Hogan Lovells

Legal and Financial Risk
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Court of Appeal emphasises importance of clear wording in exclusion clauses

Standard form contracts should be continually assessed and updated to reflect changes in both legislation and market practice. The recent case of *William Hare Limited v Shepherd Construction Limited* [2010] EWCA Civ 283 demonstrates what can happen if a contracting party fails to do this.

The main contractor, Shepherd, as is common practice in the construction industry, included a "pay when paid" clause in its agreement with its subcontractor, William Hare. This clause sought to relieve Shepherd from paying its subcontractor upon the employer's insolvency. Section 113 of the Housing Grants (Construction and Regeneration) Act 1996 had outlawed such exclusion clauses in all other circumstances and had defined insolvency by reference to the Insolvency Act 1986 to occur upon the making of a court order. The Enterprise Act 2002 subsequently widened the 1986 Act's definition of insolvency to include self-certifying options. When contracting with William Hare and other subcontractors in 2008 Shepherd used a standard "pay when paid" clause that had been drafted by its former solicitors around 10 years previously. As the clause did not reflect the changes of the 2002 Act it failed to include any reference to the self-certifying routes under which the employer subsequently went into administration.

The Court of Appeal had to decide whether or not it could rectify the mistake and allow Shepherd to refuse to pay £996,683.35 to its subcontractors. The courts have often interpreted clauses "to yield to business commonsense" (Lord Diplock in *Antaios Compania Naviera SA v Salen Rederierna* AB [1985] AC 191). In the recent case of *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 A.C. 1101 the House of Lords even went as far as altering the words themselves as it believed that the parties could not have meant what was written in the contract.

DECISION

Even though the vast majority of modern administrations are now self-certified, the Court of Appeal was not persuaded by Shepherd's argument that the parties must have intended insolvency to include all routes of administration. Lord Justice Waller stated that he saw "no reason for the courts to come to the rescue" when a party has drafted an exclusion clause in a way which actually does work, even if a reasonable person would guess that there has been an error. Lord Justice Waller added that the "dominant principle" is that a party wishing to rely on an exclusion clause must ensure that it uses "clear words".

COMMENT

The effect of the ruling on lower courts will be worth watching, especially as the more expansive *Chartbrook* judgment was decided after Mr Justice Coulson's first instance judgment in *William Hare* but before the Court of Appeal's dismissal of the appeal. The case serves as a powerful reminder, however, of the importance of keeping standard contracts up to date to reflect legal and market developments.

Agree first; start work later

In *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH & Co KG (UK Production)* [2010] UKSC 14, the Supreme Court considered two preliminary issues on appeal in relation to an unexecuted contract that was still being negotiated. First, whether a contract becomes valid following its performance, even when the contract being negotiated contained a "subject to contract" proviso and had not been executed, and secondly whether the contract had incorporated standard terms.

BACKGROUND

The claim was brought by RTS Flexible Systems Ltd ("RTS") for money due under a construction contract for the installation of two production lines in Molkerei Alois Müller GmbH & Co KG (UK Production)'s ("Müller") factories. Müller argued that the contract incorporated its standard terms, which included liquidated damages and limitation provisions restricting the quantum of RTS's claim. The parties had entered into a contract formed by a letter of intent sent by Müller to RTS dated 21 February 2005 and a confirmation letter from RTS to Müller dated 1 March 2005 (the "LOI contract"). The LOI Contract was set to expire and it was anticipated that the parties would negotiate and agree the final agreed terms (the "Agreement") by the time of expiry of the LOI Contract.

The first draft of the Agreement was sent by Müller to RTS and included clauses incorporating or referring to the standard terms laid out in Schedule 1 of the draft. Negotiations continued and second and third drafts of the Agreement were exchanged. As a result, the LOI Contract was extended until 27 May 2005. Müller emailed a fourth draft of the Agreement to RTS on 16 May 2005, which was complete except for the Schedules. RTS accepted the fourth draft other than the force majeure term. On 5 July 2005, following further email exchanges, the parties had agreed on everything, with the exception of the guarantee provisions but including the Schedules. The Agreement included a "subject to contract" provision that it would not be binding unless executed, however, it was not executed by the parties but RTS continued to install the production lines. On 25 August, the parties met to alter the delivery schedules of the production lines, which they understood to be a contractual variation.

DECISION

The Supreme Court held that a contract did exist between the parties. Lord Clarke argued that, if a contract price was agreed, there must be an agreement between the parties. He held, on a number of grounds, that the price in the LOI Contract was the contract price for completion of the whole project by RTS. First, the parties did not negotiate the price further and RTS invoiced percentages of the price, which Müller paid. Secondly, the price in the LOI Contract was included on the footing that a detailed contract would follow including the standard terms. Thirdly, there was an agreed variation on 25 August, implying that there was in existence a contract to vary. As the LOI Contract had expired, Lord Clarke concluded that a distinct agreement was in existence between the parties.

The Supreme Court also held that the Agreement included the standard terms. It made commercial sense that the Agreement included the Schedules as work was carried out by RTS on this basis and the standard terms were included as part of Schedule 1. The difficult issue for the Supreme Court was that the standard terms included the "subject to contract" provision, which suggested that the contract needed to be signed if it were to include the standard terms. However, the Supreme Court held that the "subject to contract" proviso had been waived by an unequivocal agreement of the parties on the basis of their conduct. The fact that a price had been agreed, work had commenced, agreement reached on 5 July and the contract varied on 25 August, led to the clear inference that the subject to contract proviso had been waived. Honest businessmen, Lord Clarke said, would have assumed that the necessity for a formal written agreement had been overtaken by events.

COMMENT

As Lord Clarke acknowledged, the moral of this case is, "to agree first and to start work later", otherwise negotiating companies may find themselves bound by contractual obligations, even if the draft agreement under negotiation contains a subject to contract proviso. Care must be taken where a letter of intent or heads of terms are in place, particularly where a price for the final transaction is given and performance occurs before final agreement is reached.

Balance sheet blues no defence to contractual breach

In *RTS Tandrin Aviation Holdings Limited v Aero Toy Store LLC, Insured Aircraft Title Service, Inc* [2010] EWHC (Comm), the High Court considered whether a breaching party to a contract could rely on a force majeure clause in defence of a contractual breach resulting from unforeseen economic circumstances.

BACKGROUND

An application was brought by RTS Tandrin Aviation Holdings Limited ("Tandrin") for summary judgment and/or strike out of Aero Toy Store LLC, Insured Aircraft Title Service, Inc ("ATS")'s defences. ATS had contracted with Tandrin to purchase a jet aircraft from Tandrin (the "Agreement"). ATS, however, failed to accept Tandrin's tendered delivery of the jet aircraft or pay the purchase price. The Agreement contained a force majeure clause that provided that neither party shall be liable to the other for breaching the Agreement during the period of time that such breach arises from (amongst other things) Acts of God, war, or any cause beyond the Seller's reasonable control. ATS argued in its defence that the alleged "unanticipated, unforeseeable and cataclysmic downward spiral of the world's financial markets" triggered the force majeure clause of the Agreement, thereby extending its time to purchase the aircraft.

DECISION

Mr Justice Hamblen decided that ATS' defence had no real prospect of success. He stated that it was well established that a change in economic circumstances could not be regarded as a force majeure event, even if the party suffered a rise in costs or expenses, or lacked sufficient financial resources as a result. He referred to Lord Loreburn's dictum in *Tennants (Lancashire) Ltd v CS Wilson & Co Ltd* [1917] AC 495 that it is a dangerous contention that a party can be excused from contractual performance because it has become "commercially impossible" and this defence is only permissible where the parties contracted to that effect.
Mr Justice Hamblen also noted that none of the particular examples in the force majeure clause referred to economic downturn (or anything similar) as a trigger for the force majeure clause. He rejected the argument that, "any cause beyond the Seller's reasonable control" could cover ATS' breach because its plain and ordinary meaning did not stretch to include ATS as the purchaser. The phrase "beyond the Seller's reasonable control" could only "sensibly be construed to apply to a matter which would (or would be expected to) have a causal link with the performance of the Seller's own obligations". He noted that there is no causal link in this case between any inability of the seller to influence or control the credit markets and the purchaser's inability to pay the purchase price.

Mr Justice Hamblen also confirmed that arguments relating to frustration would fail stating that there was nothing in this argument to assist ATS. To the extent that there may be some overlap between the operation of force majeure clauses and the doctrine of frustration, he held that Lord Simon in *National Carriers Ltd v Panalpina (Northern) Ltd* made it clear that an increase in the mere expense or onerousness of the contract cannot constitute frustration. For frustration to occur Lord Simon indicated that there must be a supervening event, "which so significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated".

COMMENT

This High Court decision reiterates the position already established in law that force majeure clauses cannot excuse contractual breaches resulting from the declining financial position of the breaching party, unless expressly provided for. Lord Loreburn in *Tennants* had previously stated that the contention that a party could be excused was dangerous because it would be very easy for parties to rely on the worsening economic position to avoid their economic and contractual obligations, which from a public policy perspective would not be acceptable. It is clear that Mr Justice Hamblen shared this concern. Therefore, if companies wish to include financial decline as a trigger for a force majeure clause, it must be expressly provided for in the contract with clear unequivocal language. However, there is always the risk of disagreement over the meaning of "financial decline" or similar economic terms, and so a clause of this type would have to be very carefully worded.

Disclosure in litigation will not affect an employee's duty of confidence

The effectiveness of employee confidentiality covenants in protecting trade secrets and other confidential information, even in respect of disclosed documents, was reaffirmed by the recent Commercial Court decision in *Porton Capital Technology Funds (A Body Corporate) v 3M UK Holdings Limited* [2010] EWHC 114 (Comm).

BACKGROUND

The dispute arose out of a Share Purchase Agreement ("SPA") under which the first defendant, 3M UK Holdings ("3M"), had acquired the whole share capital of Acolyte Biomedica Ltd ("Acolyte"), a medical device company specialising in infection detection devices. The terms of the SPA specified that 3M was to develop and market BacLite, a device to detect MRSA, and to pay the vendors an "earn-out" payment amounting to Acolyte's net sales in the year 2009. 3M asserted that BacLite's clinical trials failed to yield promising results, therefore, it applied to the sellers, as was necessary under the SPA, to be permitted to cease further development and marketing of the product.

The claimant, Porton, an investment fund incorporated in the Cayman Islands, refused such permission and instead claimed for damages under the earn-out provision. In order to obtain evidence as to the manner in which 3M developed and marketed BacLite, the claimant's solicitors sought to question two former employees of Acolyte and 3M. The employees, however, were bound by post-employment confidentiality covenants. The claimant subsequently argued that 3M's extensive disclosure of confidential documents effectively waived the former employees' duty of confidence, thereby allowing them to answer relevant questions about BacLite's development.

DECISION

Mr Justice Christopher Clarke confirmed the principle that there is no property in a witness and held that employees, both current and former, who were acting as witnesses were free to choose which side to support in a dispute. However, he held that if such witnesses are subject to a duty of confidentiality, they will be prevented from providing any information, unless the beneficiary, in this case the former employer, waives such privilege. Mr Justice Clarke stated that the disclosure of documents and the interviewing of witnesses were two independent matters and that an employee's duty of confidentiality is in no way affected by the employer's obligatory disclosure. The fact the disclosing party has been compelled to disclose documents through legal proceedings does not alter the duty of confidence. Mr Justice Clarke indicated that his decision was influenced by a fear that allowing disclosure to override duties of confidentiality would allow parties to question the other side's employees "about anything that could plausibly be said to relate to something in dispute in the action".

Mr Justice Clarke also dismissed the claimant's argument that the effect of the above rule would be to place the parties on an "unequal footing" as the claimant would, practically, be unable to obtain information from the witness in advance of the trial. The judge was convinced that a fair trial of the action could still be held under these circumstances, where the case was fully pleaded, extensive disclosure had been given, and the two employees were going to be called as witnesses.

Mr Justice Clarke held that, "the obligation of the court to deal with matters 'justly' sits ill with an exercise of judicial discretion which absolves an individual from his legal duty". He confirmed that the objective of ensuring that the parties are on an equal footing ought not, in ordinary circumstances, to require that obligations of confidence are overridden, otherwise the party being overridden would itself no longer be on an equal footing.

In order to safeguard 3M's large amount of confidential information, the judge also granted 3M's application for a "confidentiality club", under which access to disclosed documents is limited to a small number of identified individuals. He indicated that there was likely to be a substantial body of confidential information, the existence of which justifies such an order. The claimant's request that this application should operate as a waiver of the former employees' duty of confidence was denied by the Judge as he considered the issues to be unrelated to each other. He thought it inappropriate to use this fact as the means by which to procure a waiver of obligations of confidence.

COMMENT

The case highlights the importance of well-drafted post termination confidentiality clauses. However, it also indicates the difficulty of obtaining access to ex-employees and confidential agents before trial. It increases the pressure on advocates to ask witnesses the right questions at trial and to ensure that they have a good understanding of the evidence available to support their case at the start of proceedings. Mr Justice Clarke also commented on the use of confidentiality clubs, stating that they are the exception rather than the rule, but that they are available if justice demands. This case highlights how useful these "clubs" can be, but it is clear from the judgment that the court will only agree to them if the normal legal restrictions on the use of documents obtained on disclosure are insufficient.

The UK Bribery Act

Are your anti-corruption procedures adequate?

The UK's new Bribery Act received Royal Assent on 8 April 2010. The Act radically overhauls the UK's outdated and discredited corruption legislation and introduces a new regime which, in many respects, is more stringent even than the US Foreign Corrupt Practices Act of 1977 (the "FCPA"), which has historically been the "gold standard" in this area.

Most significantly, the Bribery Act introduces a new strict liability offence of "failure to prevent bribery" by a "relevant commercial organisation". Where a bribe is paid for the benefit of a corporate, whether by an employee, agent, or subsidiary, the corporate will automatically be guilty of a criminal offence itself.

In a reversal of the usual burden of proof, the corporate will only be able to avoid conviction if it can prove that it had "adequate procedures" in place to prevent bribery, ie that the incident was a one-off anomaly and not the result of institutional or management failure.

The jurisdictional scope of the Act is also unprecedented. It applies not only to UK individuals and companies, and to conduct which takes place in the UK, but to any foreign company which carries on business in the UK. There is no requirement for a UK listing such that the Act, in effect, gives the UK authorities jurisdiction over most multi-nationals. In the case of the corporate offence, liability will arise even if the bribe is paid in an overseas jurisdiction by a foreign agent or subsidiary, with no connection to the UK.

The potential ramifications of this are far-reaching, particularly when coupled with the increasingly aggressive approach to enforcement of the UK authorities. Following the decision to drop the investigation into BAE Systems' Saudi arms deals, there has been a sea change in the approach of the UK law enforcement agencies.

Even with the complications and deficiencies of the existing law, this has already resulted in the prosecution of two companies, Mabey & Johnson and Innospec. After the new strict liability offence comes into force, the authorities will be significantly better placed to pursue prosecutions of major corporates. Unlike in years gone by, the UK authorities pose a genuine threat, and corporates cannot afford to ignore the potential exposure.

In the recent Innospec case, Lord Justice Thomas signalled that the financial penalties imposed by the English courts ought to be consistent with those imposed in the US. The scale of the penalties imposed in the US on corporates such as Siemens (US$800 million) and, more recently, Daimler (US$185 million) serves to illustrate the extent of the risk in this area.

That is, of course, to say nothing of the adverse publicity and disruption associated with a criminal investigation, or of the prospect for individual directors to be prosecuted. The recent sentencing of former DePuy executive Robert Dougall to a 12-month jail term emphasises the personal exposure in this area.

The new corporate offence is unlikely to come into force before autumn 2010. Nevertheless, corporates are well advised to review and, as appropriate, update their compliance programmes without delay to ensure that they have in place "adequate procedures" to prevent bribery. Depending on the risk profile of the business, such procedures ought to cover a wide range of areas, including not merely written policies but also practical training, financial controls, due diligence on third parties, and reporting and investigation procedures.

It is also insufficient to assume that an established FCPA compliance programme will necessarily meet the standard set by the Act. In a number of respects, the Act goes further than the FCPA. Unlike the FCPA, for example, the Act contains no exception for "facilitation payments" or certain promotional expenditures. It also applies equally to bribes paid in either the public or the private sectors.

For further information on the latest developments in bribery and corruption, as well as further details on the UK Bribery Act, please contact Michael Roberts (Senior Associate) of Hogan Lovells, London.

Key points:

- companies will automatically be liable for bribes paid on their behalf, including by overseas agents and subsidiaries
- a company will only avoid conviction if it can prove that it had "adequate procedures" in place to prevent bribery, ie that it was a one-off incident rather than an institutional failure
- the basic bribery offences are broad in scope, and require no dishonest or corrupt intention. As such, a wide range of commercial practices are capable of being caught
- the UK authorities will have jurisdiction over any corporate which conducts business in the UK, irrespective of whether the relevant conduct takes place in the UK or overseas
- the Act increases the penalties applicable to bribery offences to 10 years' imprisonment and/or an unlimited fine
- all businesses should act now to review and, as appropriate, update their compliance programmes. It cannot be assumed that an established FCPA compliance programme will be sufficient to meet the bar set by the Act
- unlike in years gone by, the UK authorities pose a real, and increasing, threat in this area.

The Financial Services Act 2010

Washed out and washed up

On 8 April 2010 the Financial Services Bill (the "Bill") received Royal Assent following the removal of certain contentious provisions. The Financial Services Act (the "Act") took shape in the aftermath of the credit crunch when the current system of regulation came under fire. It aimed to make significant reforms to the regulation of financial services in the UK by strengthening financial regulation, improving corporate governance and remuneration practices, and giving consumers greater rights and access to information.

WHAT THE BILL PROPOSED

Key amongst the Bill's proposals were radical reforms to the current system whereby consumers can pursue claims against financial institutions through collective actions. The current system allows the court to manage multi-party litigation through test cases, consolidation and single trial of multiple actions, Group Litigation Orders and representative actions. In its July 2008 report, "Improving Access to Justice through Collective Actions" the Civil Justice Council (the "CJC") concluded that, although the existing system did provide collective actions that were effective in part, improvements could and should be made to promote better enforcement of citizens' rights. The Government rejected the notion of legislating for generic collective actions but took some of the CJC's proposals forward and included them in the Bill as follows:

- the court could make a "collective proceedings order" in respect of a group of financial services claims that share the same, similar or related issues of fact or law
- the proceedings could be brought either by a person who would be able to bring their own claim directly or by a representative body, such as a consumer group, with no direct interest in the proceedings
- the court would decide whether the claim should proceed on an opt-in or opt-out basis
- damages could be assessed on an aggregated basis without the court having to undertake an assessment of the amount recoverable in respect of each individual claimant.

OPPOSITION TO THE BILL

There was considerable opposition to the above proposals, with the then Conservative opposition proposing numerous amendments which included the following:

- collective actions would only be available in circumstances where the FSA had refused to impose a consumer redress scheme or had failed to act expeditiously
- the scope of the test should be narrowed from "same, similar or related issues" to require "common issues"
- any representative must not have a financial interest in the proceedings and would need to be authorised by the Lord Chancellor or under the Civil Procedure Rules
- opt-out proceedings would only be available where opt-in proceedings would not be practicable.

The highly contentious nature of the collective action proposals led to this part of the Bill eventually being dropped in order to ensure less contentious parts of the Bill passed into law prior to the recent election. The proposed amendments to the Bill were therefore not fully analysed in committee.

In spite of a lack of detailed debate, all parties acknowledged that although there was cross-party desire to tackle the proposals in the future, further work and consultation would first be required.

COMMENT

The Bill's collective action proposal, now dropped, would have allowed consumers or consumer groups to issue collective actions against financial institutions on an opt-out basis and receive damages based on a general award. This would have drastically changed the current collective action landscape, shifting it closer to the US class action model. The Act, however, does not make any substantive changes to the system currently available to consumers. It remains to be seen whether the remaining parts of the Act dealing with consumer redress are commenced in the new Parliament and whether there are renewed moves towards the introduction of collective actions generally or on an industry-specific basis.

Developments in US e-discovery

The US District Court for the Southern District of New York recently decided a case, *Pension Committee of the University of Montreal Pension Plan v Banc of America Securities, LLC*, bearing on litigants' e-discovery obligations and the possibility of sanctions when those obligations are not met.

The case involves a situation in which the "plaintiffs failed to timely institute written litigation holds and engaged in careless and indifferent collection efforts after the duty to preserve arose". *Pension Comm. of Univ. of Montreal Pension Plan v. Banc of America Secs.*, LLC, ___ F.R.D. ____, No. 05-Civ. 9016 (SAS), 2010 WL 184312, at *2 (S.D.N.Y. Jan. 15, 2010). As the case was decided by a district judge (court of first instance), it lacks precedent value as a formal matter. That said, the author of the decision, Judge Scheindlin, has written a number of earlier decisions in this area (particularly in the *Zubulake* case) and is an active member of the Sedona Conference, giving her considerable influence in the US on matters of e-discovery.

The *Pension Committee* decision provides examples of negligence and gross negligence in the e-discovery context, though with the caveat that, "[t]hese examples are not meant as a definitive list". Negligence includes failure to collect evidence or sloppy review resulting in the loss or destruction of evidence; failure to obtain discoverable paper and electronic records from all employees; failure to take all appropriate measures to preserve electronically stored information; and failure to assess the accuracy and validity of search terms used to collect relevant electronic records. *Id.* at *3. Gross negligence includes failure to collect paper or electronic records from "key players"; destruction of email or, in some instances, backup tapes, once the duty to preserve has attached; failure to collect information from the files of former employees within a party's possession, custody or control; and failing to issue a written litigation hold of emails or records. Willfulness is not addressed because the case did not present any egregious examples of litigants purposefully destroying evidence. *Id.* at *2.

Additional discovery failures, described in more detail at pages 12-17 (gross negligence) and 18-23 (negligence) of the opinion, include:

- poor supervision of discovery efforts (see *id.* at *13)
- neglecting to search all computer storage (see *id.* at *19)
- neglecting to search an employee's personal digital assistant (see *id.* at *20)
- signing declarations without full investigation of the underlying facts and without personal knowledge of the facts (see *id.* at *21; and *10)
- leaving "key players" and employees to search their own files (ie, as opposed to company-performed searches) (see *id.* at *21)
- searching only folders labelled with the subject heading of the litigation (see *id.* at *23).

A consequence of negligent or grossly negligent conduct is that documents may be lost or destroyed*,* ie, spoliation of evidence may occur. Accordingly, in the court's view, an innocent party bringing a motion for sanctions must prove that, "the spoliating party: (1) had control over the evidence and an obligation to preserve it at the time of destruction or loss; (2) acted with a culpable state of mind upon destroying or losing the evidence; and (3) that the missing evidence is relevant to the innocent party's claim or defense". *Id.* at *5. Further, when the spoliating party has acted in bad faith (ie, wilfully) or in a grossly negligent manner, the court may presume, subject to rebuttal, that the reliance and prejudice requirements of the test have been satisfied. *Id.*

Sanctions for spoliation include further discovery, cost-shifting, fines, special jury instructions, preclusion, and terminating sanctions (ie, entry of default judgment or dismissal). Terminating sanctions are the most severe and should be applied only in particularly egregious cases (for example, perjury, evidence-tampering or intentional destruction of evidence). *Id.* at *6. For Judge Scheindlin, the appropriateness of a sanction depends largely on the court's "gut reaction" – "based on years of experience" – to "whether a litigant has complied with its discovery obligations and how hard it worked to comply". *Id.* at *7. Although the court cautions that a court should give "the most careful consideration" before imposing discovery sanctions, parties "need to anticipate and undertake document preservation with the most serious and thorough care, if for no other reason than to avoid the detour of sanctions". *Id.* The sanctions imposed in *Pension Committee* included adverse jury instructions and monetary sanctions (including attorneys' fees).

The *Pension Committee* decision has already been criticized as a potential "trap" that might cause litigants to "be found negligent in their practices". *See* H Christopher Boehning and Daniel J Toal, "In 'Pension Committee', Judge Revisits 'Zubulake'", N.Y.L.J., Feb. 2, 2010. Nonetheless, *Pension Committee* illustrates that companies should adopt a serious approach with respect to managing electronic records. The case also demonstrates that at the collection stage it is important to take a generous view of relevance and likely sources of relevant materials, including those individuals who had even a passing involvement with the issues being litigated.

For further information on this case or the issues discussed, please contact Scott Reynolds (Partner) or Michael Roffe (Associate) in Hogan Lovells, New York.

FSA Update

May 2010

This edition of the FSA Update focuses on the numerous high profile convictions and investigations by the FSA in relation to market abuse, insider trading and failure to comply with regulatory requirements.

FORMER CAZENOVE PARTNER FOUND GUILTY OF INSIDER DEALING AND SENTENCED TO 21 MONTHS IN PRISON

The Southwark Crown Court has found Malcolm Calvert, a former Cazenove trader, guilty of five counts of insider dealing after he made £103,883 profit from trades that took place between June 2003 and October 2004.

The FSA also published a Final Notice for Bertie Hatcher, who had bought shares on Calvert's instructions, fining him £56,098 for his involvement in the illicit activity. The FSA decided to sanction Hatcher using its regulatory powers rather than pursuing a criminal prosecution after Hatcher agreed to provide evidence against Calvert. Notably, the financial penalty against Hatcher was limited to the disgorgement of his profits from the illicit trades.

The case indicates the FSA's intention to pursue individuals when fighting financial crime. The case also highlights the FSA's willingness to use plea bargains as a way to secure convictions against "key figures". The FSA was mindful of the need to ensure that others would be prepared to come forward in the future, which was why Hatcher was not prosecuted.

The prosecution of Calvert is the highest profile prosecution by the FSA for insider dealing. Margaret Cole, Director of Enforcement of the FSA said, "This is another milestone in our fight against market abuse. It’s a misconception that insider dealing is a victimless crime: it damages the very confidence and trust our markets operate on and it must be stopped". Regulated firms will need to be increasingly scrupulous in ensuring that their employees do not fall foul of the strict rules in place to prevent insider dealing.

SEVEN ARRESTED IN FSA AND SOCA INSIDER DEALING INVESTIGATION

Seven men have been arrested in the first operation carried out jointly between the FSA and the Serious Organised Crime Agency ("SOCA"). The men, arrested on suspicion of insider dealing, include two senior City professionals at leading City institutions and one City professional at a hedge fund. The operation, carried out by 143 FSA personnel and officers from SOCA, commenced in late 2007.

Christian Littlewood, a senior investment banker, and his wife Angie Littlewood, have been charged with 13 counts of insider dealing and one count of conspiracy to commit insider dealing. A third suspect, Helmy Omar Sa'aid, was extradited from Mayotte, a French overseas territory, pursuant to a European Arrest Warrant issued at the request of the FSA, and charged with the same offences. This is the first time the FSA has sought the extradition of a suspect from abroad to face criminal charges in the UK.

The arrests serve to demonstrate the lengths that the FSA will go to in order to tackle insider dealing; of particular note is the fact that so many people worked on the investigations, and for such a long time, without the investigations becoming public knowledge until the arrests had been made. Again, this should act as a warning to all regulated firms that the FSA have the means to carry out large and successful investigations of this type.

FSA ISSUES FINES TOTALLING £4.2 MILLION FOR TRANSACTION REPORTING FAILURES

The FSA has fined Credit Suisse (£1.75 million), Getco Europe (£1.4 million) and Instinet Europe Limited (£1.05 million) for failing to provide it with accurate and timely transaction reports. Each firm received a 30% discount on account of their full cooperation with the FSA; had the firms not so cooperated, the fines would have totalled £6 million.

Firms are required to have systems and controls in place to ensure they submit accurate data for reportable transactions by close of business the day after a trade is executed. The FSA uses this data to detect and investigate suspected market abuse.

It is notable that each of the firms was sent repeated reminders by the FSA on numerous occasions, and thus the firms could have avoided the fines by carrying out regular and detailed reviews of their data. Regulated firms will therefore need to ensure that they provide accurate and timely data, and as such they should have suitable systems and controls in place so as to be able to provide the FSA with the information it requires.

Alexander Justham, Director of Markets at the FSA, has said that, "without quality data we cannot properly detect and investigate market abuse, identify market wide risks or have a comprehensive understanding of the activities of each firm".

FSA FINES LONDON IFA FOR PENSION SWITCHING ADVICE

The FSA has fined Robin Bradford (Life and Pension Consultants) Ltd, a London-based IFA firm, £24,500 for exposing customers to unacceptable levels of risk of receiving poor pension switching advice. The firm is also reviewing the pension switching advice conducted during the period in question to see whether any redress is required. This is the FSA's third enforcement action following its review on pension switching advice.

During its investigation, the FSA found that between 6 April 2006 and 21 April 2008, the firm had exposed customers to the risk of receiving poor advice by failing to obtain and record relevant information from its customers to assess whether advice was suitable, and failing to include relevant information in suitability letters to help customers make an informed choice on the decision to switch. It also failed adequately to monitor the quality of its pension switching advice. Among other specific failings, the FSA found that some of the firm's files did not contain a proper assessment of a customer's attitude to risk and some files did not contain an explanation of the advantages and disadvantages of switching pension. It is interesting to note that the firm has now put in place new procedures to reduce the risk of giving poor advice in the future (and it was given a reduced fine as a result).

The FSA's reasons for fining the firm highlight the fact that all firms who advise on pensions switching must strongly consider the needs of consumers when providing such advice. In particular, firms must consider the particular customer's attitude to risk and the customer's understanding of pensions switching generally.

Court upholds without prejudice rule

In *Oceanbulk Shipping and Trading SA* ("Oceanbulk") *v TMT Asia Ltd and Others* ("TMT") [2010] EWCA Civ 79 the Court of Appeal reversed a High Court decision that stated that without prejudice communications between parties, which helped to ascertain the meaning of terms in a settlement agreement, were admissible in court.

BACKGROUND

In our November 2009 edition we considered the decision of the High Court in this case. In summary, Oceanbulk and TMT had entered into a number of freight forward agreements with one another. TMT had failed to pay an invoice arising under one such agreement. Following communications between the parties concerning this unpaid invoice, they entered into a settlement agreement to resolve the dispute (the "Settlement Agreement"). However, Oceanbulk claimed that TMT had not complied with the Settlement Agreement, which led them to commence proceedings. TMT disagreed with Oceanbulk's interpretation of a clause in the Settlement Agreement, and argued that it had complied with its obligations. In the High Court, TMT sought to rely on exchanges made between the parties prior to finalising the Settlement Agreement to support its interpretation of the disputed clause. Oceanbulk maintained that these communications were without prejudice and, so inadmissible in court.

In the High Court, Mr Justice Andrew Smith relied on the exceptions to the without prejudice rule set down in *Unilever plc v Procter & Gamble Co* [2001] 1 WLR 2436 ("Unilever"). He held that the communications between Oceanbulk and TMT should be admissible for the purposes of both identifying the terms of the Settlement Agreement and establishing the meaning of this agreement. Mr Justice Andrew Smith's decision was, however, appealed. The principal issue before the Court of Appeal was whether the without prejudice communications should be admissible in order to help ascertain the meaning of the relevant clauses.

DECISION

Lord Justice Longmore, who gave the leading judgment, looked at the reasons behind Mr Justice Smith's decision. He concluded that the exception to the without prejudice rule that Mr Justice Smith had relied upon, did not fall within the list of exceptions set down in *Unilever.* The Court considered whether there should be another exception to the without prejudice rule, perhaps as a necessary part of the first exception, whereby the information contained in a without prejudice communication leads to the formation of a settlement agreement. However, the Court decided against this stating that the general rule against admission of without prejudice exchanges was based on the policy that negotiating parties should not be discouraged by fear of subsequent litigation. Lord Justice Longmore noted that whilst the policy behind the without prejudice rule conflicts with the policy of having the best and most useful evidence, in this case the former policy was found to trump the latter. The Court, therefore, ordered that the paragraphs in the defence and counterclaim which were the subject of the dispute should be struck out.

Lord Justice Ward strongly dissented, stating that, "logic and justice seem to me to be good enough reasons to remove the protection" and that, "Andrew Smith J was absolutely correct for the reasons he gave". He also queried the justice of a rule which prevented the court having before it the facts which would truly establish what the parties meant by their compromise.

COMMENT

The without prejudice rule in these circumstances takes effect to prevent exchanges between parties made as part of a genuine attempt to settle an existing dispute from being admissible in court. It was previously believed that such exchanges would be admissible to the extent of evidencing a settlement agreement but not to aid interpretation of the terms of such an agreement.

The High Court decision effectively created a further exception to the without prejudice rule; however, that decision seemed at odds with previous decisions, notably *Ofulue v Bossert* [2009] UKHL 16 which had confirmed the without prejudice rule whereby statements made in a genuine attempt to settle an existing dispute should not be put before the Court. However, in refusing to recognise this new exception created by Mr Justice Andrew Smith, the Court of Appeal has reverted to the established position and has confirmed that there should only be limited exceptions to the rule. This decision is likely to be welcomed by practitioners and their clients, who may have been concerned that communications made on a without prejudice basis may have become admissible in court.

In *Linsen International Ltd* ("Linsen") *v Humpuss Sea Transport* ("Humpuss") [2010] EWHC 303 (Comm) the Court considered the without prejudice rule in relation to full and frank disclosure obligations.

BACKGROUND

Humpuss made an application to set aside a worldwide freezing order obtained by Linsen, on the grounds that there had been a failure to make full and frank disclosure of all material facts and circumstances, and the absence of any real risk of dissipation of assets. Humpuss claimed that the fact and content of a without prejudice meeting two days before the order was made should have been disclosed.

DECISION

The Court rejected the application and the freezing order was continued. Mr Justice Clarke held that the basic without prejudice rule should be the starting point for any consideration of what the Court needs to be told especially in an *ex-parte* context. Although there are exceptions to the rule, Mr Justice Clarke noted that considerable care should be taken in

Court upholds without prejudice rule

holding that a claimant is bound to disclose without prejudice material. Some disclosure of without prejudice communications would be necessary if it is clear that, without it, the Court may be misled, but the judge rejected the proposed test that disclosure of without prejudice material should be made when it is "compellingly obvious".

Mr Justice Clarke stated that Linsen was not required as part of its duty to the Court to have drawn the judge's attention to the fact and content of the without prejudice meeting. The Court noted that no agreement was reached at the meeting nor was any offer capable of acceptance made. Mr Justice Clarke held that Humpuss had made a deliberate choice that the meeting should be on a without prejudice basis and not on an open basis, no doubt with the intention that its content should not be put before a court. Further, the Court took into consideration that neither the fact nor the content of the meeting cast any real light on whether there was a risk that Humpuss would remove their assets from the effective grasp of Linsen.

COMMENT

This case also serves to demonstrate the continuing emphasis placed by the English Court on upholding the without prejudice rule. The courts are reluctant for public policy reasons to allow inroads into the without prejudice rule, not least because of the role the rule plays in promoting parties to enter into discussions that could lead to the settlement of a dispute.

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