter others in the future to infringe copyright in similar circumstances.[13] Willmer LJ agreed with Sellers LJ, and took this case as "a proper case in which to award exemplary damages",

> "a case in which the damages were very much at large … having regard to the conduct of the defendant it was clearly a case which did call for heavy damages".[14]

The finding that additional damages were exemplary under the Act of 1956 is, however, subject to different interpretations. In *Rookes v Barnard*,[15] the House of Lords made some comments on the case. Lord Devlin believed that the damages awarded in *Williams v Settle*[16] were aggravated damages rather than exemplary damages. Similarly, in *Cassell & Co v Broome*,[17] Lord Kilbrandon was of the opinion that additional damages in *Williams v Settle*[18] were not exemplary. Subsequent lower courts appear to support the view that additional damages are not exemplary. Some view the additional damages under the Act of 1956 as compensatory. Pumfrey J in *Nottinghamshire Healthcare National Health Service Trust v News Group Newspapers Ltd*[19] believed that "section 17(3) of the 1956 Act did not authorise an award of exemplary damages, but only an award of aggravated damages". Similarly, in *Rank Film Distributors v Video Information Centre*,[20] Templeman LJ was of the opinion that damages under s.17(3) were "compensatory but not punitive, and do not involve the imposition of a penalty".

Following the Whitford Committee Report,[21] the law of additional damages was reformed through s.97 of the CDPA 1988.[22] The provision marks some notable differences from that of the Act of 1956. First, rather than being part of the overarching provision for remedies, it now stands alone as a separate provision. Then, there is no longer the requirement that the court be satisfied that effective relief would not otherwise be available to the claimant. Though the Whitford Committee Report also recommended abolishing the requirement of showing any benefit accruing to the defendant from the infringement, it was not explicitly adopted; rather, the factor of benefit remains part of the test for additional damages.

If uncertainty exists over whether additional damages are exemplary under the Act of 1956, this should no longer be the case with the CDPA 1988. The Whitford Committee Report made explicit reference to exemplary damages in terms:

[11] *Williams* [1960] 1 W.L.R. 1072 at 1082.
[12] *Williams* [1960] 1 W.L.R. 1072 at 1082.
[13] *Williams* [1960] 1 W.L.R. 1072 at 1081.
[14] *Williams* [1960] 1 W.L.R. 1072 at 1086–1087.
[15] *Rookes* [1964] A.C. 1129.
[16] *Williams* [1960] 1 W.L.R. 1072.
[17] *Broome* [1972] 2 W.L.R. 645 at 727.
[18] *Williams* [1960] 1 W.L.R. 1072.
[19] *Nottinghamshire Healthcare National Health Service Trust v News Group Newspapers Ltd* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33 at [40].
[20] *Rank Film Distributors v Video Information Centre* [1980] F.S.R. 242 CA (Civ Div) at 266.
[21] *Whitford Committee Report* (1977), Cmnd 6732, para.704.
[22] CDPA 1988 s.97(2).

> "No one has submitted that *exemplary damages* in cases of flagrant infringement should be abolished, and we are of the opinion that this provision should undoubtedly be retained."[23]

As such, it is legitimate to suppose that additional damages were intended to be exemplary damages, even though the CDPA 1988 did not use the nomenclature "exemplary damages" in providing for additional damages. In *Cala Homes (South) Ltd v Alfred McAlpine Homes East Ltd (No.2)*,[24] Laddie J was of the opinion that when the CDPA 1988 was implemented:

> "The difference between aggravated and exemplary damages at common law was well appreciated. It appears that what the committee was recommending was the retention of the form of financial relief which could be likened to exemplary damages at common law."

Indeed, in earlier proceedings Laddie J in *Cala Homes (South) Ltd v Alfred McAlpine Homes East Ltd*[25] viewed additional damages under the CDPA 1988 as punitive, rather than compensatory.

In *Cala Homes (No.2)*,[26] Laddie J was asked to decide whether the claimant was entitled to claim additional damages when they opted to claim an account of profit rather than damages. He reasoned from the structure of the CDPA 1988 that s.97(2) is a provision separate from s.96(2) providing the normal relief of damages or account of profit; it concerns "the court's power to award 'additional damages as the justice of the case may require'."[27] Accordingly, Laddie J held that the claimant was entitled to claim additional damages when they opted to claim an account of profit rather than damages.[28] This view of Laddie J, however, was disapproved of by the House of Lords. In *Redrow Homes Ltd v Bett Brothers Plc (Scotland)*,[29] the House of Lords held that additional damages are not a self-standing remedy and are only available where the copyright owner claims damages; they cannot be claimed where the copyright owner opts to claim an account of profit. In that case, Lord Jauncey did not "determine whether additional damages are by nature punitive or purely compensatory" since he believed that it was unnecessary to do so, given that the appeal is about the construction of ss.96 and 97 of the CDPA 1988.[30] Lord Clyde tended to think that additional damages are "more probably" characterised as aggravated damages rather than exemplary damages, but he indicated that that characterisation is not important because the award of additional damages "remains an award of damages".[31]

Some authors such as Laddie et al. argue that additional damages are not exemplary; if the defendant is convicted and sentenced, then it is not appropriate to punish him again; if not, it is unfair for him to suffer "double jeopardy".[32] Similarly, in *Nottinghamshire Healthcare National Health Service Trust v News*

[23] *Whitford Committee Report* (1977), Cmnd 6732 (emphasis added).
[24] *Cala Homes (South) Ltd v Alfred McAlpine Homes East Ltd (No.2)* [1996] F.S.R. 36 Ch D at 43.
[25] *Cala Homes (South) Ltd v Alfred McAlpine Homes East Ltd* [1995] EWHC 7 (Ch); [1995] F.S.R. 818.
[26] *Cala Homes (No.2)* [1996] F.S.R. 36.
[27] *Cala Homes (No.2)* [1996] F.S.R. 36 at 40.
[28] *Cala Homes (No.2)* [1996] F.S.R. 36 at 43.
[29] *Redrow Homes Ltd v Bett Brothers Plc (Scotland)* [1999] A.C. 197 HL.
[30] *Redrow Homes* [1999] A.C. 197 at 207.
[31] *Redrow Homes* [1999] A.C. 197 at 207.
[32] Laddie et al., *The Modern Law of Copyright and Designs*, 4th edn (London: Butterworths, 2011), p.1796.

Group Newspapers Ltd,[33] Pumfrey J insisted that, with the availability of criminal liability for knowing infringement, "a purely punitive or exemplary award" in civil action was not appropriate." Neuberger J in *Michael O'Mara Books Ltd v Express Newspapers Plc*[34] was

> "inclined to think [additional damages as] a separate category of damages which may have some features which are similar to those of exemplary or aggravated damages."

Unfortunately, he fails to specify which features, those of exemplary or those of aggravated damages, this separate category of damages may share.

As from the above, the history of the law of additional damages is a chequered one, with no clear revelation as to its nature. This is certainly problematic insofar as the application of the law is concerned. Before we address the difficulty in applying the law, we will first examine the issue of the availability of exemplary or aggravated damages at common law as it is related to our later evaluation of the law of additional damages.

Availability of exemplary damages or aggravated damages at common law

With the statutory provision of additional damages, can the copyright owner claim exemplary damages or aggravated damages at common law?

It is quite clear that neither exemplary nor aggravated damages are now available for copyright infringement at common law. In discussing additional damages under s.17 of the Copyright Act 1956, Ungoed-Thomas J in *Nora Beloff v Pressdram Ltd*[35] stated:

> "[C]opyright is now exclusively a creature of statute and governed by statute; and it seems to me that section 17(3) is a code for damages which are 'additional' without providing a place for additional exemplary and aggravated damages outside the subsection. The substantial result is that the subsection excludes exemplary damages for infringement of copyright and replaces any aggravated damages that might otherwise have been obtainable for infringement of copyright."

Similarly, with respect to the CDPA 1988, Neuberger J said in *Michael O'Mara Books v Express Newspapers*[36] that the defendants "may not be entitled to [those damages at common law] in light of the existence of additional damages".

The position that exemplary damages cannot be awarded at common law can be understood from another perspective. Before *Rookes v Barnard*,[37] there had been no case where infringement of copyright gave rise to exemplary damages[38]; the only case, *Williams v Settle*,[39] awarding exemplary damages was believed by Lord Devlin and other members of the House of Lords to be a case of aggravated

[33] *Nottinghamshire Healthcare* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33 at [51].
[34] *Michael O'Mara Books Ltd v Express Newspapers Plc* [1999] F.S.R. 49 Ch D at 57.
[35] *Nora Beloff v Pressdram Ltd* [1973] F.S.R. 33 Ch D at 65.
[36] *Michael O'Mara Books* [1999] F.S.R. 49 at 60.
[37] *Rookes* [1964] A.C. 1129.
[38] Laddie et al, *The Modern Law of Copyright and Designs* (2011), p.1798.
[39] *Williams* [1960] 1 W.L.R. 1072.

damages; in any event, that case was decided under the Copyright Act rather than at common law. Thus, exemplary damages for infringement of copyright at common law cannot be awarded as there was no cause of action resulting in the award prior to 1964. Lord Reid made it clear in *Cassell & Co Ltd v Broome (No.1)*[40] that "firmly established authority required us to accept this category [of exemplary damages] however little we might like it, but did not require us to go farther"; and he would "refuse to extend the right to inflict exemplary damages to any class of case which is not already clearly covered by authority".

As far as aggravated damages are concerned, there is one view that *Williams v Settle*[41] is a case where the court awarded aggravated damages at common law.[42] But it is hard to find or even deduce that proposition from the judgment of the case. In *Rookes v Barnard*,[43] the House of Lords merely said that, though the Court of Appeal in *Williams v Settle*[44] claimed to have awarded additional damages as exemplary under s.17 of the Act of 1956, that should be understood as aggravated damages; but that award, if indeed aggravated damages as the House of Lords believed, was made under the Act as additional damages rather than at common law.

US copyright law takes a similar approach with respect to the availability of punitive damages at common law. In US law, the copyright owner is entitled to elect to claim either actual damages and profits of the infringer, or statutory damages.[45] The US Copyright Act 1976 provides:

> "The copyright owner is entitled to recover the actual damages suffered by him or her as a result of the infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages."[46]

In lieu of damages and an account of profits, the copyright owner may elect to recover an award of statutory damages for all infringements involved in the action.[47] With respect to infringement of any one work, the copyright owner can be awarded a sum between $750 and $30,000 as the court considers just.[48] The amount may be increased up to $150,000 or reduced accordingly, but not below $200, depending on whether the infringer wilfully infringed or whether he did not know or had no reason to believe that his acts amounted to infringement.[49] Statutory damages are only available where the copyright owner registers his copyright work.[50] Where the copyright owner fails to register his work, he can only claim damages and profits; if he suffers no loss and the defendant makes no profit, the copyright owner

[40] *Broome* [1972] A.C. 1027. It should be noted that the House of Lords in *Kuddus* [2001] 2 W.L.R. 1789 decided that a claim for exemplary damages is not necessarily "in respect of a cause of action for which prior to 1964 such an award had been made".

[41] *Williams* [1960] 1 W.L.R. 1072.

[42] Law Commission, "Aggravated, Exemplary and Restitutionary Damages" (Law Com. No.247, 1997), p.180, *http://www.lawcom.gov.uk/wp-content/uploads/2015/04/LC247.pdf* [Accessed 18 July 2017].

[43] *Rookes* [1964] A.C. 1129.

[44] *Williams* [1960] 1 W.L.R. 1072.

[45] United States Code 17 USC (1976) Ch.5 s.504(a)(1) and (2).

[46] 17 USC (1976) Ch.5 s.504(b).

[47] 17 USC (1976) Ch.5 s.504 (c)(1).

[48] 17 USC (1976) Ch.5 s.504 (c)(1).

[49] 17 USC (1976) Ch.5 s.504 (c)(2). See also P. Samuelson and T. Wheatland, "Statutory Damages in Copyright Law: A Remedy in Need of Reform" (2009) 51 Wm & Mary L. Rev. 439; P. Samuelson, "Statutory Damages: A Rarity in Copyright Laws Internationally, But for How Long?" (2013) 60 J. Copyright Off. Soc'y USA 529.

[50] 17 USC (1976) Ch.5 s.412.

will not receive anything. He cannot recover punitive damages at common law, no matter how wilful the infringement may have been.[51] Punitive damages cannot be recovered at common law,[52] because the Supreme Court ruled that copyright protection is "wholly statutory" and the "remedies for infringement 'are only those prescribed by Congress'".[53] In *Blanch v Koons*,[54] the claimant could not claim statutory damages because she had not registered her copyright. Neither could she claim damages for her actual loss as she suffered none. Given the wilful infringement, the district judge Louis L. Stanton granted her

> "leave to amend the complaint so that plaintiff has a chance to prove malice and raise squarely the question whether punitive damages are available to her".[55]

However, the ruling in that regard is no longer good law, and indeed Judge Stanton himself said in *Viacom v Youtube*[56] that "It is time to extinguish the *ignis fatuus* held out by *Blanch*".

It must be concluded that, with the statutory additional damages, no exemplary or aggravated damages could possibly be claimed at common law, irrespective of how the court understands additional damages and whether additional damages include exemplary damages or aggravated damages. The conclusion is significant—as will be seen, with no aggravated damages to claim at common law, the innocent party might not obtain any damages for his injured feelings in some cases. As we argue later, this preposterous situation inter alia necessitates the urgent reform of the law of additional damages.

Factors relevant in awarding additional damages

Additional damages now have much wider scope than those under the Act of 1956, given the abolition of the precondition "that effective relief would not otherwise be available". In *Beloff v Pressdram*,[57] in analysing the precondition for additional damages in s.17(3) of the Act of 1956, Ungoed-Thomas J reasoned that: "The relief otherwise available is necessarily, of course, by its very meaning, a relief alternative to the additional damages obtainable in the infringement action." He concluded that

> "if effective relief is available to the plaintiff in respect of another cause of action, relief cannot be given for it by way of additional damages for infringement of copyright".[58]

In the case, additional damages would not cover damage flowing from either libel or breach of confidence as they constitute separate causes of action for which

[51] *Oboler v Goldin* 714 F. 2d 211, 213 (2d Cir.1983), cited with approval in *On Davis v The Gap Inc* 246 F. 3d 152, 172 (2001); *Calio v Sofa Express Inc* 368 F. Supp. 2d 1290, 1291 (M.D. Fla. 2005).
[52] *Viacom Intern. Inc v YouTube Inc* 540 F. Supp. 2d 461 (S.D.N.Y. 2008).
[53] *Sony Corp of America v Universal City Studios Inc* 464 U.S. 417, 431 (1984); *Viacom v YouTube* 540 F. Supp. 2d 461 (S.D.N.Y. 2008).
[54] *Blanch v Koons* 329 F. Supp. 2d 568 (S.D.N.Y. 2004), 396 F. Supp. 2d 476 (S.D.N.Y. 2005), aff'd, 467 F. 3d 244 (2d Cir. 2006).
[55] *Blanch* 329 F. Supp. 2d 568, 570 (S.D.N.Y. 2004).
[56] *Viacom v YouTube* 540 F. Supp. 2d 461 (S.D.N.Y. 2008).
[57] *Nora Beloff* [1973] F.S.R. 33 at 66.
[58] *Nora Beloff* [1973] F.S.R. 33 at 67.

effective relief is available.[59] The omission of the pre-condition from the CDPA 1988 is significant; it is not "a change in expression" but "a change of substance", hence the court is thereby empowered to award additional damages even where effective relief is otherwise available to the claimant.[60]

There are non-exhaustive factors that the courts consider in awarding additional damages. As specified in the 1988 Act, the court must have regard to the flagrancy of the infringement, and the benefit accruing to the defendant from the infringement. It is an open question whether means and mitigation are relevant. We discuss the various factors below in turn.

Knowledge and flagrancy

Despite no provision in s.97(2), knowledge of infringement is here discussed alongside flagrancy as they are closely related. To start with, it is clear that knowledge of infringement is not required in awarding additional damages. Laddie J in *Cala Homes*[61] observed:

> "This anomalous power to award additional damages is not stated to be restricted to cases where the infringer knows or has reason to believe that copyright has been infringed."

Where knowledge is present, it is not difficult for the court to find flagrancy and award additional damages. In *Phonographic Performance Ltd v Reader*,[62] the defendant was aware of the need for a PPL licence, and indeed he had bought such a licence previously, and gave no excuse for failing to buy it on the instant occasions. Similarly, in *ZYX Music GmbH v King*,[63] the defendant knowingly distributed infringing copies "without any pangs of conscience on exploiting for its own profit the infringing copies". In both cases, the court awarded additional damages.

Flagrancy may involve knowledge. As Brightman J in *Ravenscroft v Herbert*[64] said: "Flagrancy in my view implies scandalous conduct, deceit and such like; it includes deliberate and calculated infringement." But knowledge is not essential; taking the attitude of "could not care less" could constitute flagrancy.[65] In *Nottinghamshire Healthcare National Health Service Trust v News Group Newspapers Ltd*,[66] the judge observed that

> "carelessness sufficiently serious to amount to an attitude of 'couldn't care less' is in my judgment capable of aggravating infringement and of founding an award of damages under section 97(2). Recklessness can be equated to deliberation for this purpose".

Though explicitly provided for in the CDPA 1988, flagrancy is not "a pre-condition" for awarding additional damages".[67] The court is merely required

[59] *Nora Beloff* [1973] F.S.R. 33 at 67.
[60] *Cala Homes (No.2)* [1996] F.S.R. 36 at 40–41.
[61] *Cala Homes* [1995] F.S.R. 818 at 838.
[62] *Phonographic Performance Ltd v Reader* [2005] EWHC 416 (Ch); [2005] E.M.L.R. 574.
[63] *ZYX Music GmbH v King* [1995] E.M.L.R. 281 Ch D at 305.
[64] *Ravenscroft v Herbert and New English Library Ltd* [1980] R.P.C. 193 Ch D at 208.
[65] *Nottinghamshire Healthcare* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33 at [52].
[66] *Nottinghamshire Healthcare* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33 at [52].
[67] *ZYX Music* [1995] E.M.L.R. 281 at 304.

to "have regard to" it; there is no requirement that it must be present in such an award.[68] Indeed, the court is required "to look at all the circumstances of the case"; the award is made where justice so requires.[69] Nevertheless, Laddie J in *Cala Homes*[70] found it

> "difficult to envisage cases where there has been no flagrancy and the court would be prepared to exercise its discretion to award damages under the section".

Fundamentally, in most cases, it is "the flagrancy of the infringer's actions" that justifies the award of additional damages which reflects "the level of disapproval of the court".[71] In *Springsteen v Masquerade Music Ltd*,[72] though Ferris J complained of lack of guidance of s.97(2) or help from Laddie et al.'s *The Modern Law of Copyright*, he would focus on the issue of flagrancy in awarding additional damages. He observed that:

> "[The defendant] appears, however, to have taken very few precautions against being found to be in breach of copyright. He acted in breach of rights and in conflict with rights holders with whom he was negotiating a deal. He had no regard to the position of the originators of the copyright materials incorporated in sound recordings. This flagrancy *alone* justifies additional damages."[73]

As to the amount, the judge holds that it depends on the extent of the infringement already committed. In the case, 54,000 CDs were manufactured and some were already sold. The number of infringing copies was found to be "quite substantial", and the judge would hold that "additional damages should be at the rate of perhaps £1 per CD for those produced but not sold and £5 per CD for those actually sold".[74] It should be noted that the quantum would exceed the maximum fine of £50,000 under s.107(4A) of the CDPA 1988 were the defendant convicted under criminal proceedings.

Benefit

Apart from flagrancy, the court must have regard to the benefit accruing to the defendant by reason of the infringement. In *Ravenscroft v Herbert and New English Library Ltd*, [75] Brightman J was of the opinion that benefit "implies that the defendant has reaped a pecuniary advantage in excess of the damages he would have otherwise to pay". However, it must be noted that the benefit in connection with the additional damages does not necessarily have to come in the form of pecuniary benefit; it could be in other forms.[76] A benefit in the form of an advantage gained in the market from the infringement would suffice.[77] In this aspect, the catch of additional damages appears broader than exemplary damages solely concerning

[68] *Cala Homes* [1995] F.S.R. 818 at 838, per Laddie J.
[69] *Cala Homes* [1995] F.S.R. 818 at 838.
[70] *Cala Homes* [1995] F.S.R. 818 at 838.
[71] *Cala Homes* [1995] F.S.R. 818 at 838.
[72] *Springsteen v Masquerade Music Ltd* [1999] E.M.L.R. 180 at 227.
[73] *Springsteen* [1999] E.M.L.R. 180 at 228 (emphasis added).
[74] *Springsteen* [1999] E.M.L.R. 180 at 228.
[75] *Ravenscroft* [1980] R.P.C. 193.
[76] *Redrow Homes* [1999] 1 A.C. 197 at 209; *Harrison v Harrison* [2010] F.S.R. 25 PCC at [39], per Fysh J.
[77] Laddie et al., *The Modern Law of Copyright* (2011), p.1798.

"profit" as its prerequisite. In *Rookes v Barnard*,[78] Lord Devlin inter alia pronounces the situation for awarding exemplary damages (the second category) where "the Defendant's conduct has been calculated by him to make a *profit* for himself which may well exceed the compensation payable to the plaintiff". Lord Devlin explains the rationale for exemplary damages:

> "Where a Defendant with a cynical disregard for a Plaintiff's rights has calculated that the money to be made out of his wrong-doing will probably exceed the damages at risk, it is necessary for the law to show that it cannot be broken with impunity."[79]

This prerequisite of profit is subject to criticism. In *Cassell & Co Ltd v Broome (No.1)*,[80] Lord Reid believed that Lord Devlin's second category was "not happily phrased", asking

> "suppose he commits the tort not for gain but simply out of malice, why should he not also be punished. Again I freely admit there is no logical reason".

Such malice would probably amount to flagrancy, hence engaging additional damages for copyright infringement. Another element with exemplary damages is "calculated conduct", which should have nothing to do with additional damages. In *Beloff v Pressdram*,[81] Ungoed-Thomas J stated that

> "additional damages concern compensatory rather than exemplary damages, hence the mere fact of benefit suffices to satisfy the requirement of additional damages; whether the benefit results from calculated conduct is not relevant".

As with flagrancy, the element of benefit is not essential in awarding additional damages; the court may still award additional damages in its absence. In *Cavalcade Records v HHO Multimedia*,[82] the defendant exploited the claimant's copyright sound recording of a music track without a licence. Though he was "not satisfied that the Defendant has recouped any real significant benefit as a result of this infringement", the judge awarded £3,500 additional damages.[83] Flagrancy alone justified the award—the defendants

> "had a reckless attitude to the Claimant's rights. They could not have cared less. A prudent company, run by individuals who had been through the experience in 2006/2007, would have taken steps to ensure that it did not happen again".[84]

Where profit is made, should it be considered in quantifying additional damages, and if so to what extent? Pumfrey J in *Nottinghamshire Healthcare v News Group Newspapers*[85] believed that the profit made by the defendant should be considered. In his view, additional damages are restitutionary and aim at the profit made by

[78] *Rookes* [1964] A.C. 1129 at 1126.
[79] *Rookes* [1964] A.C. 1129 at 1227.
[80] *Broome* [1972] A.C. 1027 at 1088.
[81] *Nora Beloff* [1973] F.S.R. 33 at 65.
[82] *Cavalcade Records v HHO Multimedia* [2013] EWPCC 41.
[83] *Cavalcade Records* [2013] EWPCC 41 at [23].
[84] *Cavalcade Records* [2013] EWPCC 41 at [21].
[85] *Nottinghamshire Healthcare* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33.

the defendant. Pumfrey J takes note of benefit as one of two factors particularly identified in s.97 along with flagrancy; hence,

> "if benefit to the defendant is to be a factor relevant to an award of such additional damages as 'the justice of the case may require', that is a strong suggestion that those damages may include a restitutionary element".[86]

Later in the judgment, Pumfrey J said that he believed that

> "the section is drafted in the widest terms and, although it is not concerned with punitive damages, it permits, in my judgment, an aggravation of an award of damages upon a basis far wider than the factors admitted as aggravation at common law. In particular, it permits an element of restitution having regard to the benefit gained by the defendant, and I should envisage such an award being made where the normal compensation to the claimant leaves the defendant still enjoying the fruits of his infringement".[87]

In *Phonographic Performance v Reader*,[88] it is reiterated that: "In suitable cases, the calculation of additional damages is based on the profits gained by the infringer as a result of the infringement." In this case, the judge awarded additional damages to include the expenses which could have been reasonably foreseen as a result of the defendant's acts of infringement and which included expenditure incurred in the course of investigation.[89]

Means and mitigation

As Lord Devlin said in *Rookes v Barnard*,[90] "the means of the parties, irrelevant in the assessment of compensation, are material in the assessment of exemplary damages". Arguably, the means of the defendant would only be relevant if additional damages were exemplary, aiming to punish the defendant, in which case the court would consider the defendant's means. When the court insists that the defendant's means may be relevant in assessing additional damages, obviously the court has in mind additional damages as exemplary damages.

In *Michael O'Mara Books v Express Newspapers*,[91] Neuberger J rejects the argument by the claimant's counsel that evidence of mitigation or means is irrelevant in awarding additional damages, as some precedents show. The judge stated that "in none of those cases did the court reject an argument that mitigation or means could be taken into account".[92] Hence:

> "I am not prepared to hold that such factors must be irrelevant for the purpose of assessing additional damages, at any rate in a case such as this. Accordingly, in my judgment, it would not be fair on Mr and Mrs Monk if the court were to determine whether they were liable for additional damages, and if so in

[86] *Nottinghamshire Healthcare* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33 at [48].
[87] *Nottinghamshire Healthcare* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33 at [51].
[88] *Reader* [2005] EWHC 416 (Ch); [2005] E.M.L.R. 574 at 576.
[89] *Reader* [2005] EWHC 416 (Ch); [2005] E.M.L.R. 574 at 580.
[90] *Rookes v Barnard* [1964] A.C. 1129 at 1228.
[91] *Michael O'Mara Books* [1999] F.S.R. 49 at 57.
[92] Those cases referred to are *Williams v Settle* [1960] 1 W.L.R. 1072 on earlier legislation; *ZYX Music GmbH v Chris King* [1995] F.S.R. 566; and *Cala Homes* [1995] F.S.R. 818.

> what amount, without first giving them the opportunity to put in evidence on these two topics."[93]

As said before, Neuberger J expresses uncertainty over the nature of additional damages, but tends to regard them as a separate category, having features similar to exemplary or aggravated damages. In this case, he appears to treat additional damages as featuring exemplary damages, which may underscore the reason that he would consider the means of the defendants. Neuberger J was careful not to award compensatory damages on generous grounds as he would consider it

> "particularly inappropriate to assess compensatory damages on a high basis, not reflecting the reality of the plaintiffs' loss or the defendants' gain, when Parliament has permitted the court to award additional damages, that is, damages 'additional to other damages already assessed'".[94]

Neuberger J's cautious approach toward the quantum of compensatory damages must be preferred over that of *Nottinghamshire Healthcare v News Group Newspapers*,[95] where Pumfrey J treats compensatory damages as being generously awarded. Neuberger J's approach at least would ensure that normal compensatory damages are not to be mixed up with additional damages. The separation of additional damages as a distinct item of award from compensatory damages would serve the useful purpose of ameliorating the concerns of applying criminal law in a civil law award without the safeguards of criminal law. Indeed, in the US context, Samuelson argues that:

> "If punitive damages are necessary to punish and deter, they should not be inextricably intertwined into a unitary award of statutory damages that does not delineate compensatory amounts from extra-compensatory amounts. Instead, punitive damages should be awarded separately from compensation and disgorgement remedies. Once separated, the proportionality between compensation and punishment can be assessed under ordinary Due Process standards."[96]

Other factors

On the basis of the Copyright Act of 1956, Ungoed-Thomas J in *Beloff v Pressdram*[97] notes that, apart from flagrancy and benefit, the court is required to have regard to "all other material considerations". The judge listed those considerations as including

> "such matters as the defendant's conduct and motive for infringement, injury to the claimant's feeling for suffering insults, indignities and the like, and the claimant's own corresponding behaviour".[98]

[93] *Michael O'Mara Books* [1999] F.S.R. 49 at 58.
[94] *Michael O'Mara Books* [1999] F.S.R. 49 at 60.
[95] *Nottinghamshire Healthcare* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33.
[96] Samuelson, "Statutory Damages" (2013) 60 J. Copyright Off. Soc'y USA 529, 643.
[97] *Nora Beloff* [1973] F.S.R. 33.
[98] *Nora Beloff* [1973] F.S.R. 33 at 68.

The reason why those factors are material and must be considered is because the additional damages "go largely to compensation for the plaintiff's suffering from injured feelings and distress and strain".[99]

Under the CDPA 1988, the court is required to have regard to "all the circumstances" in awarding additional damages. Pumfrey J in *Phonographic Performance Ltd v Reader*[100] held that infringement of copyright committed in breach of an injunction restraining such infringement can be part of the "all the circumstances" required by s.97(2), and can be flagrant. As such, it can found an award of additional damages.

Once the judge weighs the above various factors and decides to award additional damages, the next question is how to assess the amount. It is not precise science; rather, it is "a matter of impression":

> "[T]he process of assessment is not by the meticulous quantification of individual items, as the damages cannot, generally at any rate, be ascertained by an accounting operation. They are fixed by judgment, not by calculation, and judgment of the whole is likely to produce a less unsatisfactory result. They are a matter of impression rather than scientific or mathematical calculation."[101]

Determining the amount of additional damages is a difficult task as it is complicated by the different interpretations of additional damages by the courts and various "considerations of law on which different views are tenable".[102]

Given the complexities arising from the different interpretations of additional damages, a proposal was made to reform the law. In the following part, we discuss the proposal and its eventual rejection by the Government. We also explore the changes brought about by the Enforcement Directive.

Reform of additional damages

Two strands of reform are discussed here: the failed reform by Parliament, and uncertain reform brought about by the Enforcement Directive.

First, we discuss the failed reform by Parliament. The Law Commission believed that the law "cries aloud for parliamentary intervention",[103] and recommended that the statutory provision be abolished.[104] To the Commission, aggravated damages, namely damages for mental distress, would thereby be awarded at common law. They argued that Lord Devlin "recharacterised" *Williams v Settle*[105] not as a case awarding exemplary damages pursuant to the statutory provision of additional damages under s.17(3) of the Copyright Act of 1956, but "as a case awarding 'aggravated damages' at common law for infringement of copyright".[106] Further, they believed that *Beloff v Pressdram*[107] was no hurdle to awarding aggravated damages at common law; though the case apparently decided that it was impossible

[99] *Nora Beloff* [1973] F.S.R. 33 at 68.
[100] *Reader* [2005] EWHC 416 (Ch); [2005] E.M.L.R. 574 at 579.
[101] *Nora Beloff* [1973] F.S.R. 33 at 76.
[102] *Nora Beloff* [1973] F.S.R. 33 at 76.
[103] Law Commission, "Aggravated, Exemplary and Restitutionary Damages" (1997), p.2.
[104] Law Commission, "Aggravated, Exemplary and Restitutionary Damages" (1997), p.180.
[105] *Williams* [1960] 1 W.L.R. 1072.
[106] Law Commission, "Aggravated, Exemplary and Restitutionary Damages" (1997), p.180.
[107] *Nora Beloff* [1973] F.S.R. 33.

to award aggravated damages at common law with the statutory provision for additional damages provided under the Act of 1956, it did not decide that the court would not make such an award before the Act of 1956.[108] Additional damages were statutorily recognised for the first time by the Act of 1956. Hence, with the abolition of statutory additional damages, the court would be empowered to award aggravated damages at common law.[109]

The Law Commission also believed that an account of profits would fill any lacunae left by the abolition of statutory additional damages.[110] However, it is questionable whether an account of profits could assume that role. An account of profits is only possible where the defendants gain pecuniary profits, not profits in any other forms; further, "it is an account of the net profits made by the defendant".[111] It is submitted that the recommendation would create a loophole where the defendant merely gains benefits other than in a financial form. The current scheme of additional damages takes account of the benefits, in whatsoever form, pecuniary or otherwise, as gained by the defendant.[112] Furthermore, unlike an account of profits, additional damages do not appear to require the benefit to be the net profits, either. As Laddie et al. argue:

> "[A] piratical business may make no net profits at all and so an account would be of no use to the claimant, but the sums earned by the infringement have been applied to keep the business going. This is certainly a benefit to the defendant, gained by the unlawful use of the claimant's property, and if his infringements were flagrant it is rather hard to see why he should be allowed to retain that benefit or, at any rate, all of it."[113]

The Law Commission further recommended that exemplary damages be made available for infringement of other property rights; as such, exemplary damages would be available to infringement of copyright under s.92(2), which provides that the copyright owner is entitled to

> "all such relief by way of damages, injunctions, accounts or otherwise is available to the plaintiff as is available in respect of the infringement of *any other property right"*.[114]

In the consultation paper proposing reform of the law of damages, the Ministry of Justice considered the use of the term "additional damages" in the Copyright Act of 1988 as "anomalous" and "not helpful".[115] However, the Ministry of Justice did not consider abolishing additional damages. Rather, it considered amending the law by replacing the term "additional damages" with "aggravated and restitutionary damages".[116] That amendment

[108] Law Commission, "Aggravated, Exemplary and Restitutionary Damages" (1997), p.180.
[109] Law Commission, "Aggravated, Exemplary and Restitutionary Damages" (1997), p.180.
[110] Law Commission, "Aggravated, Exemplary and Restitutionary Damages" (1997), p.181.
[111] Laddie et al., *The Modern Law of Copyright* (2011), p.1796.
[112] *Redrow Homes* [1999] 1 A.C. 197 at 209; *Harrison v Harrison* [2010] F.S.R. 25 at [39], Fysh J.
[113] Laddie et al., *The Modern Law of Copyright* (2011), p.1796.
[114] Law Commission, "Aggravated, Exemplary and Restitutionary Damages" (1997), p.180.
[115] Department for Constitutional Affairs, "The Law on Damages", *Consultation Paper CP 9/07* (4 May 2007), para.211, *http://webarchive.nationalarchives.gov.uk/+/http://www.dca.gov.uk/consult/damages/cp0907.pdf* [Accessed 18 July 2017].
[116] Department for Constitutional Affairs, "The Law on Damages" (May 2007), para.211.

> "would ensure that damages awarded under the…1988 Act[] could include, for example, restitutionary elements such as the recovery of profits from the tortfeasor as well as aggravated damages".[117]

Some objected that the wording "aggravated damages and such amount by way of restitution" was unclear and would not assist the court, and that potential problems might arise when a company sues for a type of damages that is available for "mental distress".[118] In *Collins Stewart Ltd v Financial Times Ltd*,[119] the Court of Appeal held that a company cannot suffer injured feelings or distress and hence cannot claim aggravated damages. Given that, the Ministry of Justice proposed that the Copyright Act be further amended to make aggravated and restitutionary damages available to corporate claimants.[120] The Bar Council argued against the proposal, believing that "it creates a further anomaly by making these the only two areas where the company can claim aggravated damages for mental distress".[121] To the Bar Council,

> "the [whole] matter [of additional damages] is best left alone as it stands, as these provisions have not caused any real difficulty in interpretation with the courts so far. It is best left to further judicial development".[122]

There is another issue making any reform of the law in that area even more difficult. It is an established principle that the claimant is not entitled to claim both damages and an account of profits; he must make an election between them.[123] Though the Government realised the necessity of reforming the law to enable the court to award both damages and an account of profits, it took no clear stance over any reform.[124]

In the end, the Government accepted that there lacked "evidence that the 'additional damages' provisions applicable to copyright infringement cases have caused any great difficulty in the courts".[125] The Government decided not to take forward the recommendation, holding "that some further judicial development of the law in this area might help clarify the issues".[126]

Having discussed the failed reform by Parliament, let us next discuss the reform brought about by Directive 2004/48 on the Enforcement of Intellectual Property Rights, if any. The Directive, binding on the UK, concerns damages for infringement of intellectual property.[127] It is implemented through the Intellectual Property (Enforcement, etc.) Regulations 2006. To what extent, if at all, do the Directive/Regulations reform the law of additional damages?

[117] Department for Constitutional Affairs, "The Law on Damages" (May 2007), para.211.
[118] Department for Constitutional Affairs, "The Law on Damages" (May 2007), para.211.
[119] *Collins Stewart Ltd v Financial Times Ltd (No.1)* [2004] EWHC 2337 (QB); [2005] E.M.L.R. 5.
[120] Department for Constitutional Affairs, "The Law on Damages" (May 2007), para.212.
[121] Department for Constitutional Affairs, "The Law on Damages" (May 2007), para.163.
[122] Department for Constitutional Affairs, "The Law on Damages" (May 2007), para.163.
[123] *Island Records Ltd v Tring International Plc* [1996] 1 W.L.R. 1256 Ch D (per Lightman J, the claimant is not required to make the election before judgment and can do so after the conclusion of the trial).
[124] Department for Constitutional Affairs, "The Law on Damages" (May 2007), para.211.
[125] Department for Constitutional Affairs, "The Law on Damages" (May 2007), para.164.
[126] *Hansard*, HC, Vol.606, col.502 (9 November 1999).
[127] The Enforcement Directive has not changed the law of ordinary compensatory damages for infringement of copyright. See *Absolute Lofts South West London Ltd v Artisan Home Improvements Ltd* [2015] EWHC 2608 (IPEC); [2017] E.C.D.R. 6 at [11].

In *Henderson v All Around the World Recordings Ltd*,[128] Hacon J suggested that the statutory provisions for additional damages are now made "redundant" by art.13 of the Directive or reg.3 of the Regulations implementing art.13. Not only does art.13 enjoy "an independent effect", but it must be complied with, effectively altering the provisions for additional damages.[129] However, he left open the possibility that the law of additional damages may be unaltered and hence art.13 would operate "in parallel" with it.[130] In *Henderson*, Hacon J did not have to decide the issue. In *Absolute Lofts South West London Ltd v Artisan Home Improvements Ltd*,[131] however, Hacon J felt obliged to make the decision. He apparently did an about-face concerning the issue. In his opinion, pursuant to art.2(1) of the Directive, national law with more favourable remedies than the Directive is preserved. In implementing the Directive in the UK, there was no clear "intention to sweep s.97(2) into the ambit of regulation 3".[132] Rather, s.97(2) is preserved. The claimant can rely on either s.97(2) or art.13(1). The court must consider both and award the greater amount. He warned that the end result of damages will often be the same.[133]

The law of additional damages apparently complements art.13. As distinct from the law of additional damages, knowledge rather than flagrancy is required under art.13.[134] In the case of knowing infringement, the Directive makes reference to moral prejudice but not to flagrancy. Moral prejudice covers loss of reputation[135]; but, where the infringement is flagrant, that may not necessarily result in loss of reputation or indeed moral prejudice. Flagrancy concerns the behaviour of the infringer and does not necessarily concern the loss suffered by the copyright owner, though, of course, they can be closely connected with each other in some cases. Where there is no moral prejudice but mere flagrancy, the Directive would provide no remedy in that respect; indeed, such lack of provision for flagrancy, as Hacon J in *Absolute Lofts*[136] admitted, could in some cases "serve as a barrier to the minimum remedies available under art.13(1)". That gap would, however, be filled by the law of additional damages.

On the other hand, art.13 also complements the law of additional damages. The statutory provision of additional damages in the CDPA 1988 is an "anomaly" in that it is merely available for infringement of the economic rights of copyright and performers' property rights. One may legitimately ask: why are additional damages not available for infringement of moral rights? In the case of the infringement of moral rights, a person is arguably more inclined to suffer injured feelings where his right of integrity is infringed by having his work subjected to derogatory treatment and lowering his standing in his field. Furthermore, then why are there not additional damages for infringing performers' non-property rights, whereas they are available where performers' property rights are infringed?[137] Secretly recording their performances and dealing with such recordings can be as flagrant

[128] *Henderson v All Around the World Recordings Ltd* [2014] EWHC 3087 (IPEC) at [97].
[129] *Henderson* [2014] EWHC 3087 (IPEC) at [97].
[130] *Henderson* [2014] EWHC 3087 (IPEC) at [98].
[131] *Absolute Lofts* [2015] EWHC 2608 (IPEC); [2017] E.C.D.R. 6 at [36].
[132] *Absolute Lofts* [2015] EWHC 2608 (IPEC); [2017] E.C.D.R. 6 at [41].
[133] *Absolute Lofts* [2015] EWHC 2608 (IPEC); [2017] E.C.D.R. 6 at [41].
[134] *Henderson* [2014] EWHC 3087 (IPEC) at [97].
[135] See Directive 2004/48 on the Enforcement of Intellectual Property Rights, COM(2003) 46 final (30 January 2003), p.9.
[136] *Absolute Lofts* [2015] EWHC 2608 (IPEC); [2017] E.C.D.R. 6 at [42].
[137] CDPA 1988 s.191J(2).

as dealing with a genuine recording without a licence. If the law wants to show that "the tort does not pay", it is illogical that the law only shows that selectively. Article 13 now makes damages including an additional sum available for infringement of those rights to which additional damages do not extend under the CDPA 1988. As those rights fall within intellectual property rights, infringing them should arguably be treated in the same way as infringing other types of intellectual property rights; hence, arguably, damages are to be awarded without discrimination.

Overall, if Hacon J is correct, the Directive does not replace the law of additional damages. Rather, it merely provides an alternative to remedies while leaving intact the law of additional damages. The Directive can address cases to which the law of additional damages does not extend, namely the infringement of moral rights and performers' non-property rights. However, as will be seen below, it is an open question whether it would address other issues with the law of additional damages.

Evaluation of additional damages

It is regrettable that no reform was made to the law of additional damages.[138] Many defects exist with the current scheme of statutory additional damages, calling for urgent attention. For example, the current provision of additional damages may result in injustice, leaving the defendant with no remedies for his injured feelings. The House of Lords in *Redrow Homes v Bett Brothers*[139] held that additional damages are not available where the claimant claims an account of profit. Lord Clyde made it clear that "the basic principle is that an award for damages is inconsistent with an accounting".[140] Furthermore, he did not believe that, in providing for additional damages in the CDPA 1988, "Parliament intended to innovate upon the basic principle and allow a claim of this kind [i.e. additional damages] to be pursued alongside an accounting".[141] Additional damages are only available where damages are claimed.[142] Where the claimant cannot show his pecuniary loss, or indeed suffers no pecuniary loss, logically he would opt to claim an account of profit; if he does do so, then he cannot claim additional damages to cover aggravated damages in connection with his injured feelings. Furthermore, as discussed before, he cannot claim aggravated damages at common law. The court in *Beloff v Pressdram*[143] stated that the statutory additional damages left no place for aggravated damages or exemplary damages outside its ambit. The combined effect is that if the claimant opts to claim an account of profits, then there will be no remedy for his injured feelings.

It is far from clear whether such a defect can now be addressed by the Directive. To show this, we first discuss whether an account of profits can be claimed under the Directive; if so, whether damages can also be claimed together with an account; and then, whether an additional sum can be claimed alongside an account. Article 13(1) requires the court to consider several matters including the claimant's lost

[138] To be more exact, reform of some sort is made; e.g., as said, an additional sum may now be awarded for infringements of moral rights and performers' non-property rights under the Directive.
[139] *Redrow Homes* [1999] A.C. 197.
[140] *Redrow Homes* [1999] A.C. 197 at 207.
[141] *Redrow Homes* [1999] A.C. 197 at 207.
[142] *Redrow Homes* [1999] A.C. 197 at 207.
[143] *Nora Beloff* [1973] 1 All E.R. 241.

profits and the unfair profits made by the defendant. Furthermore, in suitable cases, the court shall consider "elements other than economic factors, such as the moral prejudice caused to the rightholder by the infringement".[144] As Hacon J argued, art.13(1) aims "to achieve objectively assessed *compensation*" rather than to introduce punitive damages.[145] It is believed that the claimant can claim an account of profits which, though not compensatory, would comply with the aim of art.13(1). The Court of Appeal in *Hollister Inc v Medik Ostomy Supplies Ltd*[146] awarded an account of profits, explaining that:

> "[A]n account of profits does not compensate the trade mark owner for the losses he has suffered. It simply deprives the infringer of the profits he has made from an activity in which he should never have engaged. It therefore ensures the infringer does not benefit from his wrong, but it contains no element of punishment."

Though Kitchin LJ admits that "The scope of Article 13 is not entirely clear", he does not believe that art.13 "preclude[s] the award of an account of the profits made by the infringer".[147]Regulation 3(3) provides that it does not affect the operation of any rule of law relating to remedies for infringement save to the extent it is inconsistent with the regulation. Kitchin LJ is of the opinion that "the remedy of an account of profits is [not] inconsistent with the regulation or, perhaps more importantly, the Enforcement Directive".[148] Furthermore, an account of profits would satisfy the three principles of proportionality, equivalence and effectiveness under European law: it is proportionate to "ensure the infringer does not benefit from his wrong" and "contain no element of punishment"; it is equivalent as "a long standing and well established remedy for infringement of all kinds of intellectual property rights"; and it is effective that "an infringer knows he will not retain any profits derived from his infringement".[149]

In claiming an account of profits, can damages also be claimed? It does not appear that art.13 changes the principle that damages and an account of profits are not "cumulatively" available and the claimant can only claim either of them.[150] The award for infringement is to order the knowingly infringing defendant to "pay the rightholder damages appropriate to the actual prejudice suffered by him/her as a result of the infringement".[151] And it is "hard to envisage circumstances in which an award for both damages *and* an account of profits would be appropriate to the actual prejudice suffered".[152] As just noted above, Hacon J opines, in relying on Recital 26 of the Directive, that "the aim of art.13(1) is to achieve objectively *assessed* compensation, but not more than that. More would carry the risk of imposing punitive damages".[153]Recital 26 of the Directive states, inter alia, that:

[144] Directive 2004/48 on the Enforcement of Intellectual Property Rights art.13(1).
[145] *Henderson* [2014] EWHC 3087 (IPEC) at [70]. See also the Enforcement Directive, Recital 26.
[146] *Hollister Inc v Medik Ostomy Supplies Ltd* [2012] EWCA Civ 1419 at [69].
[147] *Hollister* [2012] EWCA Civ 1419 at [60].
[148] *Hollister* [2012] EWCA Civ 1419 at [62].
[149] *Hollister* [2012] EWCA Civ 1419 at [64].
[150] *Henderson* [2014] EWHC 3087 (IPEC) at [72]–[73] (quoting *Redrow Homes* [1998] R.P.C. 793 at 796–797.).
[151] *Henderson* [2014] EWHC 3087 (IPEC) at [76].
[152] *Henderson* [2014] EWHC 3087 (IPEC) at [76].
[153] *Henderson* [2014] EWHC 3087 (IPEC) at [70].

> "The aim is not to introduce an obligation to provide for punitive damages but to allow for compensation based on an objective criterion while taking account of the expenses incurred by the rightholder, such as the costs of identification and research."[154]

If an account of profits and damages cannot be awarded together, does art.13 authorise the court to award an account of profits and an additional sum? As an established principle in English law, where the claimant claims an account of profits, he cannot claim additional damages.[155] In awarding an account of profits under the Directive, the Court of Appeal in *Hollister*[156] did not even consider awarding an additional sum. However, in the view of Hacon J:

> "[W]herever the court reaches the view that the claimant would not receive adequate compensation for the actual prejudice he has suffered if damages were to be assessed by reference to lost profits, moral prejudice and expenses (part of art.13(1)(a)), or royalties according to the 'user principle' (art.13(1)(b)), or *an account of profits*, there is flexibility under art.13(1)(a) to award an additional sum related to the profit the defendant has made from knowing infringement."[157]

The above exposition is far from convincing. It is hard to imagine how an additional sum could be awarded alongside an account of profits under the Directive. Indeed, Hacon J himself points out that "the aim of art.13(1) is to achieve objectively assessed *compensation*, but not more than that. More would carry the risk of imposing punitive damages".[158] Awarding an additional sum alongside an account of profits would certainly have a strong appearance of punishment. One would have to bear in mind that an account of profits is not, as the Court of Appeal in *Hollister*[159] says, compensating the loss flowing from infringement; rather, it is to prevent the wrongdoer from benefiting from his wrong. It is true that it is the proposition of the *Hollister* court that an account itself contains "no element of punishment",[160] but this is far from the case when an additional sum is added to it. Having thus prevented the wrongdoer from benefiting from his wrong, how would the court justify adding an additional sum to the account? Hacon J argued that it is because the account would not sufficiently compensate the claimant. But if the court can determine the actual prejudice and the sufficiency of compensation, compensatory damages would be appropriate rather than the uncompensatory account of profits, far less an account of profits plus an additional sum. Indeed, it is with compensation that the Directive is concerned. Overall, rather than offer a solution, the Directive creates further uncertainty.

Another issue with the law of additional damages lies with the uncertainty of its nature. In *Nottinghamshire Healthcare v News Group Newspapers*,[161] Pumfrey J held that additional damages are restitutionary, aiming at the profit made by the defendant. A problem arises where the claimant sues for the damages. When the

[154] *Henderson* [2014] EWHC 3087 (IPEC) at [77].
[155] *Redrow Homes* [1999] A.C. 197.
[156] *Hollister* [2012] EWCA Civ 1419.
[157] *Henderson* [2014] EWHC 3087 (IPEC) at [80].
[158] *Henderson* [2014] EWHC 3087 (IPEC) at [70].
[159] *Hollister* [2012] EWCA Civ 1419.
[160] *Hollister* [2012] EWCA Civ 1419.
[161] *Nottinghamshire HealthCare* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33.

court sets out to disgorge the profit in awarding additional damages, it is possible to disgorge the whole of the profit. For invasion of property, the remedy at common law is generally "either of price or of hire".[162] However, equity takes a broader approach and in some cases "require[s] the wrongdoer to yield up all his gains".[163] The difference between common law and equity is regarded "as an accident of history".[164] Hence, in suitable cases, an account of the whole profit can be awarded at common law.[165] As copyright is private property, an account of the whole profit is possible as the remedy for infringement. Thus, to disgorge the profit as additional damages effectively means that in suitable cases the claimant is allowed to claim both damages and an account of profit. That would contravene the fundamental principle of the law that the claimant cannot claim both damages and an account of profit.[166] Indeed, as Lightman J made clear, the copyright owner is not entitled to both damages and an account of profits; he must make an election between them.[167] To use additional damages to circumvent a fundamental principle in law cannot be the intention of Parliament and indeed cannot be justified. But the above approach of the court is disconcerting.

There is the risk that, with additional damages, the deterrent effect aimed to be achieved through the imposition of criminal liability as provided in the CDPA 1988 may not be achievable—the copyright owner may have all the impetus to resort to additional damages to gain the pecuniary award, a large windfall which they would not otherwise have obtained, had criminal proceedings been brought. As discussed before, in *Springsteen v Masquerade Music*,[168] Ferris J would hold, regarding the 54,000 infringing copies, that "additional damages should be at the rate of perhaps £1 per CD for those produced but not sold and £5 per CD for those actually sold", which signifies that the quantum would exceed the maximum fine of £50,000 under s.107(4A) of the CDPA 1988 were the defendant convicted under the criminal proceedings. It follows that money can buy out the infringer's criminal act. This is in addition to the risk of "double jeopardy" as noted before.

Introducing the element of punishment from criminal law to civil law is neither necessary nor desirable because:

> "It is confusing the function of the civil law which is to compensate with the function of the criminal law which is to inflict deterrent and punitive penalties."[169]

As Lord Wilberforce put it,

> "[I]t is an 'anomaly', that it brings a criminal element into the civil law without adequate safeguards, that it leads to excessive awards, an unmerited windfall for the plaintiff."[170]

[162] *Watson, Laidlaw & Co Ltd v Pott, Cassels and Williamson* (1914) 31 R.P.C. 104 HL at 119, per Lord Shaw.
[163] *Attorney-General v Blake* [2001] 1 A.C. 268 HL at 279.
[164] *Blake* [2001] 1 A.C. 268 at 280.
[165] *Blake* [2001] 1 A.C. 268.
[166] See *Redrow Homes* [1999] A.C. 197.
[167] *Island Records* [1996] 1 W.L.R. 1256.
[168] *Springsteen* [1999] E.M.L.R. 180 at 228.
[169] *Broome* [1972] A.C. 1027 at 1029, per Lord Hailsham.
[170] *Broome* [1972] A.C. 1027 at 1114.

Lord Wilberforce firmly believes that "civil courts have no business to impose fines".[171] Despite different interpretations of *Williams v Settle*,[172] the judges in that case explicitly awarded the additional damages in the form of exemplary damages. In fact, Lord Hailsham in *Cassell & Co v Broome (No.1)*[173] left open the possibility of *Williams v Settle*[174] being a case of exemplary damages falling within Lord Devlin's second category.[175] Indeed, Laddie J in *Cala Homes*[176] frankly held additional damages under the CDPA 1988 as punitive, rather than compensatory. In other cases where the judges awarded additional damages, they in fact awarded punitive damages without admitting so. In *Nottinghamshire Healthcare*,[177] the NHS as a company as the copyright owner could not suffer injured feelings; the award could not be aggravated damages. In *Phonographic Performance Ltd v Reader*,[178] the defendant clearly made some sort of calculation that if sued the damages would be the licence fees and his profits from infringing the copyright would certainly exceed the fees; arguably, this is a case falling within Lord Devlin's second category; again, the judge refused to admit that the decision was based on exemplary damages. In this case, the copyright owner, the claimant, was a company, so on what basis did the court rely in awarding additional damages while there were no injured feelings for which aggravated damages could have been awarded? Obviously it is essentially exemplary damages, namely damages to punish the defendant, that had been awarded. In fact, Pumfrey J admitted that there was a punitive element in the award; indeed:

> "[I]t is permissible for an award of statutory additional damages to include a punitive element provided that the purpose of the award of damages is not solely to punish the defendant."[179]

That certainly invites the question of what would have empowered the court to award damages with the punitive element and how that would be distinguished from a purely punitive award, both in theory and, more importantly, in practice.

In *Nottinghamshire Healthcare*,[180] Pumfrey J pronounced additional damages as neither aggravated nor exemplary damages; rather, it is a special kind. The distinction between aggravated and exemplary damages was already accused of merely semantic exercise with no practical use. In *Cassell & Co v Broome (No.1)*,[181] Lord Wilberforce does not regard the distinction between aggravated and exemplary damages as useful in practice. Lord Wilberforce does not believe that "the different labels denote concepts really different" and indeed, "in seeking to preserve the distinction we shall sometimes find ourselves dealing more in words than ideas".[182]

Then, categorising additional damages as a special kind is as much an instance of semantic acrobatics as attempting the distinction between aggravated and

[171] *Broome* [1972] A.C. 1027 at 1115.
[172] *Williams* [1960] 1 W.L.R. 1072.
[173] *Broome* [1972] A.C. 1027 at 1030.
[174] *Williams* [1960] 1 W.L.R. 1072.
[175] *Broome* [1972] A.C. 1027 at 1030.
[176] *Cala Homes* [1995] F.S.R. 818.
[177] *Nottinghamshire Health Care* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33.
[178] *Reader* [2005] EWHC 416 (Ch); [2005] E.M.L.R. 574.
[179] *Nottinghamshire Health Care* [2002] EWHC 409 (Ch); [2002] E.M.L.R. at [51].
[180] *Nottinghamshire Health Care* [2002] EWHC 409 (Ch); [2002] E.M.L.R. 33.
[181] *Broome* [1972] A.C. 1027.
[182] *Broome* [1972] A.C. 1027 at 1115 (in agreement with Windeyer J in *Uren v John Fairfax & Sons Pty Ltd* [1966] HCA 40; (1966) 117 C.L.R. 118 at 152).

exemplary damages. The key issue is how additional damages are to be awarded. If it is a special kind aimed to show the law's disapproval of the defendant's behaviour, then its distinction from exemplary damages is a distinction without a difference. Furthermore, in treating it as a special kind, there are no safeguards in the award. Additional damages may well turn into a monster unregulated and unbound by any of the established rules. Though no safeguards exist with respect to exemplary damages, and, indeed, exemplary damages are mainly criticised for that reason, at least what the court has instructed over the years with respect to exemplary damages would constrain the award of additional damages if explicitly treated as exemplary damages.

As seen from the above, the law of additional damages is problematic in so many respects. With the inconsistent interpretation of the law by the courts, it is particularly a case for reform. It is unfortunate that the Government has decided not to make any reform.

Conclusion

The law of additional damages is stricken with problems. It has not been definitively resolved whether it is punitive or compensatory; neither has it been resolved how additional damages are to be awarded and on what scale. Some courts treat damages as punitive, whereas other courts claim to treat them as other than punitive but in fact make awards indicative of punishment. Fundamentally, punishment falls within the domain of criminal law and it is not the business of civil law. Where punishment is warranted, the copyright owners should resort to criminal proceedings rather than wave the civil remedy flag to achieve punishment for their personal windfalls. In those rare cases where the infringement comes short of being criminal but is flagrant enough, the award of additional damages would arguably "serve [the] useful purpose in vindicating the strength of the law", as with an award of exemplary damages at common law.[183] In that respect, the law should be limited in scope rather than enjoy free rein to compete with the provision for criminal liability.

Though a proposal was made to reform the law, it was unfortunately not carried through. Rather, the Government decided to leave the matter to further judicial development. However, it is a risky path to pursue, given the courts' inconsistent interpretation of the law of additional damages. Then, with the Directive of 2004 and the Regulations of 2006 implementing the Directive, it is believed that the law of additional damages is preserved, operating in parallel with art.13. While it makes damages including an additional sum available for infringement of moral rights and performers' non-property rights, the Directive/Regulations provide no clear answer to issues with the law of additional damages such as lack of compensation for injured feelings where an account of profits is claimed.

Given the longstanding inconsistent interpretation of the law of additional damages, it is our belief that, unless Parliament intervenes to clarify the area of law by reform, the law continues to offer no clear guidance to consumers and judges alike, and principled judicial development is hard to come by. It is imperative that Parliament intervene at the earliest opportunity to bring sanity to the law.

[183] *Kuddus* [2001] 2 W.L.R. 1789 at [53], per Lord Nicholls.

Pre-Contractual Misrepresentations: Mistaken Belief Induced by Mis-statements

Kelry C.F. Loi[*]
National University of Singapore; and University of Oxford

Contracts; Fraudulent misrepresentation; Innocent misrepresentation; Pre-contractual misrepresentation; Rescission

Abstract

A claimant cannot rescind a contract for pre-contractual misrepresentation if he discovered the truth before entering into it. This is because the right to rescind is grounded on the fact that the contract must have been founded on his mistaken belief induced by a mis-statement. As Lord Reed reiterated in Cramaso LLP v Ogilvie-Grant *[2014] UKSC 9; [2014] 1 AC 1093: "The law relating to the effect of representations upon a contract proceeds on the basis that a representation made in the course of pre-contractual discussions may produce a misapprehension in the mind of the other party which continues so as to have a causative effect at the time when the contract is concluded. It is on that basis that a misrepresentation may lead to the setting aside of the contract as being vitiated by error or fraud. ... Where a misrepresentation does not have a continuing effect, for example because it is withdrawn or lapses, or because the other party discovers the true state of affairs before the contract is concluded, it cannot induce the other party to enter into the contract and therefore cannot affect its validity or give rise to a remedy in damages for any loss resulting from its conclusion". Dicta in* Zurich Insurance Co Plc v Hayward *[2016] UKSC 48; [2016] 3 WLR 637, suggesting that rescission for misrepresentation is possible even if the claimant discovered the truth at the time of contracting, is liable to cause confusion. It is better, as demonstrated in* Borrelli v Ting *[2010] UKPC 21; [2010] Bus LR 1718, to accept that a contract be set aside for duress instead of misrepresentation, if the claimant*

[*] Faculty of Law (CLB & CBFL). The author is grateful for the helpful advice and support of Prof. E. Peel (Oxford) and Prof. M. Chen-Wishart (Oxford). The usual caveats apply.

entered into it because he was pressured, rather than misled, by the defendant's mis-statements.

Rescission for pre-contractual misrepresentation—three basic requirements

Under current orthodoxy, accepted by general treatises[1] and specialist texts[2] alike, a claimant asserting a prima facie right to elect to rescind a contract for pre-contractual misrepresentation must, at minimum, establish the following three requirements:

1. There must, first of all, be a representation that is made by the defendant (or of which the defendant had notice or was put on inquiry).[3]
2. In the second place, the representation must be substantially false; in other words, the representation must amount to a *mis*representation in a way which appears material to a reasonable person in the claimant's position.[4]
3. The third requirement is that the claimant must in fact have been induced by the misrepresentation to enter into the impugned contract which he now seeks to rescind, thus demonstrating a factual causal link between the misrepresentation and the contract.[5]

Finally, but this is not a requirement *stricto sensu*, the fourth point is that wholly innocent misrepresentations are sufficient to generate the right to rescind. As such, it is a requirement neither that the defendant knew that his representation was false when he uttered it, nor that he was reckless or careless as to its veracity. While the right of rescission was limited at common law to cases of fraudulent misrepresentation or total failure of consideration,[6] the remedy was available much

[1] *Chitty on Contracts Volume I: General Principles*, 32nd edn, edited by H.G. Beale (London: Sweet & Maxwell, 2015), p.709. para.7-111; *Treitel: The Law of Contract*, 14th edn, edited by E. Peel (London: Sweet & Maxwell, 2015), p.404; *Anson's Law of Contract*, 30th edn, edited by J. Beatson, A. Burrows and J. Cartwright (Oxford: Oxford University Press, 2016), p.320; M. Chen-Wishart, *Contract Law*, 5th edn (Oxford: Oxford University Press, 2015), p.206. See also *Meagher, Gummow & Lehane's Equity Doctrines & Remedies*, 5th edn, edited by J.D. Heydon, M.J. Leeming and P.G. Turner (Sydney: LexisNexis Butterworths, 2015), p.454; *Snell's Equity*, 33rd edn, edited by J. McGhee (London: Sweet & Maxwell, 2015), p.405.

[2] J. Cartwright, *Misrepresentation, Mistake and Non-Disclosure*, 4th edn (London: Sweet & Maxwell, 2017), p.93, para.4-21; *Spencer Bower & Handley: Actionable Misrepresentation*, 5th edn, edited by K.R. Handley (London: Butterworths Law, 2014), p.115, para.10.03; p.171, para.14.01; p.187, para.15.01. See also P.M. Eggers, *Vitiation of Contractual Consent* (Abingdon/New York: Informa Law, 2017), p.569; D. O'Sullivan, S. Elliott and R. Zakrzewski, *The Law of Rescission*, 2nd edn (Oxford: Oxford University Press, 2014), p.72, paras 4.02, 4.03.

[3] *Barclays Bank Plc v O'Brien* [1994] 1 A.C. 180 HL; *Royal Bank of Scotland v Etridge (No.2)* [2001] UKHL 44, [2002] 2 A.C. 773; *Chitty on Contracts Volume I: General Principles* (2015), pp.660–663, paras 7-024 to 7-029.

[4] *Avon Insurance Plc v Swire Fraser Ltd* [2000] 1 All E.R. (Comm) 573 QBD (Rix J); *Raiffeisen Zentralbank Osterreich AG v Royal Bank of Scotland Plc* [2010] EWHC 1392 (Comm), [2011] 1 Lloyd's Rep, 123 at [149] (Christopher Clarke J); *Bonham-Carter v SITU Ventures Ltd* [2012] EWHC 3589 (Ch) at [120] (Asplin J); *Spencer Bower & Handley: Actionable Misrepresentation* (2014), pp.40–41, paras 4.04 to 4.05.

[5] *Attwood v Small* (1838) 6 Cl. & F. 232, 7 E.R. 684 at 765 (Lord Brougham); *Smith v Chadwick* (1884) 9 App. Cas. 187 HL at 190 (Lord Selborne LC), 195 (Lord Blackburn); *Bradford Third Equitable Benefit Building Society v Borders* [1941] 2 All E.R. 205 HL at 211 (Viscount Maugham); *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd (No.2)* [1995] 1 A.C. 501 HL at 542 (Lord Mustill); *Zurich Insurance Co Plc v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [18], [23], [25], [32], [44] (Lord Clarke of Stone-cum-Ebony JSC), [67], [71] (Lord Toulson JSC); K.R. Handley, "Causation in Misrepresentation" (2015) 131 L.Q.R. 275, 275–285; Eggers, *Vitiation of Contractual Consent* (2017), pp.644–645.

[6] *Kennedy v Panama, New Zealand & Australian Royal Mail Co Ltd* (1866–67) L.R. 2 Q.B. 580.

more broadly in equity. It has been clear since *Redgrave*,[7] if not earlier,[8] that a claimant could rescind a contract in equity even if induced by a wholly innocent misrepresentation without any fault on the defendant's part.[9]

Misrepresentation leading to a mistaken belief

The sharp distinction in English law between the effects of an operative misrepresentation and a spontaneous mistake on the validity and enforceability of contracts tends to obscure the close relationship between mistake and misrepresentation, namely that an operative misrepresentation is nothing more than an "induced mistake",[10] and the implications of this will be examined here.

A failure to appreciate the fundamental nature of an operative misrepresentation as an induced mistake, coupled with a mechanical application of the aforementioned three basic requirements for establishing a right to rescind, is liable to lead to confusion. For this reason, it is appropriate to clarify the relationship and emphasise the crucial connection between mistake and misrepresentation, before we look into the application of the objectivity principle in establishing those three requirements.

As Prof. Cartwright puts it, in order to preserve the security of contracts, courts are slow to allow a claimant to escape from what appears objectively to be a contract merely because subjectively he has made a spontaneous mistake; yet, where a defendant has made (or has notice of) a misrepresentation which induced a claimant to enter into a contract with the defendant, the claimant is entitled, at his election, to rescind or set aside the apparent or voidable contract.[11]

This is because courts regard the claimant's intention or consent to be contractually bound as "defective" or "impaired" since he had been "misled" or "deceived" (fraudulently or otherwise) by a false representation made by the defendant or of which the defendant had notice: how the claimant's mistaken belief

[7] *Redgrave v Hurd* (1881–82) L.R. 20 Ch. D. 1 at 12–13 (Sir George Jessel MR): "According to the decisions of Courts of Equity it was not necessary, in order to set aside a contract obtained by material false representation, to prove that the party who obtained it knew at the time when the representation was made that it was false. It was put in two ways either of which was sufficient. One way of putting the case was, 'A man is not to be allowed to get a benefit from a statement which he now admits to be false. He is not to be allowed to say, for the purpose of civil jurisdiction, that when he made it he did not know it to be false; he ought to have found that out before he made it'. The other way of putting it was this: 'Even assuming that moral fraud must be shewn in order to set aside a contract, you have it where a man, having obtained a beneficial contract by a statement which he now knows to be false, insists upon keeping that contract. To do so is a moral delinquency: no man ought to seek to take advantage of his own false statements'. The rule in equity was settled, and it does not matter on which of the two grounds it was rested."

[8] *Reese River Silver Mining Co v Smith* (1869) L.R. 4 H.L. 64 at 79–80 (Lord Cairns LC); *Lamare v Dixon* (1873) L.R. 6 H.L. 414 at 428; *Duranty's Case* (1858) 26 Beav. 268, 53 E.R. 901 at 902 (Lord Romilly); *Torrance v Bolton* (1872–73) L.R. 8 Ch. App. 118 at 124 (James LJ).

[9] In any event, subsequently, it was clearly accepted that rescission in equity could rest on an entirely innocent misrepresentation in *Derry v Peek* (1889) 14 App. Cas. 337 HL at 359 (Lord Herschell): "it is only necessary to prove that there was a misrepresentation; then however honestly it may have been made, however free from blame the person who made it, the contract, having been obtained by misrepresentation, cannot stand."

[10] Cartwright, *Misrepresentation, Mistake and Non-Disclosure* (2017), p.2, para.1-03; S.J. Stoljar, *Mistake and Misrepresentation: A Study in Contractual Principles* (London: Sweet & Maxwell, 1968), pp.83–84.

[11] Cartwright, *Misrepresentation, Mistake and Non-Disclosure* (2017), p.2, para.1-03: "Misrepresentation and mistake are generally treated entirely separately in English law, although this tends to mask the fact that misrepresentation is really a sub-category of mistake: induced mistake. In a claim of misrepresentation the claimant asserts that the defendant communicated to him inaccurate information on which he relied: that is, by his statement the defendant caused him to make a mistake … The courts are reluctant to allow one party's mistake to vitiate a contract, because it would undermine the other party's security of contract. By contrast, where he can show that the mistake was induced by the other party's statement, and so can plead his claim not as mistake but as misrepresentation, the possibility of avoiding the contract is much greater: rescission of the contract is generally available as a remedy for misrepresentation."

came about "makes the critical difference".[12] According to Lord Nicholls in the context of fraudulent misrepresentations[13]:

> "The existence of a fraudulent misrepresentation means that a person's intention is formed on a false basis — a basis, moreover, known by the other party to be false.
>
> … The necessary coincidence of intention, or consensus ad idem, may exist even where the intention and consent of the victim were induced by fraud. An intention thus induced is regarded by the law as sufficient to found a contract, even though the victim may repudiate the contract as soon as he discovers the fraud.
>
> … The law adopts the same approach where the goods offered for sale are fraudulently misrepresented to be a unique item such as the original of a specific painting by a named artist or the football shirt worn by Bobby Moore in the 1966 World Cup final match … But the effect of the misrepresentation is that the buyer, believing the proffered goods to be as represented, agrees to buy the proffered goods. He enters into a contract on the basis of what he believes is the position … The fact that his belief was induced by the other's fraudulent misrepresentation entitles him to repudiate the contract. His belief means there was a contract, but the fraudulent inducement of his belief means the contract is voidable.
>
> The position is similar if the owner of goods agrees to sell them to a prospective buyer on the basis of a fraudulent assertion of his financial reliability … The fraud means only that the seller's contractual intention was formed, and his consent to hand over the goods obtained, on a fraud-induced basis. There is a contract but it may be avoided on discovery of the fraud."

In other words, the claimant may rescind the contract because he entered into it under a mistake or misapprehension which was induced by a mis-statement or false representation made by the defendant (or of which the defendant had notice). Hence, it is fundamental that an "operative misrepresentation" is simply an "induced mistake" which gives rise to the right to rescind a contract.[14] It follows that there can be no operative misrepresentation if the claimant was not misled into making

[12] O'Sullivan, Elliott and Zakrzewski, *The Law of Rescission* (2014), pp.71–72, paras 4.01 to 4.02: "misrepresentation is a ground for rescission. It may be contrasted with a mere mistake, which generally does not permit rescission. The way in which the representee's erroneous belief is brought about makes the critical difference as to whether a right to rescind arises."

[13] *Shogun Finance Ltd v Hudson* [2003] UKHL 62; [2004] 1 A.C. 919 at [6], [8], [10], [11] (Lord Nicholls of Birkenhead) (Lord Nicholls was in the minority, but nothing turns on his Lordship's dissent).

[14] Cartwright, *Misrepresentation, Mistake and Non-Disclosure* (2017), p.2, para.1-03. See also F. Pollock, *Principles of Contract*, 10th edn (London: Stevens and Sons, 1936), pp.525, 556, 568–569; Eggers, *Vitiation of Contractual Consent* (2017), pp.20, 25, 26, 569; *Meagher, Gummow & Lehane's Equity Doctrines & Remedies* (2015), p.455, para.13-030 ("The misrepresentation must have produced a misunderstanding on the part of the representee and this must have been one of the reasons which induced the contract").

a mistake,[15] for instance, because he did not believe in the mis-statement or he knew the truth.[16]

Pressure and duress

Although this is not new, it is at risk of being overlooked; thus, it is now necessary to be reminded of what Prof. Stoljar said half a century ago[17]:

> "[A] misrepresentation causes or induces a mistake, for unless the representee is in error he does not even have a *misrepresentation* to complain about … Hence it is important to repeat that fraud and duress … differ precisely in this: that while the former depends on the existence of a mistake, the latter does not. More particularly, in duress it is precisely because the relevant facts are known by both sides that coercion has to be used, while in fraud exactly the opposite occurs: the defrauded party only enters the contract because he is mistaken'."

Prof. Stoljar's distinction between the two contractual vitiating factors of duress and misrepresentation is instructive in pointing out the obvious, but understated, axiom that induced pressure is the hallmark of the former, and induced mistake is the hallmark of the latter.

If this fundamental distinction is borne in mind, it will be patent that a mechanical application of the aforementioned three basic requirements without regard to the nature of an operative misrepresentation as an induced mistake or erroneous belief is liable to cause confusion: for instance, it has been wrongly asserted that since the third requirement, namely inducement, merely requires a factual causal link

[15] *Beattie v Lord Ebury* (1874–75) L.R. 7 H.L. 102 at 111 and 118 (Lord Cairns LC), 122 and 125 (Lord Chelmsford), 130 (Lord Hatherley); *Mackender v Feldia AG* [1967] 2 Q.B. 590 CA at 603–604 (Diplock LJ) ("It is argued that innocent misrepresentation or, in the case of contracts of insurance, non-disclosure of material facts vitiates consent and makes the apparent consent of the party misled, no consent at all. But this is specious. What is really meant is that the party did in fact consent but would not have done so if he had known then what he knows now. Fraud may raise other considerations into which it is not necessary to go"); *Shogun Finance v Hudson* [2003] UKHL 62, [2004] 1 A.C. 919 at [6]–[11] (Lord Nicholls of Birkenhead), [56]–[59] (Lord Millett). See also *CIBC Mortgages Plc v Pitt* [1994] 1 A.C. 200 HL at 209 (Lord Browne-Wilkinson): "A man guilty of fraud is no more entitled to argue that the transaction was beneficial to the person defrauded than is a man who has procured a transaction by misrepresentation. The effect of the wrongdoer's conduct is to prevent the wronged party from bringing a free will and properly informed mind to bear on the proposed transaction which accordingly must be set aside in equity as a matter of justice."

[16] *Dyer v Hargrave* (1805) 10 Ves. Jr. 505, 32 E.R. 941; *Attwood v Small* (1838) 6 Cl. & F. 232, 7 E.R. 684 at 765 (Lord Brougham) ("moreover, the representation so made must have had the effect of deceiving the purchaser; and moreover, the purchaser must have trusted to that representation, and not to his own acumen, not to his own perspicacity, not to inquiries of his own"); *Strover v Harrington* [1988] Ch. 390 Ch D at 407 (Browne-Wilkinson VC); *Malhi v Abbey Life Assurance Co Ltd* [1994] C.L.C. 615 CA (Civ Div); *Sprecher Grier Halberstam LLP v Walsh* [2008] EWCA Civ 1324, [2009] C.P. Rep. 16 at [17] (Ward LJ) ("A man cannot be deceived if he knows the truth"); *Vigers v Pike* (1842) 8 Cl. & F. 562, 8 E.R. 220 at 253 (Lord Cottenham) ("In a case depending upon alleged misrepresentation as to the nature and value of the thing purchased, the defendant cannot adduce more conclusive evidence, or raise a more effectual bar to the plaintiff's case, than by showing that the plaintiff was from the beginning cognisant of all the matters complained of, or, after full information concerning them, continued to deal with the property, and even to exhaust it in the enjoyment, as by working mines").

[17] Stoljar, *Mistake and Misrepresentation* (1968), pp.83–84. See also Eggers, *Vitiation of Contractual Consent* (2017), pp.20, 25, 26, 569: "Where consent is lacking or undermined, whether because there is an inability to give such consent, or because any consent is not given freely or because the consent is based on a misinformation, it is sometimes said that the consent is vitiated, meaning that the consent is invalidated or rendered ineffectual or defective … The effect of fraud, misrepresentation or mistake, for example, is to inculcate into the mind of the innocent party an error or misapprehension that itself induces the party to consent. That is not to say that the innocent party did not freely state 'I consent', but the consent was proffered based on a mistaken assumption … In such cases, if the consent was based on such misinformation, it is negatived or diminished by the error … Where a party to a contract enters into that contract by reason of a misrepresentation made by the other party to the contract, the representee's consent that underlies the concluded contract will have been undermined by the misinformation provided by the representor."

between the defendant's pre-contractual misrepresentation and the claimant's entering into the impugned contract, neither the claimant's "disbelief in the misrepresentation [n]or knowledge of its falsity would automatically negate inducement as a matter of law".[18]

Fraudulent misrepresentation in Zurich Insurance

That misconceived assertion was made on the strength of dicta pronounced in *Zurich Insurance*.[19]

The claimants in *Zurich Insurance* were insurers of the defendant's employers. The claimants entered into a settlement agreement with the defendants, even though they suspected that the defendant had dishonestly made exaggerations about the extent of the injury he suffered in the course of employment and the duration of his inability to work. The claimants settled at a much larger sum than they would otherwise have done because they thought they would not have been able to prove their suspicion of fraud in court, and that a trial judge would have believed the defendants and awarded a larger sum as damages for the defendant's injuries.

After the settlement agreement was entered into, the defendant's neighbours provided the claimants with evidence proving that the defendant had made fraudulent representations prior to the settlement agreement and that the defendant had recovered from his injuries earlier than he asserted. Therefore, the claimant commenced proceedings against the defendant for damages in the tort of deceit and for rescission of the settlement agreement (and repayment of disbursed settlement sums) on the ground that it had been induced by the defendant's fraudulent misrepresentation.

The claimants succeeded in the Supreme Court where, although Lord Toulson delivered a concurring judgment, the leading judgment was delivered by Lord Clarke, with whom all their Lordships agreed. Lord Clarke held that the defendant had dishonestly made material false representations which were intended to induce, and did induce, the claimants to enter into the settlement agreement on terms far more generous to the defendants than if the defendants had not made such fraudulent exaggerations. Whether the claimants were induced by the defendant's fraudulent misrepresentation to enter into the settlement agreement was a question of fact which established a causal link between the misrepresentation and the impugned contract.[20]

Nonetheless, it must be emphasised that Lord Clarke held that, although the claimants suspected that the defendant had exaggerated the extent of his injuries and had conducted their own investigations prior to the settlement, "this is not a case in which *Zurich* [the claimants] or the employer knew that Mr Hayward [the defendant] was deliberately exaggerating the seriousness and long term effects of his injuries", because "the fact is that *Zurich* [the claimants] did not know the extent of Mr Hayward's [the defendant's] misrepresentations", so "no very clear

[18] R. Lee, "Proof of Inducement in the Law on Misrepresentation" [2017] L.M.C.L.Q. 150, 158; commenting on *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637.

[19] *Zurich Insurance v Hayward* [2016] UKSC 48; [2016] 3 W.L.R. 637 at [18], [23], [25], [32], [44] (Lord Clarke of Stone-cum-Ebony JSC), [67], [71] (Lord Toulson JSC).

[20] *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [29] (Lord Clarke of Stone-cum-Ebony JSC), [63] (Lord Toulson JSC); *Gipps v Gipps* [1978] 1 N.S.W.L.R. 454 at 460 (Hutley JA); *Downs v Chappell* [1997] 1 W.L.R. 426 CA (Civ Div) at 433 (Hobhouse LJ).

allegations were, or could be made" against the defendant for fraudulent exaggerations at the time of entering into the settlement agreement.[21]

As such, it follows that Lord Clarke's opinion on the following two issues were clearly obiter dicta. First, although his Lordship opined that "there may be circumstances in which a representee may *know* that the representation is false but nevertheless may be held to rely upon the misrepresentation as a matter of fact" because "questions of inducement and causation are questions of fact",[22] that is obiter. As Lord Clarke explained, since "it cannot fairly be said that *Zurich* [the claimants] had full knowledge of the facts here", it was "not necessary to express a final view on the question whether it always follows from the fact that the representee *knows* that the representation is false that he cannot succeed".[23] Secondly, Lord Clarke's second opinion, that "it is difficult to envisage any circumstances in which mere *suspicion* that a claim was fraudulent would preclude unravelling a settlement when fraud is subsequently established", is also obiter, because his Lordship considered that the answer to the second issue "seems to … follow from the answer to the first".[24]

It should also be clear that since the claimants pleaded and established the defendant's dishonest exaggeration of claims in order to obtain a better settlement agreement, the Supreme Court was concerned exclusively with fraudulent misrepresentations and the tort of deceit. Indeed, Lord Toulson's and Lord Clarke's judgments were focused on the tort of deceit, thus effectively eliding the right to rescind a contract for fraudulent misrepresentation with the commission of the tort of deceit.[25] Their Lordships' decision turned on the defendant's dishonesty at multiple points. Thus, the facts (1) that the claimants already suspected that the defendant was making fraudulent exaggerations before entering into the settlement agreement; (2) that the defendants consciously took the risk that they were settling with the defendant on an ill-founded claim; and (3) that there is a public policy in favour of encouraging the compromise of claims disputed in litigation by upholding settlement agreements, were all considered "not sufficient to allow" the defendant to retain the benefit of the settlement agreement "which he only obtained by fraud": to hold otherwise would be putting "the position too high in favour of fraudsters".[26] After all, although the impugned settlement agreement was meant to compromise litigation, "fraud is a thing apart" which "unravels all", and "it vitiates judgments, contracts and all transactions whatsoever".[27]

In the context of *Zurich Insurance*—that is, fraudulent misrepresentation and the tort of deceit—the legal threshold is not high for establishing inducement or

[21] *Zurich Insurance v Hayward* [2016] UKSC 48; [2016] 3 W.L.R. 637 at [20], [22], [45] (Lord Clarke of Stone-cum-Ebony JSC).

[22] *Zurich Insurance v Hayward* [2016] UKSC 48; [2016] 3 W.L.R. 637 at [44] (Lord Clarke of Stone-cum-Ebony JSC) (emphasis added).

[23] *Zurich Insurance v Hayward* [2016] UKSC 48; [2016] 3 W.L.R. 637 at [44] (Lord Clarke of Stone-cum-Ebony JSC) (emphasis added).

[24] *Zurich Insurance v Hayward* [2016] UKSC 48; [2016] 3 W.L.R. 637 at [48] (Lord Clarke of Stone-cum-Ebony JSC) (emphasis added).

[25] *Zurich Insurance v Hayward* [2016] UKSC 48; [2016] 3 W.L.R. 637 at [18], [23] (Lord Clarke of Stone-cum-Ebony), [58], [67] (Lord Toulson JSC).

[26] *Zurich Insurance v Hayward* [2016] UKSC 48; [2016] 3 W.L.R. 637 at [20]–[22], [44] (Lord Clarke of Stone-cum-Ebony JSC), and [53], [55], [56] (Lord Toulson JSC).

[27] *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [53] (Lord Toulson JSC); *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6, [2003] 1 All E.R. (Comm) 349 at [15]–[16] (Lord Bingham of Cornhill); *Lazarus Estates Ltd v Beasley* [1956] 1 Q.B. 702 CA at 712 (Denning LJ).

a factual causal connection between the misrepresentation and impugned contract. Since "materiality is evidence of inducement because what is material tends to induce", it follows that a material misrepresentation will raise a "presumption of inducement" through "an inference of fact"; and, furthermore, that factual presumption of inducement is "very difficult to rebut" because a "party who has practised deception with a view to a particular end, which has been attained by it, cannot be allowed to deny its materiality or that it actually played a causative part".[28] Moreover, a misrepresentation need not be its sole or decisive cause in order to have induced a contract: It is "sound policy" that where "a fraudulent representation is relied upon", it is "sufficient for the misrepresentation to be an inducing cause and that it is not necessary for it to be the sole cause".[29] However, the idea that the misrepresentation need not be the "sole" inducement is not limited to fraudulent misrepresentations; thus, even in cases of a non-fraudulent misrepresentation, "it is sufficient if it can be shown to have been one of the inducing causes" if the claimant "would not entered the contract but for the misrepresentation".[30]

Unlike the "normal rule" which requires that,[31] outside the context of fraud, "where a party has entered a contract after a misrepresentation has been made to him, he will not have a remedy unless he would not have entered the contract (or at least not on the same terms) but for the misrepresentation",[32] this "but for" causative requirement does not apply where fraud is made out. A fraudulent defendant cannot avoid a claimant's election to rescind merely by attempting to show that the claimant might have entered into the same contract if the misrepresentation had not been made.[33] All that is required is that the fraudulent

[28] *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [29], [34], [37] (Lord Clarke of Stone-cum-Ebony JSC); *Pan Atlantic Insurance v Pine Top Insurance (No.2)* [1995] 1 A.C. 501 HL at 551 (Lord Mustill); *Smith v Kay* (1859) 7 H.L. Cas. 750 at 759 (Lord Chelmsford LC); *Sharland v Sharland* [2015] UKSC 60, [2015] 3 W.L.R. 1070 at [32] (Baroness Hale of Richmond).

[29] *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [33] (Lord Clarke of Stone-cum-Ebony JSC); *Barton v Armstrong* [1976] AC 104 PC (Australia) at 118 (Lord Cross of Chelsea); *Standard Chartered Bank Ltd v Pakistan National Shipping Corp Ltd (Nos 2 and 4)* [2002] UKHL 43, [2003] 1 A.C. 959 at [15]–[16] (Lord Hoffmann); *Gould v Vaggelas* (1984) 157 C.L.R. 215 at 236 (Wilson J).

[30] *Chitty on Contracts Volume I: General Principles* (2015), p.668, para.7-037; *Edgington v Fitzmaurice* (1885) 29 Ch. D. 459 CA at 481 (Cotton LJ); *Taberna Europe CDO II Plc v Selskabet AF1.September 2008 in Bankruptcy (formerly known as Roskilde Bank A/S)* [2015] EWHC 871 (Comm) at [153] (Eder J).

[31] *Chitty on Contracts Volume I: General Principles* (2015), p.668, para.7-038; *Assicurazioni Generali SpA v Arab Insurance Group (BSC)* [2002] EWCA Civ 1642, [2003] 1 W.L.R. 577 at [59] (Clarke LJ), and [187] (Sir Christopher Staughton); *Raiffeisen Zentralbank Osterreich AG v Royal Bank of Scotland* [2010] EWHC 1392 (Comm), [2011] 1 Lloyd's Rep. 123 at [195]–[198] (Christopher Clarke J); *Taberna Europe CDO II Plc v Selskabet* [2015] EWHC 871 (Comm) at [153] (Eder J); cf. Handley, "Causation in Misrepresentation" (2015) 131 L.Q.R. 275, 281.

[32] It seems that the "but for" test of inducement for non-fraudulent misrepresentations is "whether the misrepresentee would have entered the contract had the representation not been made, rather than what he would have done had he known the truth": *Chitty on Contracts Volume I: General Principles* (2015), p.668, para.7-038 n.199, citing *Raiffeisen Zentralbank* [2010] EWHC 1392 (Comm), [2011] 1 Lloyd's Rep 123 at [174]–[191] (Christopher Clarke J); cf. Handley, "Causation in Misrepresentation" (2015) 131 L.Q.R. 275, 281, 284–285.

[33] *Chitty on Contracts Volume I: General Principles* (2015), p.669, para.7-039; *In re London & Leeds Bank Ltd* (1887) 56 L.J. Ch. 321 at 324 (Stirling J); *Smith v Kay* (1859) 7 H.L. Cas. 750 at 759 (Lord Chelmsford LC: "Can it be permitted to a party who has practised a deception with a view to a particular end which has been attained by it, to speculate on what might have been the result if there had been a full communication of the facts?"); *William's Case* (1869–70) L.R. 9 Eq. 225 at 226 (James VC); *Broome v Speak* [1903] 1 Ch. 586 at 621 (Sir Richard Collins MR); *Reynell v Spyre* (1852) 1 De G.M. & G. 660, 42 E.R. 710 at 728–729 (Cranworth LJ): "But this is a matter on which I do not feel called upon or indeed at liberty to speculate. Once make out that there has been anything like deception, and no contract resting in any degree on that foundation can stand. It is impossible to analyze the operations of the human mind as to be able to say how far any particular representation may have led to the formation of any particular resolution, or the adoption of any particular line of conduct. No one can do this with certainty, even as to himself, still less as to another. Where certain statements have been made, all in their nature capable, more or less, of leading the party to whom they are addressed, to adopt a particular line of conduct, it is impossible to say of any one such representation so made that, even if it had not been made, the same resolution would have been taken, or

misrepresentation was one of the reasons for the claimant's decision, or that it had "an impact" or "an influence" on the claimant's mind or judgment, such that inducement is negated only if the misrepresentation "did not influence" or "had no effect" on the claimant's mind or decision.[34]

Clearly, there is a strong judicial policy to formulate rules "intended to deter fraud" by, inter alia, lowering the threshold for the "inducement" requirement in cases of fraudulent misrepresentation.[35] The rule that a defendant may not rely upon a contractual provision to exempt himself from the consequences of his fraudulent misrepresentations[36] could also be attributed to the policy to deter fraud.

In this light, it is tempting to read Lord Clarke's dicta in *Zurich Insurance* to mean that where a defendant had made a fraudulent misrepresentation which had some effect on the claimant's decision to enter into the impugned contract, the policy to deter fraud means that the claimant may rescind even if he *did not believe* in the defendant's representations. Since the Supreme Court in *Zurich Insurance* emphasised that "fraud is a thing apart" which "unravels all",[37] perhaps deterrence of fraud justifies deviating from the fundamental principle that an operative misrepresentation amounts to an induced mistake and, as such, justifies allowing the claimant to rescind even if he was not mistaken because he did not believe in the defendant's fraudulent misrepresentations.

However, one should resist that temptation. One should not read the dicta of Lord Clarke to mean that the claimant's prior knowledge of the truth will not preclude rescission for an operative misrepresentation, fraudulent or otherwise. If their Lordships had intended to overturn the fundamental principle that an operative misrepresentation is an induced mistake (so that prior knowledge of the truth precludes misrepresentation because it precludes mistake), they would have said so explicitly. Instead, Lord Clarke simply noted that the parties "accepted" that "where the representee knows that the representation is false, he cannot succeed" and that "there is some support in the authorities for this view"; and continued to conclude that since "it cannot fairly be said that" the claimant "had full knowledge of the facts here", it followed that it was "not necessary to express a final view on the question whether it always follows from the fact that the representee knows

the same conduct followed … Who can say that the untrue statement may not have been precisely that which turned the scale in the mind of the party to whom it was addressed?"

[34] *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [29] (Lord Clarke of Stone-cum-Ebony JSC); *Pan Atlantic Insurance v Pine Top Insurance* [1995] 1 A.C. 501 at 517 (Lord Goff of Chieveley), and 545–551 (Lord Mustill); *Barton v Armstrong* [1976] A.C. 104 at 118 (Lord Cross of Chelsea); cf. Handley, "Causation in Misrepresentation" (2015) 131 L.Q.R. 275, 285 ("The [test for causation] … excludes only those misrepresentations which were forgotten or ignored as irrelevant or immaterial and those where the truth was known. All others will in some degree have been causative").

[35] *Chitty on Contracts Volume I: General Principles* (2015), p.667, para.7-035 ("In cases of fraud … it is no defence for the representor to show that if the misrepresentation had not been made, the misrepresentee would still have made the contract … This does not seem to be merely a reversal of the usual burden of proof but a special rule that in fraud cases that, provided the misrepresentation had some influence, it is no defence that the misrepresentee would have entered the contract even if the statement had not been made. The rule is intended to deter fraud."); cf. Handley, "Causation in Misrepresentation" (2015) 131 L.Q.R. 275, 285 ("The representor must have decided to make the misrepresentation because he or she judged that the truth or silence would not, or might not, serve their purposes or serve them so well. In doing so they fashioned an evidentiary weapon against themselves, and the court should not subject the victim to 'what if' enquiries which the representor was not prepared to risk at the time.").

[36] *S Pearson & Son Ltd v Dublin Corp* [1907] A.C. 351 HL at 362, 353–354; and *HIH Casualty and General Insurance* [2003] UKHL 6, [2003] 1 All E.R. (Comm) 349 at [16] (Lord Bingham of Cornhill).

[37] *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [53] (Lord Toulson JSC); *HIH Casualty and General Insurance* [2003] UKHL 6, [2003] 1 All E.R. (Comm) 349 at [15]–[16] (Lord Bingham of Cornhill); *Lazarus Estates v Beasley* [1956] 1 Q.B. 702 at 712 (Denning LJ).

that the representation is false that he cannot succeed".[38] Secondly, the reason why Lord Clarke thought there might be circumstances in which a claimant should be held to have been induced to enter into an impugned contract and thus have the right to rescind, even though he knew the defendant's representations were false, is that the claimant might have had no real practical choice given the defendant's assertion of illegitimate pressure through fraudulent misrepresentations and giving false evidence. Thus, both Lord Clarke and Lord Toulson emphasised that, although a claimant might suspect or even know that the defendant was fraudulently making exaggerated claims, the claimant might be influenced to reach a settlement agreement on terms favourable to the defendant because the claimant thinks that the defendant's fraudulent statements might be believed by a judge at trial: And it is in this sense that the defendant's fraudulent statements have "caused" or "induced" the impugned settlement agreement.[39] The two examples relied upon by Lord Clarke and Lord Toulson are cases of this nature.

Duress in Borrelli and Zurich Insurance

In their Lordships' first example in *Zurich Insurance*, a wife who entered into a property settlement agreement with her former husband during their divorce proceedings may be entitled to set aside the settlement even though prior to the settlement she suspected that he had dishonestly undervalued his assets.[40] In the second example, the claimants entered into a settlement agreement with a defendant even though they knew that the defendant had fraudulently "staged" a traffic accident, because the claimants "cannot choose to ignore it; they must still take into account the risk that it will be believed by the judge at trial"; and "this situation is quite different from a proposed purchase, where if in doubt one can simply walk away".[41] Both settlement agreements were said to be causally linked to, and hence induced by, the defendant's prior fraudulent misrepresentations; and both are said to be susceptible to rescission if the claimants are subsequently able to obtain evidence to prove fraud.

However, their Lordships' two examples are cases where the claimants entered into an impugned contract under threat of proceedings perverted by false evidence, and they concern the claimants' lack of pragmatic or realistic choice arising from the illegitimate assertion of pressure. Properly regarded, these should really be treated as cases of duress, not misrepresentation.

We must not forget Prof. Stoljar's warning to carefully distinguish between (1) contracts induced by pressure and voidable under the doctrine of duress, and (2) contracts induced by a *mistaken belief* in mis-stated facts and voidable under the doctrine of misrepresentation.[42]

[38] *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [43], [44] (Lord Clarke of Stone-cum-Ebony JSC).

[39] *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [15], [19], [32], [45] (Lord Clarke of Stone-cum-Ebony JSC) and [52], [67], [71] (Lord Toulson JSC).

[40] *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [29], [43] (Lord Clarke of Stone-cum-Ebony JSC) and [69] (Lord Toulson JSC); citing *Gipps v Gipps* [1978] 1 N.S.W.L.R. 454 at 460 (Hutley JA).

[41] *Zurich Insurance v Hayward* [2016] UKSC 48, [2016] 3 W.L.R. 637 at [45] (Lord Clarke of Stone-cum-Ebony JSC); citing the judge (Judge Moloney QC) at first instance.

[42] Stoljar, *Mistake and Misrepresentation* (1968), pp.83–84.

The Privy Council decision in *Borrelli*[43] is the clearest modern example of a voidable settlement agreement being set aside for duress because (1) it was induced by the defendant's "illegitimate economic or similar pressure", leaving the claimant "with no reasonable or practical alternative"; (2) the illegitimate pressure arose from, inter alia, the defendant's use of "forgery and false evidence" to unjustifiably oppose the claimant's proposed corporate scheme of arrangement of an insolvent company in the company's scheme meeting and in court proceedings for sanctioning the proposed scheme; and (3) the claimant *knew* (or "did believe (correctly)") that the defendant resorted to forgery and false evidence. It is true that the development of the law of duress would always be constrained at its fringes by doubts about how far the doctrine of duress should be allowed to undermine the security of contract and the liberty of contracting parties to exploit practical pressures to obtain the best deals, but these are not categorical or fundamental problems of principle. They are, instead, inevitable questions of degree to be managed on a case-by-case basis concerning: the level of pressure, extent of lack of practical choice, and degree of reprehensibility of the defendant's conduct, which the claimant must establish before he is entitled to invoke duress to vitiate a contract.

Conclusion

It has been necessary to spend substantial time in this article to emphasise the legal affinity between *Borrelli* and *Zurich Insurance* as well as to clarify the impact of Lord Clarke's dicta in the latter case.

This is because the latter might, if misunderstood, become highly disruptive of the internal coherence of the law of misrepresentation. First of all, post-*Zurich Insurance*, authoritative treatises continue to treat voidable contracts resulting from operative misrepresentations as contracts based on a mistaken belief induced by mis-statements,[44] thus treating misrepresentations as induced mistakes. Secondly, and consistently with the first fundamental premise, those treatises continue to accept the well-established rule that a claimant cannot rescind for misrepresentation if he has not been misled or mistaken because he knew the truth or did not believe in the defendant's mis-statements.[45] Thirdly, however, those same treatises go on to cite dicta from *Zurich Insurance* for the proposition that a claimant's knowledge of the truth or disbelief in the defendant's mis-statements would not, as a matter of law, prevent him from rescinding on the ground of misrepresentation.[46]

[43] *Borrelli v Ting* [2010] UKPC 21; [2010] Bus. L.R. 1718 at [29], [31], [34], [35] (Lord Saville of Newdigate).

[44] Cartwright, *Misrepresentation, Mistake and Non-Disclosure* (2017), p.2, para.1-03 ("misrepresentation is really a sub-category of mistake: induced mistake"); Eggers, *Vitiation of Contractual Consent* (2017), pp.569, 645 ("representee's consent … will have been undermined by the misinformation provided", and "representee being misled"); *Chitty on Contracts Volume I: General Principles* (2015), (incorporating the First Supplement, 2016), p.667, para.7-036 ("if established, knowledge on the part of the representee is of course a complete defence, because he is then unable to show that he was misled by the misrepresentation").

[45] Cartwright, *Misrepresentation, Mistake and Non-Disclosure* (2017), p.66, para.3-50 ("A representee cannot normally succeed where he knows that the representation is false, although it has been said that there may be circumstances in which a representee may know that the representation is false but nevertheless may be held to rely upon the misrepresentation as a matter of fact."); Eggers, *Vitiation of Contractual Consent* (2017), pp.668–671, para.7.7.5; *Chitty on Contracts Volume I: General Principles* (2015), (incorporating the First Supplement, 2016), p.667, para.7-035 ("if the misrepresentation did not affect the representee's mind, because he was unaware that it had been made, or because he was not influenced by it, or because he knew it was false, he has no remedy").

[46] Cartwright, *Misrepresentation, Mistake and Non-Disclosure* (2017), p.66, para.3-50; Eggers, *Vitiation of Contractual Consent* (2017), pp.670–671, para.7.7.5 ("Whether the representee was induced to enter into the contract … is a question of fact and does not necessarily require the representee to believe in the truth of the representation, although such belief is relevant to the question of fact. That said, it was common ground before the Supreme Court

These treatises are merely taking their cue from Lord Clarke: His Lordship refused to take a final stand and elected instead to sit on the fence between the second and third propositions, essentially by supporting the third proposition with strongly worded dicta, while refusing to decisively abrogate the second.[47] However, one cannot sit on the fence on matters as fundamental as this, particularly since the first and second propositions are conceptually bundled together, and they are simply irreconcilable with the third.

Of course, one can easily understand the Supreme Court's desire not to allow the fraudulent defendant in *Zurich Insurance* to retain the benefit of the settlement agreement which he obtained by dishonest exaggerations and false evidence. However, as the Privy Council in *Borrelli* demonstrated, the law of duress would have been more than capable of delivering the same result in *Zurich Insurance* without disrupting the existing rules of duress, and with the added advantage of not eroding a fundamental axiom of vitiation of contracts by misrepresentation.

Furthermore, taking the duress route to the same destination in *Zurich Insurance* would also avoid any potential to unintentionally elide the traditionally divergent consequences and bases of liability under a contractual undertaking and liability for pre-contractual misrepresentation. The former is based on a contractual term (sometimes dubbed a "warranty") supported by consideration which obviates the need for any belief or reliance, and results in damages on a contractual measure and in some cases the discharge or termination forthwith of the contract; whereas the latter is founded on a representation that must induce reliance upon a mistaken belief because unsupported by consideration, and results in an indemnity coupled with rescission ab initio of the contract and in some cases damages on a tortious measure.[48] And, this is where one must turn one's attention to how the law distinguishes between contractual undertakings and pre-contractual misrepresentations,[49] but that can only be addressed on a separate occasion.

[in *Zurich Insurance*] that if the representee knows that the representation is false, the representee cannot succeed."); *Chitty on Contracts Volume I: General Principles* (2015) (incorporating the First Supplement, 2016), p.667, para.7-035 n.186) ("In *Hayward v Zurich Insurance Co Plc* [2016] UKSC 48 the Supreme Court … held that a settlement of an insurance claim could be avoided by the insurer when it discovered that the amount of loss had been exaggerated fraudulently, even though at the time the insurer had doubts over the extent of the claim. … It is not necessary that the insurer believed that the claim made was true.").

[47] *Zurich Insurance v Hayward* [2016] UKSC 48; [2016] 3 W.L.R. 637 at [43]–[44] (Lord Clarke of Stone-cum-Ebony JSC).

[48] cf. R. Zakrzewski, "Representations and Warranties Distinguished" (2013) 28 J.I.B.F.L. 341, 342, 344.

[49] See, for example, *Idemitsu Kosan Co Ltd v Sumitomo Corp* [2016] EWHC 1909 (Comm) (Mr Andrew Baker QC); *Sycamore Bidco Ltd v Breslin* [2012] EWHC 3443 (Ch) (Mann J); *Eurovideo Bildprogramm GmbH v Pulse Entertainment Ltd* [2002] EWCA Civ 1235 (Rix LJ); *Invertec Ltd v De Mol Holding BV* [2009] EWHC 2471 (Ch) (Arnold J); Misrepresentation Act 1967 s.1(a).

Negligence Construction: Does Anything Remain of Canada Steamship?

Adam Shaw-Mellors*
Aston University

Construction contracts; Contra proferentem; Exclusion clauses; Interpretation; Professional negligence

Introduction

There was once a time when a clear judicial reticence could be identified when it came to allowing exemption clauses to be construed in a way that would allow an effective denial of a contracting party's liability for negligence. The courts' general policy in approaching such matters of so-called negligence construction was reflected in the guidelines of Lord Morton in *Canada Steamship Lines Ltd v The King*.[1] The introduction of the Unfair Contract Terms Act 1977 provided an additional layer of protection for parties against whom such clauses were relied on, and there then followed a more relaxed judicial attitude in relation to the construction of clauses purporting to exclude liability for negligence.[2]

Certain observations by the Court of Appeal in *Persimmon Homes Ltd v Ove Arup and Partners Ltd*,[3] and at first instance in that case,[4] suggest the earlier judicial hostility has now eased to the point that the *Canada Steamship* guidelines are no longer of application in the context of negligence construction. This note considers *Persimmon* and the modern approach to the construction of exemption clauses in connection with negligence liability.

Facts and issues in *Persimmon*

The defendants were two companies which can be referred to singly as "Arup". In 1992, Arup was engaged as a civil engineer in connection with a regeneration project at a site where it was recognised that contamination and pollution would be potential problems. On the completion of the regeneration work, the claimants, comprising three companies (collectively, the Consortium), expressed an interest in purchasing the site. In 2007, the Consortium engaged Arup to provide consultancy engineering services in respect of the Consortium's bid for the site.

* Lecturer in Law.
[1] *Canada Steamship Lines Ltd v The King* [1952] A.C. 192 PC (Canada).
[2] See e.g. *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6; [2003] 1 C.L.C. 358 at [11] per Lord Bingham.
[3] *Persimmon Homes Ltd v Ove Arup and Partners Ltd* [2017] EWCA Civ 373 (judgment of Jackson LJ, with whom Moylan and Beatson LJJ agreed).
[4] *Persimmon Homes Ltd v Ove Arup and Partners Ltd* [2015] EWHC 3573 (TCC); [2016] B.L.R. 112.

The Consortium eventually acquired the site for £53 million in September 2007 and on doing so engaged Arup to provide further engineering services via a written contract of engagement (the 2009 agreement). The 2009 agreement also required that Arup enter into individual deeds of warranty (the warranties) with each of the members of the Consortium.

In July 2012, asbestos was discovered at the site at a level the Consortium claimed was substantially more than expected. Accordingly, the Consortium alleged that Arup had been negligent in failing to identify and report the asbestos, and sought damages on that basis.[5]

Arup contended that any liability regarding the presence of asbestos was excluded via two exemption clauses, namely cl.6.3 of the 2009 agreement and cl.4.3 of each of the warranties. Clause 6.3 was expressed as follows:

> "[Arup's] aggregate liability under this Agreement whether in contract, tort (including negligence), for breach of statutory duty or otherwise (other than for death or personal injury caused by [Arup's] negligence) shall be limited to £12,000,000.00 … with the liability for pollution and contamination limited to £5,000,000.00 … in the aggregate. Liability for any claim in relation to asbestos is excluded."

Clause 4.3 of each of the warranties was in the same terms, save that the overall limit was £5 million and not £12 million.

As explained by the Court of Appeal,[6] each of the exemption clauses comprised three separate limbs: (i) an overall limit of liability (of £12 million in the 2009 agreement and of £5 million in the warranties); (ii) a limit on liability for pollution and contamination (of £5 million); and (iii) an exclusion in relation to asbestos. The relevant distinction between the limbs was thus that limb (i) imposed an overall limit on Arup's potential liability,[7] limb (ii) imposed a limit on liability for contamination, and limb (iii) denied liability altogether for a specific form of contamination, namely asbestos.[8]

The Consortium's approach before the court was essentially twofold. Its first argument focused on the wording of the relevant clauses. Its second argument concerned broader issues relating to exemption clauses and negligence construction.

The first argument focused on the word "for" as it appeared in limbs (ii) and (iii). Thus, as to limb (ii), it was said that, on its proper construction, the phrase "liability for pollution and contamination" meant "liability *for causing* pollution and contamination". As to limb (iii), it was, similarly, contended that "liability for any claim in relation to asbestos" should properly be construed as an exclusion of liability for any claim against Arup *for causing* the presence of asbestos.[9] Accordingly, as the allegation was not that Arup had *caused* the asbestos, but,

[5] *Persimmon* [2017] EWCA Civ 373 at [30]–[31].

[6] *Persimmon* [2017] EWCA Civ 373 at [40].

[7] There was no dispute as to the construction of limb (i), with the parties accepting that its effect was to limit Arup's total liability under the claims to the amount specified (*Persimmon* [2017] EWCA Civ 373 at [40]), although it remained a separate—and ultimately unresolved—question whether the effect of limb (i) as it appeared in cl.4.3 of the warranties was to limit the overall claim in respect of the Consortium as a whole or whether it applied separately to each of the individual companies comprising the Consortium (*Persimmon* [2017] EWCA Civ 373 at [43]).

[8] *Persimmon* [2017] EWCA Civ 373 at [41] and [47].

[9] *Persimmon* [2017] EWCA Civ 373 at [37] and [44]–[47].

rather, related to the fact Arup had not carried out a proper investigation as to the presence of asbestos, the allegations fell outside the scope of the exemption clauses.

Arup contended that such a construction did not make sense. Thus, it was argued that limb (ii) was concerned not with Arup's *causing* contamination, but, rather, related to Arup's potential liability for failing to identify contamination. Similarly, limb (iii) concerned a denial of liability in respect of any claim concerning asbestos and was not concerned with the cause.[10]

At first instance, Stuart-Smith J found that cl.6.3 of the 2009 agreement and cl.4.3 of the warranties amounted to an effective exclusion of liability for negligence. For reasons based on the language of the clauses and the broader contractual context, the Court of Appeal agreed. As to these reasons, first, Arup's interpretation reflected the natural meaning of the words in the clauses. Secondly, to read "for" as meaning "for causing" would be "bizarre, if not ungrammatical" (essentially requiring limb (iii) to be construed as saying "Liability for causing any claim in relation to asbestos is excluded"). Thirdly, it would be nonsensical for the parties to have agreed that Arup was not liable if asbestos was moved from one part of the site to another, but was liable if asbestos was left in place. Fourthly, an additional requirement within cl.6 of the 2009 agreement and cl.4 of the warranties requiring Arup to obtain professional indemnity insurance showed that cl.6.3 and cl.4.3 were intended to limit Arup's liability to the extent of the insurance cover and as such it would be "absurd" to read limbs (ii) and (iii) as confined to claims for moving contamination from one place to another.[11]

Exemption clauses and negligence construction

As noted above, the Consortium's second argument related to the broader issue of the construction of exemption clauses in the context of alleged negligence liability. Thus, it was said that even if the respective clauses did not have the narrow meaning contended, the effect of the application of the *contra proferentem* rule and the courts' general approach to the construction of exemption clauses was such that the clauses could not be construed so broadly as to amount to an effective exemption from liability.[12] The Court of Appeal rejected this argument.

As to the *contra proferentem* rule, that is, the rule that ambiguity in an exemption clause will be construed *against* the proferens (i.e. party seeking to rely on the clause), the court noted that such a rule, in "commercial contracts, negotiated between parties of equal bargaining power … now has a very limited role."[13] Reference was made to the observations of Lord Neuberger MR in *K/S Victoria Street v House of Fraser (Stores Management) Ltd*[14] that:

> "Quite apart from raising abstruse issues as to who is the proferens (and, in particular, whether the issue turns on the precise facts of the case or hypothetical analysis), 'rules' of interpretation such as contra proferentem are rarely decisive as to the meaning of any provisions of a commercial contract. The words used, commercial sense, and the documentary and factual

[10] *Persimmon* [2017] EWCA Civ 373 at [45]–[46].
[11] *Persimmon* [2017] EWCA Civ 373 at [48].
[12] *Persimmon* [2017] EWCA Civ 373 at [51].
[13] *Persimmon* [2017] EWCA Civ 373 at [52].
[14] *K/S Victoria Street v House of Fraser (Stores Management) Ltd* [2011] EWCA Civ 904; [2012] Ch. 497.

> context, are, and should be, normally enough to determine the meaning of a contractual provision."[15]

Such a dilution of the *contra proferentem* rule reflects the recent observations in *Transocean Drilling U.K. Ltd v Providence Resources Plc*.[16] In that case, the trial judge had accepted that a construction *contra proferentem* was the appropriate starting point in determining the scope of the relevant clause, thereby charging the party seeking to rely on the clause with the immediate requirement of establishing its effectiveness. Rejecting that approach on appeal, Moore-Bick LJ explained the *contra proferentem* rule in terms that:

> "It is an approach to construction to which resort may properly be had when the language chosen by the parties is one-sided and genuinely ambiguous, that is, equally capable of bearing two distinct meanings. In such cases the application of the principle may enable the court to choose the meaning that is less favourable to the party who introduced the clause or in whose favour it operates."[17]

On the logic of this approach, the court in *Persimmon* held that its finding as to the absence of ambiguity in respect of cll.6.3 and 4.3 precluded the possibility that an ambiguity might then be found to justify a different interpretation via the *contra proferentem* rule.[18] It follows that the relevance of the rule in the commercial context now appears confined to circumstances of genuine ambiguity, that is, cases where the prior question of construction produces an unclear outcome.[19]

The Consortium in *Persimmon* nonetheless argued that the courts' general approach to matters of negligence construction was one of hostility and that this could defeat Arup's attempts to rely on the clauses as an exemption from liability. The orthodox approach to the question whether an exemption clause could be construed in such a way as to amount to an effective defence to liability for negligence was set out in Lord Morton's guidelines in *Canada Steamship Lines v The King*[20] and can be summarised as follows:

1. If the clause contains language which expressly exempts the person in whose favour it is made (the proferens) from the consequence of the negligence of his own servants, effect must be given to that provision.
2. If there is no express reference to negligence, the court must consider whether the words used are wide enough, in their ordinary meaning, to cover negligence on the part of the servants of the proferens. If a doubt arises at this point, it must be resolved against the proferens.

[15] *K/S Victoria* [2011] EWCA Civ 904, [2012] Ch. 497 at [68]; *Persimmon* [2017] EWCA Civ 373 at [52].
[16] *Transocean Drilling UK Ltd* [2016] EWCA Civ 372; [2016] 2 All E.R. (Comm) 606 at [20].
[17] *Transocean Drilling UK Ltd* [2016] EWCA Civ 372.
[18] This reflects the observations as to the primacy of the words used in *Arnold v Britton* [2015] UKSC 36; [2015] A.C. 1619. The similar point is also found in the observation of Stuart-Smith J at first instance in *Persimmon* [2015] EWHC 3573 (TCC); [2016] B.L.R. 112 at [21] that: "The Court should not strain to find ambiguity where none exists. If at the end of the normal interpretative process, the meaning remains unclear and ambiguous, the Court has as a last resort various presumptions to assist it, such as the *contra proferentem* rule. But such presumptions, as it seems to me, only fall to be applied if the true meaning of the contract has not emerged from the normal iterative process of interpretation."
[19] In the consumer context, the rule's applicability is given statutory footing by way of s.69 of the Consumer Rights Act 2015.
[20] *Canada Steamship* [1952] A.C. 192.

3. If the words used are wide enough for the above purpose, the court must then consider whether "the head of damage may be based on some ground other than that of negligence", to quote Lord Greene MR in *Alderslade v Hendon Laundry Ltd*.[21] The "other ground" must not be so fanciful or remote that the proferens cannot be supposed to have desired protection against it; but subject to this qualification, the existence of a possible head of damage other than that of negligence is fatal to the proferens even if the words used are prima facie wide enough to cover negligence on the part of his servants.[22]

Subsequent courts nonetheless stressed the importance of recognising that these guidelines were intended to do no more than ensure a court exercised caution before arriving at the conclusion that a contracting party had given up a right to an action in negligence.[23] Thus, the guidelines were not to be applied mechanistically in such a way as to deny the possibility of a party relying on an exemption clause avoiding liability for negligence where it was clear from the parties' intentions that such avoidance properly reflected the purpose for which the clause had been included.[24] Indeed, it was on this basis that Lord Fraser had concluded in *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd*[25] that Lord Morton's guidelines were "not applicable in their full rigour when considering the effect of clauses merely limiting liability", as opposed to excluding liability altogether.[26] Moreover, in *HIH Casualty v Chase Manhattan Bank*,[27] Lord Bingham observed that "Lord Morton was giving helpful guidance on the proper approach to interpretation and not laying down a code" and thus the guidelines

> "[do] not provide a litmus test which, applied to the terms of the contract, yields a certain and predictable result. The courts' task of ascertaining what the particular parties intended, in their particular commercial context, remains".[28]

At first instance in *Persimmon*, Stuart-Smith J had pointed to two factors that had triggered "a shift in the approach" of the courts in the context of the construction of exemption clauses.[29] First, the Unfair Contract Terms Act 1977 (UCTA) introduced a new set of controls designed to police the effect of such clauses (by subjecting them to a statutory requirement of "reasonableness").[30] Secondly, the judge referred to the

[21] *Alderslade v Hendon Laundry Ltd* [1945] K.B. 189 CA at 192.
[22] *Canada Steamship* [1952] A.C. 192 at 208.
[23] See e.g. *Gillespie Bros & Co Ltd v Roy Bowles Transport Ltd* [1973] Q.B. 400 CA (Civ Div) at 419 per Buckley LJ; *Capita (Banstead 2011) Ltd v RFIB Group Ltd* [2014] EWHC 2197 (Comm) at [15] per Popplewell J.
[24] See *Lictor Anstalt v Mir Steel UK Ltd* [2012] EWCA Civ 1397; [2013] 2 All E.R. (Comm) 54 at [35], where Rimer LJ observed that Lord Morton's three principles should "not be applied mechanistically and ought to be regarded as no more than guidelines. They do not provide an automatic solution to any particular case. The court's function is always to interpret the particular contract in the context in which it was made. It would be surprising if it were otherwise".
[25] *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd* [1983] 1 W.L.R. 964 HL.
[26] *Ailsa Craig* [1983] 1 W.L.R. 964 at 970 per Lord Fraser.
[27] *HIH Casualty* [2003] UKHL 6; [2003] 1 C.L.C. 358.
[28] *HIH Casualty* [2003] UKHL 6; [2003] 1 C.L.C. 358 at [11] per Lord Bingham.
[29] *Persimmon* [2015] EWHC 3573 (TCC); [2016] B.L.R. 112 at [25].
[30] See also *Photo Production Ltd v Securicor Transport Ltd* [1980] A.C. 827 HL at 851 per Lord Diplock; *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] Q.B. 284 CA (Civ Div) at 297–298 per Lord Denning MR.

> "increasing recognition that parties to commercial contracts are and should be left free to apportion and allocate risks and obligations as they see fit, particularly where insurance may be available to one or other or both parties to cover the risks being so allocated".[31]

Reflected in this proposition was a recognition of the fact parties to commercial contracts "may choose to allocate risks and liabilities in a way that may at first sight seem unlikely to an outsider".[32] Similarly, in *Persimmon* the Court of Appeal observed that, "especially since the enactment of UCTA, the courts have softened their approach" to exemption clauses, before recording that, in commercial contracts, "the *Canada Steamship* guidelines (in so far as they survive) are now more relevant to indemnity clauses than to exemption clauses".[33]

It thus appears to be no longer necessary for contracting parties to navigate any special rules in considering questions of negligence construction. The suggestion in *Persimmon* is that the approach to the interpretation of an exemption clause is to be found within the courts' ordinary approach to contractual interpretation. The task, when interpreting an exclusion or limitation clause, as noted by Stuart-Smith J,

> "is essentially the same … as it is when interpreting any other provision of a contract: it is to identify what a reasonable person having all the background knowledge which would reasonably have been available to the parties would have understood the parties to have meant. And in pursuing that task, the commercial and contractual context may make it improbable that one party would have agreed to assume responsibility for the relevant negligence of another, so that clear words are needed".[34]

This has the merit of aligning the approach to negligence construction with the courts' increasingly apparent willingness to recognise parties' freedom to allocate contractual risk however they so wish, at least where those parties are of a similar size and equal bargaining power.[35]

Thus, where ambiguity exists as to the scope of any purported exclusion of negligence liability, an analysis of the contract, including the scope of the rights and obligations within it, will be instructive as to whether the parties' contractual intention included the giving up of any right to an action in negligence.[36] Indeed, as the Court of Appeal observed in *Persimmon*, a party's acceptance of large risks under a contract will no doubt be reflected in the contract price and any requirement as to the taking out of appropriate insurance. To that end, there should be "no need

[31] *Persimmon* [2015] EWHC 3573 (TCC); [2016] B.L.R. 112 at [25], citing in support the observations of Lord Diplock in *Photo Production v Securicor Transport* [1980] A.C. 827 at 851.

[32] *Persimmon* [2015] EWHC 3573 (TCC); [2016] B.L.R. 112 at [26].

[33] *Persimmon* [2017] EWCA Civ 373 at [56].

[34] *Persimmon* [2015] EWHC 3573 (TCC); [2016] B.L.R. 112 at [33]. As to the general approach to interpretation, see *Wood v Capita Insurance Services Ltd* [2017] UKSC 24; [2017] 2 W.L.R. 1095.

[35] In this connection, Stuart-Smith J (*Persimmon* [2015] EWHC 3573 (TCC); [2016] B.L.R. 112 at [27]) noted the approach to the application of non-reliance clauses in *EA Grimstead & Son Ltd v McGarrigan* [1998–99] Info. T.L.R. 384 CA (Civ Div), where Chadwick LJ had referred to the importance of commercial certainty and observed: "it is reasonable to assume that the price to be paid reflects the commercial risk which each party … is willing to accept." See also *Photo Production v Securicor Transport* [1980] A.C. 827 at 843 per Lord Wilberforce and 851 per Lord Diplock.

[36] See the approach of Stuart-Smith J in *Persimmon* [2015] EWHC 3573 (TCC); [2016] B.L.R. 112 at [38]–[45] and [49].

to approach [exemption] clauses with horror or with a mindset determined to cut them down".[37]

Indeed, the *Canada Steamship* guidelines have not been without difficulty in their practical application. For example, a strict application of the guidelines carried the risk of defeating the contracting parties' actual intentions, in particular in connection with the third guideline. Thus, according to that guideline, where both negligence liability and some additional liability had arisen on the facts, a court was to construe the exemption clause as covering only the additional liability (even where the words were otherwise wide enough to cover negligence liability in accordance with the second guideline). Relatedly, it has been recognised as a problem for the party seeking to rely upon the exemption clause

> "that if he over stresses the width of the relevant [clause] in order to pass test (2) [i.e. the second *Canada Steamship* guideline], he might make it more difficult to argue that the provision does not founder on test (3)".[38]

Moreover, the guidelines had the effect of encouraging an unnecessary protraction of the interpretative process that in practice came about via the third guideline and its invitation to parties to identify and plead additional liabilities so as to narrow the scope of the exemption clause to only cover those liabilities. Indeed, this can be illustrated by Stuart-Smith J's description in *Persimmon* of a submission made by the Consortium as to alternative grounds of liability as "tenuously based" before commenting that "[i]f there was any substance or merit in the submission, I have been unable to understand it".[39]

It follows that where the issue at hand concerns negligence construction in a negotiated contract between two commercial parties, there appears little reason for judicial reluctance to find that the relevant clause amounts to an effective denial of negligence liability on the facts. To the extent that safeguards are required, they can be suitably administered via the UCTA regime without any need to encroach on the separate process of an exemption clause's construction.

[37] *Persimmon* [2017] EWCA Civ 373 at [57]. See also the flexible approach to the question whether a broadly drafted exemption clause could amount to an effective defence to negligence liability taken in *Goodlife Foods Ltd v Hall Fire Protection Ltd* [2017] EWHC 767 (TCC).

[38] Jane Swanton, "Exclusion of Liability for Negligence" (1989) 15 Univ. Qld Law J. 157, 162, referring to the observation in *Lamport & Holt Lines v Coubro & Scrutton (M&I) Ltd (The Raphael)* [1982] 2 Lloyd's Rep. 42 CA (Civ Div) at 52 that "many a party putting forward such a clause to protect him might find it has got him out of the frying pan of the Privy Council's second principle [in *Canada Steamship*] into the fire of its third".

[39] *Persimmon* [2015] EWHC 3573 (TCC), [2016] B.L.R. 112 at [37]; and see also [2017] EWCA Civ 373 at [60].