C/M/S/ Cameron McKenna

Litigation annual review

2002

The Human Rights Act

Class actions

Commercial disputes

Property disputes

Construction disputes

Conditional fees

International disputes

Pensions

Pushing boundaries in advertising

Professional indemnity

Intellectual property

Health and safety

Corporate social responsibility

Banking fraud

Financial services

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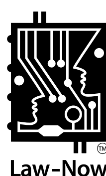

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This Review is intended for clients and professional contacts of CMS Cameron McKenna. It is not an exhaustive review of recent developments and must not be relied upon as giving definitive advice. The Review is intended to simplify and summarise the issues which it covers.

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In this issue...

The first year of the new millennium has seen the number of legal disputes started in the High Court continuing to decline, following the sweeping reforms of Lord Woolf and the increase in confidence in ADR. However, development of the law itself and the practice of litigation has not slowed at all. In an endeavour to help the busy executive, who has little time to read the mass of literature reporting on this constantly changing legal landscape, we have produced a series of articles identifying changes which came about in 2001 and their likely effects on many aspects of commerce in 2002.

"...as the public demand accountability, the law has responded with some draconian changes..."

Litigation, or should I say Dispute Resolution, underlies all aspects of commerce and reflects its diverse nature. In addition to articles of general application, we have included specialist items which are likely to be of general interest, reporting on issues ranging from *Recent extensions to the Pension Ombudsman's powers* to *Pushing the boundaries in advertising:* with the likes of Tesco challenging copyright protection *Parallel imports and repackaging* will be of interest to all brand owners: as the public demand accountability, the law has responded with some draconian changes discussed in *Responsibility for corporate manslaughter* and *Employees' liability* for professional negligence, both of which will be of interest to directors and employees; *New powers and regulations* identifies some of the more troubling new powers for those regulating the financial services industry, introduced by the Financial Services and Markets Act 2000, likely to result in an increase in the number of disciplinary proceedings; *Corporate social responsibility* highlights the need for all corporations to adopt a corporate social responsibility policy and procedures.

The Human Rights Act came into force just before the new millennium and was widely predicted to result in a bonanza for lawyers. In many respects it has been a damp squib, with the courts refusing a myriad of challenges to decisions on the basis of alleged procedural unfairness or irregularity. It is early days yet and a number of high profile cases in the next year are seeking to rely on the Act to found a cause of action which otherwise would not exist. The Act's greatest success, in terms of introducing change, has been in connection with the right to privacy which did not exist before the Act but which was used in the course of the year to restrain the publication of a number of newspaper reports. *A slow fuse not a big bang* reflects on its application in the first 15 months of its life.

"Class actions" are very much in vogue with the Equitable Life Policy Holders and Railtrack shareholders grabbing the attention of the press. However, they originate from the United States, where the procedural law is more favourable to the claimants. At present the rules governing the equivalent actions in the English courts are far more restrictive but the European Commission is actively considering changes based on the American model. The differences, and whether they may be of concern to you, are discussed in *The calm before the storm*.

"...it is early days yet and a number of high profile cases in the next year are seeking to rely on the Act to found a cause of action which otherwise would not exist..."

There is also plenty to say about the Woolf reforms, not as to the detailed changes to the rules, but rather the changes to the culture and conduct of dispute resolution which they have engendered. The official statistics show that the number of claims issued in the High Court has declined markedly and a number of surveys have shown a growing awareness of and willingness to use ADR. However, the latest statistics from the ADR providers are also showing a decline in cases. So what is happening to the disputes? In *Woolf and mediation* we suggest some answers and in *Conflicts with the overriding objective,* in the context of property disputes, we point out some of the practical difficulties encountered when applying the general principles underlying so many of the reforms to specific problems. The Woolf reforms are the most obvious reforming forces within the civil justice system but there are many other forces for change. Some have been around for a while, such as the introduction of compulsory adjudication in construction disputes since 1998. *The taming of adjudication* reviews attacks made on the process and its success, despite a great deal of resistance at the outset. In *Privatising access to justice* Dr Anthony Barton expresses a personal view on the dismantling of legal aid and its replacement with Conditional Fee Agreements.

The growth of the European Union, and with it the volume of international trade, has put pressure on the Brussels and Lugano Conventions governing the recognition of foreign judgments across international boundaries throughout Europe and the EFTA states. These Conventions are largely replaced as from 1 March 2002 and the latest developments are discussed in *Jurisdiction rules change*. Finally, as the world economy teeters on the edge of a recession, experience suggests the number of frauds coming to light will increase, particularly in international trade. Worrying changes in the courts' attitude to the effect of fraud on *Letters of credit and performance bonds* will be of interest to anyone involved in international commerce.

All in all there should be something for everyone.

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The Human Rights Act

A slow fuse not a big bang

It is now 18 months since the Human Rights Act came into force. Contrary to expectations, the courts have not been overwhelmed with cases nor have there been the excesses of which the tabloid newspapers warned. There have nevertheless been some significant cases in the first 18 months and it is possible to see some trends emerging.

To recap, the Human Rights Act incorporated the European Convention on Human Rights into English law. However, the extent of the incorporation is limited. One important limitation is that the Act does not expressly create "stand alone" rights in disputes between private individuals or companies.

A key provision of the Act relates to Public Authorities. It provides that Public Authorities should not breach Convention Rights. "Public Authorities" are defined by reference to their function. Some organisations are "hybrid" in that they are partly public and partly private . The example of Railtrack was cited in Hansard debates. Railtrack's Health and Safety function is a public function, whereas property development is private. A private act does not come within the requirement that Convention Rights should not be breached. In two recent decisions the courts have considered whether a housing association is public or private. In the first case the housing association was found to be a public authority, since it had been set up by the local authority. In the second case, another housing association, funded privately as a charity, was private, although it had a function similar to the association set up by the local authority. These cases suggest the court's are taking a restrictive approach to the "public authority" definition.

But how important is the public/private definition going to be in practice? Its significance is not as great as was thought prior to the Act coming into force. The reason is the so called "horizontal effect". The courts, as public authorities, are under an obligation to apply Convention Rights. Thus Convention Rights are being introduced in disputes between private bodies and individuals.

"...the Wednesbury approach is no longer correct. The new approach is a test of proportionality."

The decision which best illustrates this is a pawnbroker case. *Wilson v First Country Trust* concerned a dispute between a borrower and lender under a consumer credit agreement. There was no public element in the case. The courts held that the Consumer Credit Act did not comply with the requirements of Article 6 and Article 1, Protocol 1, since, under the Act, a technical breach of a requirement for information in the Credit Agreement precluded the lender's right to enforce the Agreement. The case is also notable since it was one of the first declarations of incompatibility under the Act. Under this procedure the courts, while they cannot strike down legislation, can indicate to

"...the courts are prepared to uphold Convention Rights in purely private disputes and this will be extended, particularly in relation to privacy rights."

Parliament that the legislation needs to be amended to comply with the Convention.

The horizontal effect has also been evident in cases under Article 8, the right to privacy. In the case of *Douglas & Others v Hello! Limited* the courts granted an injunction to protect the privacy rights of the Douglas's. More recently there has been the case of a footballer "A" who obtained a temporary injunction to prevent the publication in an article in the Sunday People about his relationships with two former lovers. At first instance the court decided that the right to privacy outweighed the right to freedom of expression and prevented publication. The Court of Appeal has recently reversed that decision principally on the grounds that the degree of confidentiality which the footballer was entitled to was very modest and therefore in this case the right to freedom of expression outweighed the right to privacy. The decision nevertheless indicates the courts' willingness to consider Convention Rights in private disputes.

Another important development brought about by the Act is the courts' approach to judicial review. For many years the courts have applied the so called "irrationality test" under *Wednesbury* to a decision of any public body. Under the test, the question was whether the decision of, say, the Secretary of State for the Home Department was so unreasonable that no reasonable Minister would have reached that decision. This meant that the extent of the courts' review of the decision was very limited.

In a series of recent cases, it is clear that, as a result of the influence of the Human Rights Act, the *Wednesbury* approach is no longer correct. The new approach is a test of proportionality. In practice this means that the courts will pay much closer attention to the facts of an individual case, to assess whether the decision maker has struck the right balance. This will lead to a review which looks more closely at the merits of the decision itself, something that was not possible under the *Wednesbury* principle.

The issue of independence and impartiality of tribunals is one that has been at the forefront of a number of decisions in the last 12 months. In the *Alconbury* case, the planning appeal system came under the scrutiny of the courts. The Divisional Court decided that the planning laws were potentially not compliant with Article 6 of the Convention because the power of the Secretary of State to call in decisions of a Planning Inspector meant that there was a lack of independence in the appeal system. The House of Lords overruled the Divisional Court and found that there was "sufficient" independence in the Inspector to enable him to act in a "quasi-judicial manner".

In a number of cases Convention Rights have been used to "bolster" existing rights at common law. An example of this is in relation to the law of bias. In *Director General of Fair Trading v The Proprietary Association of Great Britain* the Court of Appeal found that where a lay assessor, sitting as a member of the Restrictive Practices Court, had approached the expert witness of one of the parties for a job, this resulted in apparent bias of the Tribunal. As a result of Article 6, the court applied a more objective test to the question of bias than that which existed at common law.

Conclusion

What are the trends for the future? These are still early days, but a number are beginning to emerge. First, the courts are prepared to uphold Convention Rights in purely private disputes and this will be extended, particularly in relation to privacy rights. Secondly, the popularity of judicial review continues to grow. The proportionality approach to judicial review will only increase this trend. The Lord Chancellor has decided to introduce a pre-action protocol for judicial review, which will come into force on 4 March 2002. This should help to ease the judicial burden of managing the increase in cases now being referred to the Administrative Court.

The first 18 months of the Act have not been the disaster which many had predicted. The Act has had an important effect in diverse areas of the law and will continue to do so over the next few years.

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Class actions

The calm before the storm?

Procedural mechanisms to aggregate individual claims can seem superficially very attractive to politicians and consumers as a means of increasing access to justice. This issue is being actively considered by the European Commission and various European governments at present, particularly as the Commission and politicians seek to bring forward policies which will be attractive to consumers. This is against the background that some governments are sensitive to being accused of limiting access to justice by restricting public funding for legal aid, and for its part the Commission wishes to encourage citizens to use goods and services throughout the internal market - and to gain credit for championing consumers in this way, when most consumers regard "Europe" as being at best distant.

Multi-party mechanisms are also attractive to plaintiff lawyers under any system of remuneration, since they represent volume business, economies of scale, opportunities for publicity and sizeable litigation that may proceed for some time.

Class actions are a bane of corporate life in USA. When coupled with the ability of plaintiff lawyers to claim vast compensation through the contingency fee system, it is no surprise that many have criticised the class action mechanism. Corporations doing business in America are frequently targeted with class actions for product liability, toxic torts and investor protection claims. These are frequently lawyer-led, and require enormous resources of in-house and external counsel and considerable budgets for their defence and disposal.

Australia also introduced a Federal class action rule in 1992 which incorporates the very damaging "opt out" mechanism: individuals who may theoretically be represented by those running the class claim have to opt out of the class, but can often be unaware of the existence of the litigation, since advertising about its existence may be an ineffective method of communication.

The fear now is that class actions will be introduced into Europe without proper understanding of their dangers and without proper controls.

"Industry should continue to be very concerned about developments in this area and solid lobbying is required in Brussels..."

For various reasons, particularly defects in the legal aid system, England and Wales, followed by Ireland, were virtually the only European jurisdictions that have so far experienced major multi-claimant actions, mainly restricted to product liability claims against pharmaceutical companies. These cases were reported in a new textbook.[1] However, it is noteworthy that the vast majority of individual claims brought in the succession of cases over the past 15 years resulted in failure. The broad procedural mechanisms developed in those cases have now been incorporated in rule 19.III of the Civil Procedure Rules 1998 on multi-party actions. This rule, which requires claimants to "opt in", essentially merely encapsulates a mechanism under which multiple claims may be subject to the modern principles of case management by a single judge. The English rule does not have some of the problems of US Federal Rule 23, such as certification criteria and the automatic consequence that a decision in one case will bind all others within the group. In contrast, proposals have been discussed in Sweden which would include a number of the adverse US consequences.

However, the UK government is shortly to introduce a proposal for a further mechanism (and industry has pertinently asked whether the government has produced any evidence that such a mechanism is in fact needed, to which there has been virtually no reply). The proposal is to introduce a "representative claim" mechanism, under which an individual or consumer organisation could apply for the court's approval to start proceedings on the basis of representing others with similar causes of action. The major objection to such a mechanism is that it contains wholly inadequate controls on the bringing of time-wasting, spurious, speculative and costly litigation.

A similar representative mechanism was introduced in Spain on 1 January 2001 (although they refer to this as a "class action" mechanism).

Industry should continue to be very concerned about developments in this area and solid lobbying is required in Brussels and with all national governments in order to ensure that the message gets through that uncontrolled class action mechanisms are playing with fire.

[1] C Hodges, *Multi-Party Actions*, Oxford, 2001

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Commercial disputes

Woolf and ADR

"The acceptance of ADR by practitioners and the judiciary, particularly in commercial disputes, has been one of the most significant developments in the Civil Justice System in recent years."

In July 1996 the Right Honourable Lord Woolf, Master of the Rolls, as he then was, published his final report "Access to Justice" incorporating the first draft of the new Civil Procedure Rules ("CPR"). In essence he concluded that the Civil Justice System was too expensive, too slow and too complex. He considered the system too adversarial and recommended a wholesale change to the rules intended to address these evils.

These included the introduction of a completely new concept, the Overriding Objective; pre-action protocols, determining how parties should behave before proceedings were even issued; active case management by the courts and costs sanctions for disproportionate behaviour, even against the winning party.

Lord Woolf also expressed the view that insufficient emphasis had been placed on encouraging the parties to settle their disputes at an early stage in the proceedings. ADR initiatives had already been adopted in the Commercial Court and the Central London County Court but it was largely left to the parties to decide whether to participate and ADR was not widely accepted, or even understood. However, a surprisingly large number of cases were settling at the door of the court after all of the costs of preparing for trial and the barristers' brief fees had been incurred. In 1993 only 13% of cases in the High Court were determined by trial, the rest settling at the door of the court or sooner.

Lord Woolf lamented the fact that ADR was not used sufficiently and concluded that it was essential that the court, at least, be given power to encourage the parties to undertake settlement negotiations or ADR. He introduced in the CPR a number of new rules which have produced cultural changes forcing practitioners to address the use of ADR from the outset, in particular:

- the court now has a specific power to stay the whole, or part, of the proceedings until a specified event, or date, in order to put proceedings on hold while ADR is explored;
- after the service of the Defence the parties must complete an "Allocation Questionnaire" which includes provision for any party to request a stay for ADR;
- the Overriding Objective describes "active case management" as including "encouraging the parties to use an alternative dispute resolution procedure if the court considers that appropriate and facilitating the use of such procedure…and helping the parties to settle the whole or part of the case";
- the new principles by which a judge will determine the amount of costs to award include consideration of the conduct of the parties', including the parties' conduct in relation to efforts made to try to resolve the dispute.

How have these initiatives fared?

The reforms have had a significant effect on the conduct of litigation as can be seen by the fall in the number of claims issued in the High Court. For example, the number of claims issued in the Queen's Bench Division of the High Court has fallen by 63% between 1999 and 2000; the new rules were introduced on 26th April 1999 and in that year 72,161 claims were issued, a drop of 37% on 1998; in 2000, the first

full year after the introduction, only 26,876 claims were issued. These statistics demonstrate that the reforms have been extremely successful in reducing the number of disputes before the High Court, and yet litigation lawyers appear to be as busy as ever. Much of the work now involves pre-action investigation as required by the Protocols and ADR.

The Law Society undertook a survey in February 2001 to explore the views of the solicitors profession and 80% of the respondents expressed the view that CPR was an improvement; they considered the Reforms had increased settlement and engendered a culture of co-operation. There was also a belief that litigation was becoming quicker and less adversarial.

Mr Justice Coleman, the judge in charge of the Commercial Court, is particularly supportive of ADR and has developed a form of Order regularly used in the Commercial Court, which stops just short of compulsion, requiring the parties to attempt ADR. The Lord Chancellor's Department also carried out a survey in March 2001 and found that over 130 ADR Orders were made in the Commercial Court between 26 April 1999 and June 2000, compared with 43 in the preceding year. The Centre for Effective Dispute Resolution also reported in June 2001 that in 1999/00 the percentage of disputes which were court referred increased by 8% compared with the previous year, which year had itself seen an increase of court referrals of 11% on the previous year. Clearly the courts are taking a more interventionist stance when it comes to ADR. This can also be seen in the Court of Appeal decision in *Dyson & Field v Leeds City Council*, where the winning party was penalised in costs for declining to mediate. The drive to use ADR, as opposed litigation, was given a further boost in March 2001 when the Lord Chancellor announced the Government's commitment for all its departments to use ADR techniques to settle their disputes "in all suitable cases whenever the other party accepts it".

The latest indications from the ADR providers are that the number of disputes referred to them during 2001 has remained static, or possibly fallen slightly, compared to 2000. However, rather than reflecting a downturn in the use of ADR, this reflects the increased competition between the providers and the fact that as more practitioners become familiar with the process they by-pass the ADR provider and appoint the mediator without them.

The Lord Chancellor's Department is currently consulting on a draft Pre-Action Protocol for all actions not already covered by a specific protocol (viz Personal Injury, Clinical Negligence, Construction, Defamation and Professional Negligence). It is likely to be finalised and introduced during 2002. The current draft only "advises" the parties to consider using a form of ADR at an appropriate stage, whereas the Professional Negligence Protocol provides that if one party proposes ADR and the other party does not agree, the opposing party must justify its refusal. It is to be hoped that the consultation process will result in a similar provision in the general protocol as it is a very positive pressure to encourage the use of ADR.

The acceptance of ADR by practitioners and the judiciary, particularly in commercial disputes, has been one of the most significant developments in the Civil Justice System in recent years. It still has a long way to go, particularly in the context of international disputes where it is often regarded with suspicion. In July 2001 the ICC published its own Amicable Dispute Resolution Rules, preferring to emphasise "Amicable" over "Alternative". The rules also provide for the appointment of a "Neutral" instead of a "Mediator". Otherwise the Rules have no surprises and it is significant that the ICC has reported that a number of arbitration hearings have been stopped at the parties' request to allow them to attempt to resolve their disputes by ADR.

In domestic litigation in the UK the parties often prefer to negotiate a resolution to their dispute with the help of ADR, rather than have a decision imposed on them. There is no reason for international disputes to be any different, so it seems inevitable that ADR's use in such disputes will increase as experience and confidence in the process grows.

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Property disputes

Conflicts with the overriding objective

> **"Such relationships are generally not best served by a decision being imposed by, for example, a judgment."**

Parties in dispute are compelled by the Civil Procedure Rules ("CPR") only to commence proceedings as a matter of last resort. This approach is particularly well suited to property disputes where the parties have been in, or will continue to have, a long term relationship (especially in the context of landlord and tenant issues). Such relationships are generally not best served by a decision being imposed by, for example, a judgment. The CPR have "encouraged" opponents to consider seriously offers made to resolve the dispute either before the commencement of proceedings or shortly after the commencement of proceedings, otherwise the party who dismisses such an approach "out of hand" risks adverse costs orders and "colouring" a Judge's view of their case.

One area of property disputes which does not sit comfortably with "commencing court proceedings as a last resort", is lease renewals under the Landlord and Tenant Act 1954. That Act requires a tenant, if it wishes to preserve its prima facie right to a new tenancy, to commence court proceedings claiming a new lease within four months of service of a statutory notice terminating its tenancy. However, by that stage, it is not clear that there is even a dispute between the parties as to the new lease terms and the commencement of proceedings can hardly be said to be "last resort"; and yet the tenant has no choice. Further, once proceedings have been commenced, the CPR require an expeditious and pro-active management of the proceedings; but the reality is that the parties require time to negotiate the new lease terms and, in the vast majority of cases, it is entirely unnecessary to have a court determination. This results in unnecessary use of court time and the parties incurring costs for dealing with these proceedings.

Fortunately, some Judges (but by no means all) have given sensible directions for such proceedings, including ordering a stay, to give the parties a reasonably opportunity to negotiate the new lease terms. Further, recent changes to the CPR for these type of proceedings recognise their unique nature and should serve to provide consistency in approach and avoid costs being incurred unnecessarily.

That said, both the original, and now amended, CPR have served to encourage parties to "get on" and negotiate the new lease terms within sensible time periods, rather than let these continue for many months (and in the worse cases, over many years).

During the last three to four months, and especially since the events of 11th September, we have seen an increase in the number of instructions from clients who have reviewed their commitments in light of the current market and are either seeking to minimise future liability or ensure that an opponent's obligations owed to them are met in full. For example:

- A client has recently reassessed its obligations under an agreement for lease to take a long lease of an anchor unit in a shopping centre. From the client's point of view, the figures no longer "stack up". We have reviewed in detail the landlord's obligations under that agreement to assess whether it is in breach of them and to find, therefore, a "window of opportunity" for the client to exit that agreement, together with recovery of the (significant) deposit paid by the client, but without a material

exposure to a claim for specific performance or substantial damages.

- A landlord client became nervous when a company under an agreement for lease with it indicated that it would not take the new long lease at an initial yearly rental in excess of £1m for relatively unique premises. A detailed review of the obligations of the proposed tenant to take the new lease, adopting a robust approach in correspondence with the proposed tenant (in which we were, in effect, laying a paper trail in case it should be necessary to seek a court order for specific performance to compel the party to take the lease, but at the same time seeking to persuade the party to comply with its obligations) has avoided this scenario developing further.

For 2002, we await the enactment of the Commonhold and Leasehold Reform Bill. This contains provisions making it easier for tenants of residential properties to obtain (new) longer leases and participate in collective enfranchisements. Whilst primarily aimed at the residential sector, certain provisions, such as the right to manage, could impact adversely on mixed residential and commercial use properties. The concept of "commonhold" is not to be imposed retrospectively but we are currently monitoring the progress of this proposed legislation for a number of our clients.

"Whilst primarily aimed at the residential sector, certain provisions, such as the right to manage, could impact adversely on mixed residential and commercial use properties."

More generally, we anticipate continuing to receive instructions of the type mentioned above, but probably fewer instructions in relation to clearing sites of legal problems and adverse occupants for new developments (unless the market for a particular area is strong and justifies the new development). Inevitably we will see an acute awareness by parties, subject to property type liabilities, of their respective rights and obligations resulting in a less relaxed attitude towards, for example, tenant default.

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Construction disputes

The taming of adjudication

The Housing Grants Construction and Regeneration Act 1996 came into force on 1st May 1998 and lists mandatory terms to be included in all construction contracts from that date. These include terms on payment and restrictions on set-off, and a provision that all construction contracts must contain a right to refer a dispute to adjudication at any time.

The adjudication procedure set out in the Act is a 28 day procedure in which an appointed adjudicator decides a dispute. The adjudicator's decision is "binding until finally determined by legal proceedings or by arbitration".

For a while lawyers discussed what this meant. Would the adjudicator's decision be enforceable in court? Was it a fair process; would the rules of natural justice apply, and what happened if the adjudicator made a wrong decision?

We were put out of our misery on 12th February 1999, with the judgment of *Macob Civil Engineering v Morrison Construction Ltd*. An adjudicator's decision was successfully enforced by way of summary judgment, and the court held that this was an appropriate method of enforcement. There was much rejoicing, particularly amongst sub-contractors.

It soon became clear in the months that followed *Macob* that the courts were taking a robust approach to statutory adjudication and were using a purposive interpretation of the Act.

Statements made in relation to adjudication by judges and commentators included "fast track procedure"; "bound to make mistakes" and "rough and ready justice". It was recognised that sometimes an unfair conclusion may result from adjudication, but that the court must nevertheless enforce decisions, as the balance could always be redressed in subsequent legal or arbitration proceedings.

It is now nearly 3 years since *Macob Civil Engineering v Morrison Construction Ltd*. An enormous body of case law relating to the enforcement of adjudicators' decisions has accumulated. Imaginative lawyers and clients have submitted a cornucopia of thorny questions for judicial consideration.

So has adjudication enforcement grown out of its wild youth and become a more cautious creature like arbitration or litigation, or is it still enjoying the heady days of indulgence by the courts?

The heroes of adjudication

Four months after the Macob decision, the court stated in *A&D Maintenance and Construction Ltd v Pagehurst Construction Services Ltd* that it did not have the power to open up and review adjudicators' decisions where adjudicators were properly appointed and had considered matters under the contract properly within their remit. This has become the crux of the law relating to enforcement of adjudicators' decisions.

However the big crunch came in November 1999 with the *Bouygues UK Ltd v Dahl Jensen UK Ltd* decision, where the court enforced an adjudicator's decision even though it acknowledged that the decision was clearly wrong. This approach was upheld by the Court of Appeal in July 2000.

In *VHE Construction plc v RBSTB Trust Company Limited* the court stated that if a party had any defences or cross-claims which it had not raised in the adjudication,

then it could not rely on them in order to defeat or diminish an application for summary enforcement of the adjudicator's decision.

The next question raised by lawyers was whether Human Rights laws would apply to adjudication. The answer is no: adjudication is not a final determination of a dispute *(Elanay Contracts Ltd v The Vestry)*, and an adjudicator is not a public body *(Austin Hall Building Ltd v Buckland Securities (Scotland) Ltd)*. These decisions are a relief to the supporters of adjudication, as a declaration of incompatibility with the Human Rights Act 1998 would have been disastrous.

More good news came from the courts when they confirmed that an adjudicator's decision creates a debt which could form the basis of a statutory demand, and that the court cannot go behind this debt *(Re a Company* 2001). In the normal way, however, (unlike summary judgments) the demand would of course be set aside if there were valid cross claims.

The biggest enemy of a successful recipient of an adjudicator's award is a jurisdictional challenge. These are discussed below. However, while we are considering the heroes of adjudication, it is worth mentioning 3 important decisions which narrowed the potential for jurisdictional challenges.

In *Karl Construction (Scotland) Ltd v Sweeney Civil Engineering (Scotland) Ltd* the question was: did the Adjudicator answer a question that was not put and therefore without jurisdiction? The Adjudicator had decided that the payment provisions of the contract were not compliant with the Act, but she had not invited submissions from the parties on the point. The court decided that provided the additional question was merely an integral part of the route to the substantial question in dispute, there was no trespass outside her jurisdiction. It was a procedural mistake within jurisdiction and therefore was binding.

The court went a bit further in *LPL Electrical Services Ltd v Kershaw Mechanical Services* and stated that an error of law or interpretation is not outside jurisdiction. This has just been confirmed by the Court of Appeal in *C&B Scence Concept Design Ltd v Isobars Ltd* (31 January 02), who stated that an error of law by an adjudicator should not prevent summary judgment of his decision.

It may seem from the above that the victim of a wrong adjudicator's decision is in a hopeless position; however this is only half the story…

The enemies of adjudication

It soon became clear that jurisdictional challenges were the most useful tool available to any defendant looking at the wrong end of an adjudicator's decision. The first successful use of this defence was in *Project Consultancy Group v Trustees of the Gray Trust* in July 1999 and was on the basis that the Construction Act did not apply to the contract as the contract (if there was one) had been entered into before 1st May 1998.

Since then, challenges have been successfully raised on the basis that: there was no contract; the contract did not relate to "construction operations"; the adjudicator was incorrectly appointed; there was no "dispute"; the adjudicator considered the wrong question, or a question that was not put to him and so forth.

The law on errors of law has just been clarified by the Court of Appeal (see *C&B v Isobars* above). It now seems that an adjudicactor's error is only subject to a jurisdictional challenge if the error is deciding matters not referred to him.

In two cases the court refused to enforce the adjudicator's decision on the grounds that the parties had already reached a compromise agreement and therefore the "dispute" was not amenable to adjudication. *(See Lathom v Cross).*

One of the major concerns relating to the fairness of the enforcement of adjudication awards (especially incorrect ones!) has been: what if the winner of the adjudication becomes insolvent and therefore it is impossible to recover in subsequent litigation proceedings money paid out as a result of adjudication? The answer is now

"...has adjudication enforcement grown out of its wild youth and become a more cautious creature like arbitration or litigation, or is it still enjoying the heady days of indulgence by the courts?"

clear, following 3 cases (*Herschel Engineering Ltd v Breen Property Ltd*; Bouygues in the Court of Appeal and *Rainford House v Cadogan Ltd*): that where there is serious, provable doubt that a party will be unable to repay any money awarded, a stay of execution will be granted. Where a party is actually insolvent, summary judgment proceedings are not suitable as the paying party would be deprived of the opportunity to set off any cross claims they might have under the construction contract, or under the insolvency rules.

Another burning question amongst lawyers was, for a while, do the rules of natural justice which apply to litigation and arbitration (fairness, impartiality, both sides being heard etc) apply to adjudication? This was particularly relevant due to the fast-track nature of the procedure and the fears of "ambushing" defendants with claims.

Although the court has refused to condemn the timescale of adjudication as being unfair, it is now clear that the rules of natural justice do apply to adjudication. In one case (*Discain Project Services v Opecprime Development Limited*), the adjudicator failed to consult a party on important submissions made by the other. This failure to comply with the rules of natural justice meant that the court declined to enforce the decision. Shortly after, the court refused to enforce the decision of an adjudicator who had failed to act impartially. Then in February last year, summary judgment was not granted in a case where the adjudicator had acted as a mediator, giving rise to an arguable case of perceived bias. *(Glencot v Ben Barrett)*.

Conclusion

The courts' refusal to open and review adjudicators' decisions, the non-application of the Human Rights Act and the difficulty of raising a cross-claim or defence show that the adjudication process is very different from litigation and arbitration.

However the courts have become a little more cautious in recent times. The need for a degree of fairness has resulted in the application of the rules of natural justice and exceptions made for insolvent claimants. Jurisdictional challenges have been successful on numerous occasions and remain the key weapon in defendants' armouries.

Rough-and-ready justice? Maybe, but the purpose of statutory adjudication is to facilitate cashflow in the industry, and, in achieving this, most would agree that it has been a success.

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Conditional fees

Privatising access to justice

The introduction of the conditional fee system, supported by after-event insurance, demonstrates the government's determination to widen access to justice, by privatising it and moving away from the civil legal aid system. The Court of Appeal decision in *Callery v Gray* demonstrates the complex relationship between lawyers and insurance providers in conditional agreements. Whereas the role of lawyers in the conditional fee system has been regulated by legislation, the after-event insurance industry has been largely unregulated, apart from market forces. The case of *Callery v Gray* sets out some fundamental principles.

"Litigation is inherently risky and both parties must assess the risk of losing against the benefits of winning."

Introduction

Access to justice and rule of law are the hallmarks of a civilised society, but legal rights are only meaningful if they can be enforced. Litigation is inherently risky and both parties must assess the risk of losing against the benefits of winning. Usually the loser has to pay the winner his damages and legal costs (as well as the loser's own legal costs). This "loser pays" rule operates to promote the resolution of cases according to the merits; weak cases are abandoned and strong cases are settled. This discourages speculative litigation but the high costs and risks of civil litigation have meant that only the wealthy and those who qualify for legal aid have had access to lawyers. As a consequence the civil justice system is in danger of being brought into disrepute for not being available to ordinary people. To address the problem government has introduced radical reform which amounts to the privatisation of access to justice.

Conditional fees

Conditional fee arrangements (no win, no fee) have been permissible since 1995 for limited claims. They are available now for all civil money claims. They are not permitted in criminal cases or civil proceedings involving matrimonial, family, children or adoption matters. They represent an exception to the ancient prohibition against maintenance and champerty.

In a conditional fee arrangement solicitor and client agree that in the event of a successful outcome the solicitor may charge an enhanced fee, up to 100% of the basic fee, and nothing in the event of failure; this can operate as "double or quits", providing the lawyer with a bonus if the claim succeeds. The solicitor has to assess the prospects of success of the case and decide whether or not to take it on; the reward for assuming the risk is the increased fee. The level of the success fee is assessed according to the prospects of success. The risk of funding the litigation is underwritten by the lawyer. The element of contingent fee uplift is related to an enhancement of the basic fee; it is not related to a percentage share in any damages awarded.

Under our costs rule, an unsuccessful litigant must pay the opponent's legal costs. Conditional fee agreements thus only provide access to legal representation; however, there is exposure to costs liability should the case fail. After-event insurance to protect against such liability is available. The combination of conditional fees sup-

"The conditional fee system imposes a commercial discipline to ensure that the prospects of success of a case are properly investigated."

ported by after-event insurance provides a system for independent privatised access to justice; the risks of litigation (funding and costs liability) are shared by the lawyer and the insurer. It is probably the availability of insurance provided by the insurer rather than legal representation provided by lawyers which determines access to justice.

Recent years have seen the development of an increasing range of insurance products in response to consumer needs and demands. It is essential that there is consumer choice arising out of competition between insurance providers.

The conditional fee system imposes a commercial discipline to ensure that the prospects of success of a case are properly investigated. Competence is rewarded and incompetence is penalised. There are appropriate inbuilt incentives to ensure quality control and to deter abuse. There is an identity of interest between the client, lawyer and after-event insurer: all want the claim to succeed.

The relationship between a lawyer and client is regulated largely by the Access to Justice Act 1999 (and subordinate legislation). By contrast, the provision of after-event insurance has been largely unregulated. The successful privatisation of access to justice requires cooperation and understanding between the legal profession and the insurance industry.

Callery v Gray

This case concerned two decisions of the Court of Appeal last summer (*Callery v Gray (1)* and *Callery v Gray (2)*). These were appeals by the defendants in two personal injury cases arising out of road accidents which were run on conditional fee agreements and settled without the need for court proceedings. The issues in *Callery v Gray (1)* were (1) the time at which it was appropriate to enter into a conditional fee agreement and take out after-event insurance policy; (2) the reasonableness of the success fee charged, particularly where a claim was quickly resolved without the need for court proceedings; (3) whether claimants were entitled to recover an after-event premium at all in those circumstances; (4) the reasonableness of the after-event premiums for which claimants were seeking reimbursement by defendants when their claim succeeded. The court held that (1) after-event premiums were in principle recoverable as part of the claimant's costs, even where the claim was quickly resolved without the need for proceedings; (2) it was in principle permissible for a claimant to enter a conditional fee with a success fee and take out after-event insurance when first consulting a solicitor, and before the solicitor wrote a letter of claim and received the defendant's response; (3) in modest and straightforward claims for compensation resulting from road traffic accidents where a conditional fee agreement was agreed at the outset, 20% was the maximum uplift that could be reasonably agreed; (4) it was open to a solicitor and client to agree a two-stage success fee at the outset of proceedings, for example an uplift might be agreed at 100%, subject to a reduction to a maximum of 5%, should the claim settle before the end of the period fixed by the pre-action protocol.

In *Callery v Gray (2)* the Court examined the insurance position more closely. The court held that: (1) the words "insurance against the risk of insuring a costs liability" in section 29 of the Access to Justice Act 1999 mean "insurance against the risk of incurring a costs liability that cannot be passed on to the opposing party". This interpretation accorded with Parliament's legislative intention and with the overall scheme for the funding of legal costs; (2) in this case, the whole of the cover, including the small element of cover for "own costs insurance" could be regarded as falling within the description of insurance against the risk of liability within section 29; (3) the premium cost of £350 was considered reasonable. The Court also went on to provide guidance on the recoverability of assessment fees.

In the coming year the court is bound to be troubled with novel issues thrown up by further cases. The decisions in *Callery v Gray* helpfully provide that reasonableness and proportionality should operate in determining the level of recoverability of success fees and insurance premiums.

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International disputes

Jurisdiction rules change

The new millennium saw a spate of activity in the field of private international law. This article reviews the most significant developments including changes implemented on 1st March 2002 when EC Regulation 44/2001 replaces the Brussels Convention on Jurisdiction and Judgments (the "Convention"). References to Articles of the Brussels Convention are denoted by the letters BC.

Council Regulation No 44/2001 the Jurisdiction Regulation

The most significant development last year was the publication of this new Regulation which, from March 2002, will, **as between member states of the European Union,** largely supersede the old Brussels Convention. The one exception is Denmark, which opted out of the Regulation and to which the Brussels Convention will continue to apply.

The new Regime for the allocation of jurisdiction as between European countries will be as follows:

- Council Regulation (EC) 44/2001 applies to the European Community[1]
- Brussels Convention applies to Denmark
- Lugano Convention applies to Iceland, Norway, Poland and Switzerland
- For situations not covered by these regimes, the common law will continue to apply.

Definition of "Domicile" for companies and other legal persons.

The concept of domicile is used throughout the Regulation. Article 2, for example, provides that persons domiciled in a contracting state shall, whatever their nationality be sued in the courts of that State.

Under the Convention the question of where a party is domiciled is determined by the law of the state whose courts are seized of the matter[2]. That remains the general position under the Regulation, but Article 60 of the Regulation now provides a definition of domicile for companies and other legal persons. In practice, the domicile of an English company will be its place of incorporation or its principal place of business so, in practice, the change is likely to be of limited effect.

Place of performance of the obligation in question

Article 5(i) of the Regulation provides that in matters relating to a contract a Defendant may be sued in the courts for the place of performance of the obligation.

The Regulation preserves this general "place of performance" rule but stipulates that for contracts for the sale of goods and contracts for services the place of performance is deemed to be (unless otherwise agreed) the place of delivery of the goods and the place where the services were provided. This is a significant change since it potentially deprives the seller of goods of the opportunity of suing the defaulting buyer for payment in the place of payment, which, under English Law at least, usually means the domicile of the seller, being the place where payment is received.

> **"...for contracts for the sale of goods and contracts for services the place of performance is deemed to be (unless otherwise agreed) the place of delivery of the goods and the place where the services were provided."**

To avoid this consequence, the Seller should either expressly stipulate in the contract the place where the contract is to be performed. Alternatively, of course, the parties are free to agree that the courts of a particular state are to have jurisdiction to hear disputes.

Jurisdiction Agreements : Article 23

It has always been open to contracting parties to confer jurisdiction on the courts of

[1] The new regulation will have force in Luxembourg but the special rules under the Brussels Convention for that state will continue to apply

[2] Article 52

"One of the more controversial proposals is the provision that consumer claims in tort should be governed by the law of the place where the injury occurs."

any state to resolve their disputes. That principle was enshrined in Article 17 of the Convention. The difficulty with Article 17 of the Convention was that it appeared to assume that all jurisdiction agreements were "exclusive". Non-exclusive agreements did not fit into the framework and despite one pragmatic judgment in the English courts[3], there has been a lingering concern that they might not be valid under European Law. The new Article 17 (Article 23 of the Regulation) addresses this concern head on by providing for the parties to agree whether or not the jurisdiction should be exclusive.

Article 23 of the Regulation also omits the wording under Article 17 of the Conventions whereby the effect of agreeing jurisdiction for the sole benefit of one party was to enable that party (but not the other) to have a choice of Courts in which to sue. Now, under the Regulation, if one party only wants the benefit of non-exclusivity that will have to spelled out.

Consumer contracts: Article 15

Article 15 of the Convention provides that, in certain circumstances, consumers have the right to sue the suppliers of goods and services in the state where (the consumer) is domiciled. By extending those circumstances to include contracts where the seller has directed its activities to the state where the consumer is domiciled, it appears that the consumer's rights to sue in the courts of his own domicile will now cover contracts concluded over the internet.

Tort claims: Article 5(iii)

Article 5(iii) provides that actions in tort may be brought not only in the country where the harmful tort actually occurred but also in the country where it might occur.

Date court seized: Article 30

Articles 21 and 22 of the Convention provide that in related actions the court first seized may have priority. The Regulation contains a new provision (Article 30) determining the point at which the court is deemed to be seized. In practical terms, the relevant time for many civil law jurisdictions will be the date the proceedings are issued and, in England, the date when they are served.

Enforcement of judgments

The Regulation also contains a number of revisions intended to simplify the procedure for enforcing judgments of courts of member states.

Proposed regulation on the law applicable to non-contractual obligations

There has been much speculation concerning a new Regulation on the law applicable to non-contractual obligations. Dubbed Rome II, this is intended to supplement Rome I, the Convention on the law applicable to contractual obligations. So far only embargoed "unofficial" copies of the draft of Rome II have been in circulation, which has lent the discussions a somewhat unreal air. One of the more controversial proposals is the provision that consumer claims in tort should be governed by the law of the place where the injury occurs.

Some industry sectors have expressed a fear that this will require businesses to carry out a risk analysis based on the law of every country where their products might be used; an expensive and uncertain

[3] Kurz v Stella Musical Veranstaltungs GmbH [1992] Ch196

exercise. In fact, the proposal does little to alter the existing law and the concern is probably misplaced. In any event, it is likely that, the United Kingdom will decide to opt out of the new Regulation.

Hague Judgments Convention

Since 1992, negotiations have been underway for a worldwide convention for the enforcement of judgments. The latest round of discussions, in Brussels in July 2001, ran into the ground and the Convention was reported to be on a life support system. The main obstacles have been the desire of US to retain its wide activity-based rules on jurisdiction and a concern about of the enforceability of US judgments that include awards of punitive damages.

Service Regulation 1348/2000

This regulation came into force on 31 May 2000. It applies to the service of judicial documents between member states of the European Union and prevails over the provisions of any other bilateral or multilateral arrangements having the same scope, particularly the Hague Convention 1965 and

"...the process of harmonising jurisdiction at a European level looks set to continue apace. "

the Protocol annexed to the Brussels Convention. The rules prescribe for a harmonised primary method of service through "transmitting" and "receiving" agents. "Receiving agents" serve according to methods stipulated by local law or by a particular form requested by the "transmitting agent" so long as the method requested is compatible with local law. It also allows for other methods of service such as diplomatic and consular channels, judicial officers and competent persons abroad. These are, however, subject to express conditions or objections by the member state compiled in the EC Official Journal. Particular attention should be given to service of foreign process by international post since even where it is permitted in the Regulation local practice may mean it is ineffective.

E-Commerce

A further development has been the publication of the E-Commerce Directive. The Directive generally adopts the county of origin principle which suggests that providers of online services should be regulated by the laws of the place where they conduct business. This does not, however, alter the right (under the Jurisdiction Regulation) of consumers to bring proceedings in their own country regardless of the domicile of the defendant company.

Looking ahead

While the short term prospects for a worldwide jurisdiction and enforcement convention are not looking good, the process of harmonising jurisdiction at a European level looks set to continue apace. The fact that the rules are now contained in a Regulation means that future revisions, can be made much more speedily. Also, with Poland having signed up to the Lugano Convention (and other former eastern block countries set to follow) the future for uniform rules and ease of enforcement of court judgements across Europe looks promising.

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Pensions

Recent extensions of the Pensions Ombudsman's jurisdiction

The Pensions Ombudsman could originally investigate complaints of injustice caused by maladministration and disputes of fact or law brought by members of occupational and personal pension schemes and their spouses and dependants. They can bring complaints against trustees, managers, employers and administrators of the scheme in question.

The Ombudsman is also able to investigate complaints and disputes from employers against trustees or managers in relation to the same scheme and vice versa for complaints (but not disputes), and investigate complaints from trustees or managers of one scheme against trustees or managers of another.

Provisions in section 53 of the Child Support, Pensions and Social Security Act 2000 significantly extended (with effect from 1 December 2000) the Ombudsman's jurisdiction by allowing him to:

- investigate complaints made by the independent trustee (appointed on the sponsoring employer's insolvency) alleging maladministration by the other trustees, or the former trustees, of a scheme;
- consider disputes between trustees of the same scheme brought by at least half of the trustees (intended to include, according to the Explanatory Notes to the Act, "friendly" disputes where trustees are simply seeking directions);
- consider a question from a sole trustee about the carrying out of his functions;
- investigate a complaint or a dispute where the subject matter has previously gone before an employment tribunal or a court, and the case has been discontinued (this will not apply to any cases referred to the Ombudsman before these provisions come into force).

Under current legislation and in line with the recent Court of Appeal decision in *Edge v Pensions Ombudsman*, the Ombudsman cannot currently accept a case if the investigation of it would impact upon the interests, particularly the financial interests, of those not directly involved in the case. This is because where large classes of individuals are concerned, it is impractical for them all to be consulted in the investigation. Accordingly they cannot be bound by his determinations.

"...more formal procedures to be put in place in class actions may mean that the handling of such cases becomes much more similar to representative proceedings in the High Court."

To overcome this, section 54 of the Act when it comes into force (from a date not yet known but expected to be in mid-2002) will provide the following:

- the Ombudsman will be allowed to link to a case those whose interests may be affected by the complaint or dispute or its outcome;
- the Ombudsman will have to give actual or potential beneficiaries the opportunity to make representations;
- regulations (draft just published for consultation) will permit the Ombudsman to appoint a person to represent a group of those who have the same interest in a complaint, for instance, all the pensioner members, and it will then be this appointed person who will make representations on behalf of that group and the group will be bound by the determination.

The regulations will also include provisions to allow the Ombudsman to order that the cost of legal expenses in a particular case can be met from the funds of the scheme. It is envisaged that such orders will be made when the case is particularly complex and involves the interests of several groups.

The more formal procedures to be put in place in class actions may mean that the handling of such cases becomes much more similar to representative proceedings in the High Court.

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Pushing the boundaries in advertising

2001 saw increasing attempts by advertisers to use "shock" tactics in advertising, pushing at the boundaries of taste and decency and also in relation to comparative advertising.

The most well known and, indeed, the most complained about advertisement last year was the billboard advertisement for Opium perfume, featuring a naked woman (the model, Sophie Dahl), lying on her back, set against a dark blue velvet background. Complaints to the Advertising Standards Authority ("ASA") were on the basis that the image was offensive, degrading to women, and unsuitable for a public place. The ASA upheld the complaint, agreeing that the sexually suggestive nature of the pose meant that it was likely to cause serious or widespread offence when displayed on billboards. However, the image could still be used in glossy women's magazines and, indeed, could still be seen in magazines last Christmas, while road users remained protected from distraction. Using the advertisement in women's magazines was not considered a problem, since the risk of offence was significantly reduced.

The story of the Opium billboard advertisement was probably not one of unqualified failure, since the ban of the advertisement attracted substantial publicity. The downside is that Yves St Laurent are now subject to a two year period of compulsory vetting for their billboard advertisements.

This underlines the importance of careful targeting of advertisements, a factor apparent in a number of other ASA decisions over the year concerning advertisements using sexual innuendo. The general upshot of these decisions demonstrated that the more controversial a campaign, the more care must be taken to avoid the risk of a complaint. Complaints, of course, involve valuable management time, costs and the potential for adverse publicity. These risks can be reduced if care is taken over the placement of the advertisements so as to target an audience who will not be offended and to avoid (or at least substantially reduce) the risk of, particularly children, seeing any offensive material.

"...the more controversial a campaign, the more care must be taken to avoid the risk of a complaint. "

The other area which saw significant activity over the year related to comparative advertising. This has been one of the biggest growth areas over recent years, particularly since advertisers have increasingly sought to take advantage of Section 10(6) of the Trade Marks Act 1994. In effect, this provision allows the use of trade marks in comparative advertising, provided that the use of the trade mark is "in accordance with honest practices".

With the increase in the number of low-fare operators in the airline industry, airfares are a regular target for comparative advertising. This was certainly true over the last year. Of particular interest were two different examples, both involving Ryanair; one success for the airline and one failure.

"The extent to which the new regulations will have an impact on comparative advertising has yet to be seen, but there appears to be no sign yet of any clear impact or increased reference to the Advertising Standards Authority."

The failure related to a successful complaint to the ASA, relating to a claim "We guarantee the lowest fares to Glasgow". Ryanair demonstrated that they carried out price comparisons on all routes, that they would reduce their fare to below the competitor's fare if one of Ryanair's fares was found to be more expensive, and that if a passenger found a lower fare after booking, Ryanair would refund double the difference. Nevertheless, the ASA noted that some airlines offered prices lower than Ryanair on some comparable flights and, because Ryanair therefore did not offer the lowest fares at all times, concluded that the particular advertising claim could not be justified. Instead, Ryanair was advised to change its claim to state that it guaranteed to beat competitors' prices. The ASA, in reaching this conclusion, applied a very strict interpretation of the wording, seeking specific adherence to the wording of the claim. As recently as 9th January 2002, Ryanair was reprimanded again by the ASA over misleading claims in its advertisements.

A better outcome was achieved by Ryanair in High Court proceedings brought by British Airways in relation to a controversial campaign in which Ryanair described British Airways as "expensive BA****DS" on the basis of their high prices. (A complaint from the public on the basis of this advertisement being offensive was upheld by the ASA). A later advertisement used the headline "expensive BA". Here, British Airways brought an action for both trade mark infringement and malicious falsehood. The Court made it clear it was considered inappropriate for two large companies to be fighting a comparative advertising dispute in the Courts and also inappropriate for British Airways to be claiming that the price comparisons were misleading when, in effect, their argument was that their fares were not five times more expensive than those of Ryanair, but only three times more expensive! The Court rejected the claim in relation to both trade mark infringement and malicious falsehood, following the robust view in relation to comparative advertising which has been adopted by the Courts in a number of previous cases.

Since these advertisements were published, the Control of Misleading Advertisements Regulations 1998, have come into force in the UK as a result of European legislation. These regulations set out a more stringent list of requirements for comparative advertisements, including a requirement that the advertisement must not discredit or denigrate the trade mark of a competitor. However breach of these regulations cannot be the subject of civil action, merely a complaint to the ASA and ultimately to the Director General of Fair Trading.

This shows the problem for companies in dealing with comparative advertising. The Courts are clearly reluctant to hear disputes of this nature and it will be difficult to succeed in bringing any claim before the Courts, except in the most extreme of circumstances. A complaint to the ASA or, if a television advertisement, to the ITC, may be more effective, although it can be difficult to predict the approach which the regulatory bodies will adopt. There is also no opportunity for any sanction on the offending advertiser, only the publication of an adverse finding on the ASA website and, possibly, some adverse publicity. Offending billboard advertisers may also, like Yves St Laurent, find themselves subject to the ASA requirement for compulsory prior vetting of billboards.

The extent to which the new regulations will have an impact on comparative advertising has yet to be seen, but there appears to be no sign yet of any clear impact or increased reference to the Advertising Standards Authority. It will also be interesting to see the different interpretation of the new rules across the European market, since a number of key aspects of the directive are open to different interpretations.

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Professional indemnity

Employees liability

Employees will constantly be vulnerable to claims brought directly against them for advice given on behalf of their employers, after the House of Lords Appeal Committee refused Leave to Appeal in the case of *Merrett v Babb*.

The Court of Appeal ruled last year that employees are personally liable for professional advice when it considered the case. The Lords subsequently refused leave to appeal and professionals in all walks of life, including accountants, surveyors, independent financial advisers, architects and engineers, could now face potentially ruinous claims. Other individuals who offer specialist advice on behalf of their employers may be similarly exposed.

"Professionals at risk include accountants, insurance brokers, architects, engineers actuaries, IT consultants, advertising agents and IFAs..."

The appeal – which was supported by the Royal Institution of Chartered Surveyors (RICS) – was brought by a Mr John Babb, a member of the RICS. Following the insolvency of his former employer, Mr Babb found himself personally liable for a mortgage valuation which he carried out more than seven years earlier.

The Court of Appeal emphasised that prudent employees, whether professional, or otherwise, would wish to ensure that their employers' insurance covered them personally and that such employees may need to take steps to obtain personal insurance if that cover did not continue after their employment ended.

Key issues

The key issue in *Merrett v Babb* was whether, and in what circumstances, an employee who provides professional or other **specialist advice** on behalf of his employer, assumes a **personal duty of care** to the recipient of that advice or whether he is doing no more than simply performing his contractual duties to his employer.

Factual background

Mr Babb was employed by Clive Walker Associates (CWA), who were instructed to prepare a mortgage valuation by the Claimant's lender Bradford & Bingley (B&B) in 1992. This was carried out by Mr Babb using B&B's standard valuation form. B&B sent the valuation report to the Claimant, stating only that it had been prepared on behalf of B&B by an *"Independent Valuer"*. In 1993 Mr Babb left the firm. In 1994 CWA's Trustee in bankruptcy cancelled the firm's professional indemnity policy and a claim was subsequently pursued against Mr Babb in 1997.

Court of Appeal decision

It was submitted on behalf of Mr Babb that the law had developed since the 1990 House of Lords decision in *Harris v Wyre Forest District Council* and that it had been authoritatively restated by the House of Lords in *Williams v Natural Life Health Foods Ltd* (1998). Lord Steyn held in that case that the touchstone of liability was an assumption of responsibility such as "to create a special relationship with the director or employee", together with "reasonable reliance" by the Claimant on that assumption of responsibility by the individual who performed the services or provided the advice. In *Merrett*, it was argued that there was no factual basis to support such a finding.

Whilst those submissions were accepted by the Senior Judge, Aldour L.J., the appeal was rejected by a two to one majority. It was held that a professional qualified person giving advice may owe a duty of care to the effective recipient of his advice, in addition to the duty owed to his employer. In circumstances where Mr Babb, as a professional man, realised that the purchaser would rely upon him to exercise proper skill and judgement, and signed the original report in his personal capacity, he assumed personal responsibility for it (notwithstanding the fact that the Claimant had never met Mr Babb and the report which the Claimant received did not bear his name).

Implications

The basic principle is that an employee providing advice or services may owe a personal duty to the recipient of that advice in addition to the duty he owes his employers. The ruling will impact upon all sectors and professions where employees give specialist advice to claims on behalf of their employers.

Other professionals at risk include accountants, insurance brokers, architects, engineers, actuaries, IT consultants, solicitors, advertising agents and IFA's. Professional employees will be particularly

"The remuneration which employees receive is not commensurate with the risk of attracting a potentially ruinous personal liability, and such an exposure is unlikely to have ever been contemplated by them."

vulnerable where their firm and company:

- is insolvent or has otherwise ceased trading and has no run-off cover.
- is under-insured and cannot meet the full claim.
- is unable to pay the excess under the policy.
- is unable to obtain an indemnity from its professional indemnity insurers as a result of coverage dispute.

Individual employees have no control over any of these matters. Professionals in small firms or companies are at the greatest risk.

Those risks have also been exacerbated by Court of Appeal decisions in *Brocklesby v Armitage & Guest* (9 July 1999) and *Cave v Robinson Jarvis & Rolf* (20 February 2001), the practical effect of which has been substantially to extend the limitation period in a large number of professional negligence cases.

Employees working for companies are likely to face a greater exposure than those employed by professional partnerships, where the individual partners (particularly in larger firms), are likely to represent a more attractive target. This position is, however, likely to change over the next few years as Limited Liability Partnerships become more commonplace following the Limited Liability Partnership Act 2000. The DTI expect a significant proportion of the several hundred thousand UK partnerships to apply for LLP status over a period in time and this may, in turn, re-focus attention of Claimants on the position of individual employees who provided the advice or services in question.

Protective measures

The remuneration which employees receive is not commensurate with the risk of attracting a potentially ruinous personal liability, and such an exposure is unlikely to have ever been contemplated by them. History shows that those who suffer losses will explore all available avenues to recover those losses from advisers. Corporate failures are now at their highest level for six years and this only serves to heighten the vulnerability of such individuals.

A number of steps can be taken by an employee.

- Check that you are covered under the policy as an "assured". Professional Indemnity policies are now commonly underwritten as composite policies of insurance, that is, they comprise multiple contracts of insurance with each "assured" under the policy (including past, present and future partners, directors and employees).
- Employees could seek an indemnity and "hold harmless" from their firm or company in respect of any liabilities arising from acts or omissions by them during the course of their employment.
- Employers could also seek to agree in their retainer letters and contracts of engagement that the only duties owed to clients (or to any relevant third parties) are owed solely by the firm or company, and that there will be no assumption of personal responsibility by an employee. Such an exclusion will be subject to the reasonableness test of the Unfair Contract Terms Act 1977. Seek specialist advice.

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Intellectual property

Parallel imports and repackaging

Despite decades of case law there is still much uncertainty surrounding the status of repackaged parallel imports within the European Economic Area (EEA). However, the issues may soon be clarified by a forthcoming decision from the European Court of Justice ("ECJ"), *Boehringer Ingelheim & others v Swingward & others.* This is of particular concern to manufacturers who have struggled, largely unsuccessfully, for many years to prevent parallel traders from repackaging their branded products, due to the overriding principle of freedom of movement of goods within the EEA.

"...parallel importers have exploited not only pricing differentials but also the opportunity actively to promote their own brand names by incorporating them into new packaging."

Why is this an issue?

Repackaging by parallel importers is a significant issue because the scale of parallel importation is so large. Because of different economic conditions in different countries and sometimes because of legal and regulatory requirements, the pricing can vary enormously from country to country. Parallel importers take advantage of this by purchasing in a cheap country and selling in an expensive country. In recent years, parallel importers have exploited not only pricing differentials but also the opportunity actively to promote their own brand names by incorporating them into new packaging.

Why is repackaging allowed at all?

Case law (much of it at the highest level in the ECJ) has established that trade marked products can be repackaged by parallel importers if there is a NECESSITY to do so for legal or regulatory reasons. For example, pharmaceutical products placed on the market in Spain by a brand owner and imported for the UK market will have to be repackaged to replace the Spanish language labelling with an English language version. For this purpose, such products have commonly been overstickered following importation. The consumer has typically received from the pharmacist a product bearing the original Spanish outer packaging package with an English language label stickered over any Spanish wording.

Why is the law uncertain?

The current uncertainty has been caused by the meaning of Necessity. It is clear that the brand owner's original packaging may be changed if there is a legal or regulatory reason for the change. However, more recent case law, and in particular the Advocate General's opinion in the *Boehringer* case has referred to Necessity as including other factors which deny effective access to the market in question. In the *Boehringer* case there has been particular focus on the impact of foreign language packaging, with the parallel importers alleging that a sector of the market prefers not to receive overstickered foreign language packaging and much prefers reboxed product. Reboxing involves the removal of the brand owner's original outer

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packaging and the creation of completely fresh outer boxing in the English language into which the foreign product is placed. This is generally disliked by brand owners for the following reasons:

- often their trade mark is removed (known as "debranding");
- often the importer places his own marks on the packaging which may appear in conjunction with the brand owner's mark ("known as co-branding");
- the original product appears to the consumer in boxing which is entirely different from the brand owner's and is not immediately recognisable as such;
- parallel importers are able to build up their own "house style" by reboxing in a similar fashion a variety of different products, which in fact emanate from different manufacturers.

The Advocate General's Opinion

The Advocate General's Opinion in the *Boehringer* case was given in July 2001. His view was that **Necessity** could include widespread and substantial consumer resistance to overstickered product, which had the effect of the excluding the parallel importer from part of the market. It would be up to a national court to determine if there were such resistance. If there were, then repackaging should be carried out in the least intrusive way. Interference with the original pack simply to allow the importer to enhance his own sales should not be permitted.

The Advocate General also confirmed previous case law, which had required the parallel importer to give notice to the brand owner prior to placing any repackaged product on the market. The purpose of this is to allow the brand owner to check the packaging and make any appropriate objections regarding inaccuracies. The Advocate General thought that a period of three to four weeks notice would be appropriate (the English Court having previously suggested only two days, which would be unworkable in practice).

The likely outcome

The ECJ's judgment is expected early this year and is likely to agree with the Advocate General's opinion. Where a clear obstacle to marketing can be demonstrated, reboxing (as opposed to oversticking) should be allowed, but only in the least intrusive way. The question then arises as to how the new box is to appear. It is highly unlikely that co-branding or debranding would meet the requirement of minimal interference. There are at least two possibilities:

- creation of a new box which as closely as possible replicates the brand owner's packaging (with the appropriate notice to indicate that the product has been reboxed); or
- creation of a plain white box giving only compulsory details but no trade mark or brand indications.

It is to be hoped that the judgment in *Boehringer Ingelheim & others v Swingward & others* will provide clear answers which will give much needed certainty both to brand owners and parallel importers, and also encourage consistency in the very many similar cases which are being fought on the same grounds in national courts throughout the EEA.

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Health and safety

Responsibility for corporate manslaughter

Four cases in the last year have demonstrated the effects of recent case law in this area. Meanwhile, the introduction of a new statutory offence of 'Corporate Killing' has been delayed for another year.

The common law of Corporate Manslaughter was clarified by two important decisions in 2000 (A-G's Reference) (no 2 of 1999) (2000 2 All ER 182) and *R v DPP, ex p. Jones* (2000 IRLR 373). The first decision upheld the doctrine of identification as the basis of gross negligence manslaughter, (requiring evidence of gross negligence personally by a *'controlling mind'* - effectively a director - in causing a death). The second decision clarified that a director's lack of *subjective* negligence was not in itself an obstacle to a conviction – the test is an objective one of whether the conduct in question was grossly negligent.

In July 2001 the construction company English Brothers Limited was convicted of corporate manslaughter after a workman fell through a fragile roof. The company was fined £30,000 after pleading guilty. Manslaughter proceedings against a director of the company were dropped.

In August 2001 the Crown Prosecution Service decided not to bring manslaughter proceedings against Leeds City Council or individuals employed in its education services after two children drowned on a school trip without sufficient evidence of gross negligence against any individual the CPS were not prepared to bring corporate manslaughter proceedings.

In October 2001 the Crown Prosecution Service (CPS) announced there would be no manslaughter proceedings brought against Railtrack or other rail companies involved in the Ladbroke Grove Rail Crash. Evidence of management failures already given to Lord Cullen's Public Inquiry was inadmissible in criminal proceedings, but the CPS decided that even if such evidence were obtained in an admissible form it would not be possible to prove that any member of senior management in the companies concerned were personally responsible for any acts or admissions of gross negligence.

"Directors should have received good quality training on the principles of safety management and the main principles contained in the legislation."

In November 2001 Euromin Limited was fined £50,000 at the Old Bailey for health and safety offences after the death of Simon Jones a casual labourer caused by the company's operation of an excavator unloading cargo from a ship. The company, and its general manager, were acquitted of the manslaughter charges brought against them. The case followed the successful judicial review case referred to above was brought by campaigners when the DPP was ordered to reconsider an earlier decision not to prosecute. After the acquittal the DPP again criticised the existing law and called for the introduction of the new Corporate Killing offence.

Proposals for a new statutory framework for the law of manslaughter, including the new Corporate Killing offence, were published by the Home Office in May 2000. Corporate Killing would apply to all organisations (whether or not incorporated) and would have the following elements:

- a *'management failure'* of an *'undertaking'* is the cause or one of the causes of a person's death; and
- the management failure would have to constitute *'conduct falling far below what can reasonably be expected'* of the undertaking in the circumstances; and

There would be a management failure by an undertaking if '*the way in which its activities are organised or managed fails to ensure the health and safety of persons employed in or affected by these activities'*.

John Gilbert, Minister of State at the Home Office, indicated earlier this year that the earliest a Bill could be expected is the Parliamentary session starting in November 2002. However, the possibility is not being ruled out that the legislative programme before then might be modified to include such a measure.

The existing law is viewed by the DPP as making it much harder to secure convictions of large disparate organisations than small companies effectively run on a day to day basis by their directors. This will not be true of the 'Corporate Killing' offence when it is introduced. Organisations (and their directors) wishing to guard against the possibility of possible prosecution for the new offence can really only strive to improve further existing health and safety management arrangements. Attention

> **"The existing law is viewed by the DPP as making it much harder to secure convictions of large disparate organisations than small companies effectively run on a day to day basis by their directors. This will not be true of the 'Corporate Killing' offence when it is introduced."**

should be given to the following:

- The organisation should have a defined Safety Management System broadly based on published principles such as those contained in the Health and Safety Executive's Guidance *'Successful Health and Safety Management'* (HS (G) 65) and BS 8800.
- High level responsibilities of directors and other senior managers should be carefully defined in the Safety Policy in a way that is consistent with recommendations contained in the HSC Guidelines on *'Directors' Responsibilities for Health and Safety'* published in July 2000.
- Directors should have received good quality training on the principles of safety management and the main principles contained in the legislation. (The Institution of Occupational Safety & Health (IOSH) accredits providers with an established track record to deliver its *'Safety for Senior Executives'* course).
- A legal compliance review can be undertaken to identify potential breaches of statutory requirements and to recommend appropriate action; when carried out by the in-house legal department or external legal advisers such a review can be subject to legal professional privilege and the report may not be disclosable to any investigating authority.
- Boards of Directors or equivalent governing bodies need to consider the implications of the HSC's recent Guidelines on public reporting of organisations' health and safety performance, including accident and enforcement data. Internal reporting requirements for the board need to be aligned with these requirements because they provide an indication of the expectation of the degree of detail at which monitoring of the organisations' activities should be undertaken.
- Particular attention should be given to lessons that may be learned from accidents, near misses and reports of occupational ill-health. It is expected that a new statutory duty to investigate accidents will be created in 2002, and if directors have not ensured that any actions arising out of investigations have been followed up they and the organisation could be vulnerable to a charge of management failure.
- Policies for engaging contractors and providers of out sourced services should be reviewed: duties of care on employers, contractors are being interpreted increasingly strictly in this area.
- Any M&A transactions need to have health and safety issues dealt with in due diligence, not just to identify potential threats of enforcement action and substantial finds, but also to determine if significant changes are required to corporate governance arrangements for safety and risk management.

Further information

HSE Guidance on Directors' Responsibilities:
www.hse.gov.uk/pubns/indg343.pdf

HSC Guidelines on Annual Reports:
www.hse.gov.uk/revital/annual.htm

Home Office Corporate Killing proposals:
www.homeoffice.gov.uk/consult/invams.pdf
and see critique by CMS Cameron McKenna in the Law-Now archive.

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Corporate social responsibility

A serious business issue

Businesses of all sizes increasingly need to demonstrate their ethical behaviour to stakeholder groups. The risks to business from failure to meet society's expectations are growing, just as the pressure from stakeholder groups to be open about business ethics is being ratcheted up. However, there is also a growing body of evidence suggesting that business makes worthwhile gains from effective management of social responsibility issues.

The most significant issues in corporate social responsibility ("CSR") are human rights, labour conditions and environmental impact. The risks range from direct financial penalties such as fines for illegal acts, through lost sales or increased costs, to staff recruitment and retention problems and consumer boycotts. Companies which have a poor record will also find themselves paying a higher price for their capital, losing shareholder value, and ultimately perhaps being taken over or becoming insolvent.

"...growing numbers of mainstream institutional investors now also want assurances that investees are fully aware of CSR risks and have effective management systems to deal with them."

Pressure for change for openness on CSR comes from the usual suspects such as the OECD, Governments and NGO's, but growing numbers of mainstream institutional investors now also want assurances that investees are fully aware of CSR risks and have effective management systems to deal with them. Businesses are also increasingly at risk from "whistle blowing" by employees and investigation by aggressive NGO's and news media.

The issues

CSR is now played for high stakes. Some examples from 2001 show this: Exxon faced a boycott campaign because of its stance on global warming; major pharmaceutical companies (in particular Glaxo Smithkline) became embroiled in a damaging controversy (and litigation) with South Africa over their patents on AIDs drugs; Nike and GAP had problems following a television exposé of working conditions at their Cambodian suppliers.

Back home, Balfour Beatty and Railtrack suffered greatly over rail safety and MacDonald's received much adverse publicity when one of its franchisees in Surrey was convicted of illegally employing school age workers. Farming suffered badly from practices exposed during the recent outbreak of Foot and Mouth disease.

The pressure

Pressure is building on business from a range of guidelines which have recently come into being. In October 2001 the OECD Guidelines for Multinational Enterprises was issued and in July 2001 the Commission of the European Communities issued its own green paper "Promoting a European Framework for Corporate Social Responsibility" and a communication on "Promoting Core Labour Standards and Improving Social Governance in the Context of Globalisation".

Professional and private investors are increasingly concerned about CSR. There is increasing public awareness of CSR issues

"Shareholder value is increasingly at risk and, ultimately, so is the fate of the business itself."

and a willingness to take action in pursuit of these ends, as witness anti-globalisation protests, consumer boycotts and the growth of ethical investment funds. Investment is increasingly driven by these concerns. This has been partly fuelled by new requirements for investment policy disclosure by pension funds in the UK, France, Germany and Sweden. In the UK, this has been even further reinforced by the requirement for pension fund trustees to consider and establish a policy on ethical investing. The ABI, the trade body representing the British Insurance Industry, introduced their own disclosure guidelines on social responsibility in late 2001.

More and more investment managers are offering socially responsible investment products and, in London, there is now the "FTSE4 Good" indices to facilitate this as well as other indices such as the Dow Jones Sustainability indices. Investors increasingly seem willing to pay a premium for "ethical" stocks so exclusion from an index could well be costly.

The risks

Shareholder value is increasingly at risk and, ultimately, so is the fate of the business itself. Monsanto, the GM food pioneer, lost its independence, arguably as a result of mishandling the wider social and environmental concerns about its GM products in Europe which led to its stock market rating falling. Businesses which cannot demonstrate good CSR credentials are also increasingly at risk of being frozen out of lucrative business opportunities. Aspects of CSR are increasingly featuring in tender conditions issued by the public and private sector alike. In the UK, for example, non-discriminatory employment practices is now a common condition.

Access to capital is also increasingly coming under threat for businesses which do not embrace CSR principles.

Our domestic courts are now more willing to allow foreign-based employees of British multinationals to sue here, and the availability of conditional fees means there are lawyers prepared to act for them so, for example, African employees have access to British Justice, with all that implies.

The benefits

The broad business case is that businesses can improve profits by addressing CSR effectively and should not rely on risk management on the assumption that most risks will not materialise. The opportunities to create value from CSR include:

- harmonising business practices with stakeholder expectations to produce net benefits for all parties
- less fire fighting by taking a strategic approach
- lower costs from cutting waste
- higher sales from more satisfied customers
- higher productivity and quality
- lower risk in acquisition and divestment through better due diligence and better management of the sale or purchase process
- reduced share price volatility.

Conclusion

CSR is no longer an optional extra for business. Although multinational enterprises and other businesses which have a high impact on the environment, human rights and labour conditions are particularly vulnerable, in fact all business are susceptible and need to have policies and risk management systems in place and operating effectively now.

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Banking fraud

Letters of credit and performance bonds

It is a well-established principle that a bank is obliged to pay a beneficiary under a letter of credit if the documents, on their face, conform to the requirements of the letter of credit, irrespective of any underlying dispute between the seller and buyer.

The exception to this rule was described as follows by Lord Diplock in *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1982] A.C. 169:

> *"To this general statement of principle as to the contractual obligations of the confirming bank to the seller, there is one established exception: that is, where the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue".*

The application of this fraud exception has been considered in a number of recent cases.

"It is a well-established principle that a bank is obliged to pay a beneficiary under a letter of credit if the documents, on their face, conform to the requirements of the letter of credit, irrespective of any underlying dispute between the seller and buyer."

Banco Santander SA v Banque Paribas

Is a confirming bank, which has discounted a deferred payment letter of credit, entitled to reimbursement where allegations of fraud are made after the payment is made, but prior to the date of reimbursement?

Banque Paribas had issued a letter of credit that was available by deferred payment, payable at 180 days from the date of the bills of lading. The credit was advised and confirmed on 8th June 1998 to the beneficiary, Bayfern Ltd, by the confirming bank Banco Santander.

Banco Santander accepted the documents from Bayfern, but in accordance with standard practice, did not wait the 180 days until maturity and made a discounted payment to Bayfern on 8th June 1998. Bayfern assigned its rights to payment under the credit to Banco Santander.

On 24th June 1998, Banque Paribas informed Banco Santander that the documents presented by Bayfern included false documents and notified Banco Santander that they would not be making reimbursement at maturity. For the purpose of a preliminary issue, an assumption was made that Bayfern had made a fraudulent presentation which would have entitled Banco Santander to refuse payment had it had notice of the fraud at the time.

At first instance the court decided in favour of Banque Paribas; the Court of Appeal held as follows:

- As assignee of Bayfern's rights under the credit, Banco Santander could be in no better position than Bayfern and so

"A consequence of the judgment is that paying banks are likely to be faced with increasingly difficult decisions..."

Banque Paribas was entitled to refuse to reimburse Banco Santander in respect of its claim as assignee.

- Banque Paribas was also entitled to refuse reimbursement on the ground that Banco Santander's mandate was to pay the beneficiary at maturity. Banco Santander therefore took the risk that if evidence of fraud came to light before maturity the issuing bank would be entitled to refuse to reimburse.

The decision was controversial since, as both parties accepted, it was common practice in London for confirming banks to discount deferred payment credits. Now, confirming banks are well advised not to discount such credits unless they have express authority to do so from the issuing bank.

Solo Industries UK Ltd v Canara Bank

What is the standard of proof where a beneficiary calls on a guarantee, but a fraud is alleged in the underlying instrument?

This case involved a performance bond, but it equally applies to letters of credit. Here, in defending a claim by Solo for summary judgment, the paying bank (Canara) sought to rely on fraud in the underlying documents. When asserting that a fraudulent demand has been made, the paying bank is put to a strict test. In *United Trading Corporation v Allied Arab Bank Ltd* [1985] 2LLR.552 that test was stated as follows:

> *"If the court considers on the material before it that the only realistic inference to draw is that of fraud, then the seller would have made out a sufficient case of fraud".*

Canara Bank was, rightly as it turns out, concerned that the evidence of fraud in this case was insufficiently strong to pass the "only realistic inference" test. Instead they argued that the bond had itself been procured by fraud. The Court of Appeal upheld Canara's submission that where the challenge was to the validity of the bond itself, rather than to the demand under it, it was sufficient for Canara to show that it had a real prospect of success at trial in accordance with CPR Part 24.

The decision is controversial as it appears to make it easier for banks to raise fraud as a defence to claims for payment under performance bonds (and by extension other instructions including letters of credit). It is difficult to avoid the conclusion that the court was influenced by the unusual facts of the case including the evidence of the related fraudulent activities of the Hamco companies. A consequence of the judgment is that paying banks are likely to be faced with increasingly difficult decisions as to whether they are obliged to pay when the evidence of fraud falls short of the "only realistic inference" test, but may point towards fraud in the underlying instrument.

Similar issues arose in Safa Ltd v Banque du Caire

Here the court held that if the bank could establish a real prospect of proving that the demand was fraudulent (even though there was no such evidence at the time of the demand) or that there was a misrepresentation by the beneficiary persuading the bank to enter into the letter of credit, it may be unjust to enter summary judgment against the bank.

Although the Court of Appeal highlighted the unusually close relationship between the bank and beneficiary and

the bank's role in a related transaction in this case, this decision opens the gates slightly further for banks wishing to refuse payment by allowing challenges where there is no unmistakable evidence of fraud by the beneficiary. This is, of course, a double-edged sword since the greater latitude it gives to refuse payment has to be off-set against the reduction in certainty from which banks draw comfort, knowing that in the absence of clear evidence of fraud by the beneficiary there is an unequivocal obligation that they will be paid.

Montrod Ltd v Grundkotter Fleischvertriebs – GmbH and another

What is the position where it is alleged that the documents are a "nullity"?

The general rule is that the fraud exception applies where there is clear and unmistakable evidence that the beneficiary has made a fraudulent demand. But what is the position when the bank has no evidence that the beneficiary was involved in the fraud, but that the documents themselves are a nullity?

Usually the innocence of the beneficiary will prevent the bank from invoking the fraud exception. In *United City Merchants v Royal Bank of Canada* the House of Lords held that the fraud exception did not apply since the beneficiary had not known at the time he presented the documents, that the bill of lading had been falsely dated.

"...the fraud exception should not be extended to situations where, although the document may be forged, the beneficiary was innocent."

In the Montrod case, the letter of credit called for inspection certificates to be signed by Montrod. The applicant (who had instructed Montrod to procure the letter of credit) wrongfully led the beneficiary to believe that it, the beneficiary, had authority to sign the certificates on behalf of Montrod. The beneficiary presented the certificates unaware that they had not in fact been signed with Montrod's authority.

Jack J rejected the argument that a bank can refuse to pay the beneficiary because there is evidence that one of the documents is forged and a nullity, where there is no evidence that the beneficiary had acted fraudulently. There was no authority to support the existence of a nullity exception, which would be "contrary to the fundamental principle that banks consider the documents alone and should not take account of other matters, in particular disputes between applicant and beneficiary".

The Court of Appeal has upheld the decision stating that the fraud exception should not be extended to situations where, although the document may be forged, the beneficiary was innocent. On the facts of Montrod, the result is unsurprising. It remains to be seen whether, in future cases involving more fundamental allegations about the validity of the document, a court might be willing to take the concept of a nullity exception further.

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Financial services

New powers and regulations

The new regulatory regime established by the Financial Services and Markets Act 2000 ("FSMAct 2000") took effect from "N2", midnight on 30 November 2001. From N2, the Financial Services Authority ("FSA") has assumed new powers and the regulatory system has changed. The new statutory regime is subject to four objectives, namely market confidence, public awareness, consumer protection and the reduction of financial crime. Rather like the overriding objective governing the Civil Procedure Rules, FSA will have to take account of and try to balance these objectives in carrying out its functions.

Key changes introduced by the FSMAct 2000 include the following:

- New Conduct of Business rules;
- New financial promotion (advertising) regime;
- New monitoring regime, with risk-based monitoring and different levels of monitoring for different types of firms depending on their type of business;
- New enforcement and disciplinary regime;
- New powers to discipline and prosecute for market abuse;
- Extended ambit of responsibilities, including money laundering;
- New scope, focusing on senior management and individual responsibility;
- FSA is subject to statutory controls and endowed with statutory powers.

As with the old regulatory regime, firms need to obtain authorisation for carrying out certain investment activities within the United Kingdom. In addition to the specific rule changes, the main effect of the FSMAct 2000 is the change in focus, requiring firms and in particular senior management to take front-line responsibility for the day-to-day business, rather than seeking to rely on compliance staff or even on the regulator to detect and deal with problems. The next year is likely to be eventful as the new regime is bedded down and as firms and FSA itself become used to the new system. Likely developments in 2002 arising from this may include the following:

- FSA will be looking for an early opportunity to flex its new muscles, particularly on market abuse or money laundering. This would be consistent with one of its statutory objectives, the reduction of financial crime;
- FSA will explore new themes for consumer protection, which are likely to include pension provision (following Equitable Life) and the continuing review of endowments;
- FSA will expect management within firms to demonstrate a clear and appropriate apportionment of responsibility; The number of cases of disciplinary action brought against individuals for management failings is likely to increase;
- New disciplinary procedures involving the possibility of mediation as well as an automatic right for a public rehearing before an independent tribunal may increase the number of contested disciplinary actions;
- Mediation may be particularly attractive to firms given that the mediator may help break down FSA's tendency to take an entrenched position and so improve the prospects of reaching a negotiated settlement;
- The new appeals tribunal may be used more frequently because of the improved position on costs: state-funded legal assistance may be available for an individual appearing before a tribunal on market abuse charges. In addition, appellants will normally only have to pay their own costs, even if unsuccessful, and may obtain a costs order against FSA if the tribunal decides that FSA's original decision was unreasonable. On the other hand, the increased formality of the tribunal procedure and the expectation that hearings will be public may well discourage appeals to the tribunal;
- Certain of the new powers are likely to be tested, including FSA's power to force firms to appoint third party investigators, and the right for defendants in disciplinary proceedings to inspect FSA's documents. Challenges to the new regime can be expected where the extent of FSA's new powers is unclear, whether by application for judicial review or by appeal to the independent tribunal.
- Following criticism of the FSM Act 2000 in its draft form, FSA's powers as set out in the FSM Act 2000 are likely to be tested for their compatibility with the Human Rights Act. In April 2001, the court decided that the use before the tribunal of evidence obtained by the regulator under its compulsory powers was not in breach of article 6 of the European Convention on Human Rights. The decision was affirmed on appeal (R *(on the application of Fleurose) v Securities and Futures Authority)*. Further challenges are expected to follow.

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