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In Dispute

Review of Developments from Dechert's London Dispute Resolution Practice

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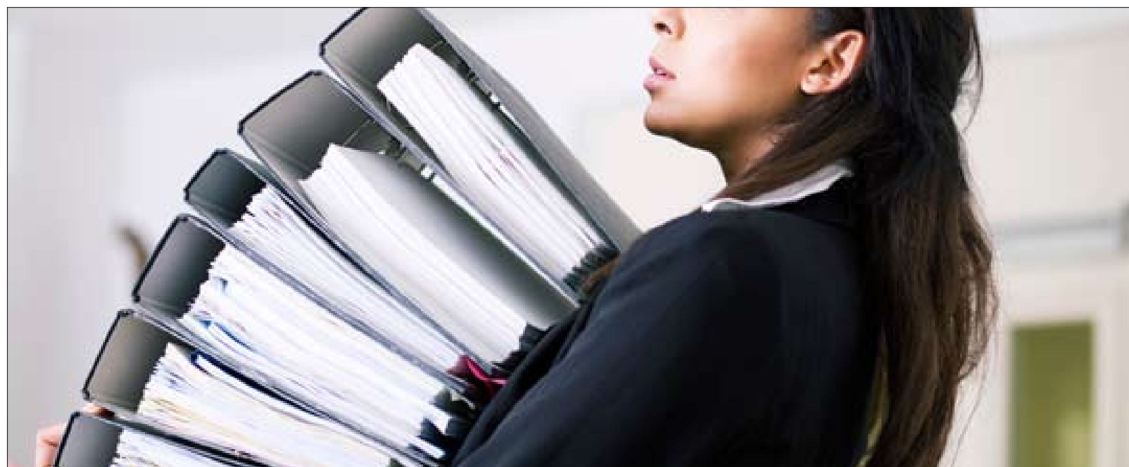

The Limits of In-House Lawyers' Privilege

Legal professional privilege protects the confidentiality of communications made between a lawyer and his or her client. The rationale behind this important principle recognised in all EU States is that it allows detailed and frank disclosure by clients to their lawyers.

However, the European Court of First Instance ("CFI") has delivered a blow to the role of in-house lawyers in the recent case of *Akzo Nobel Chemicals Ltd and Akcros Chemicals Ltd v European Commission*.

The result of the case is that whether companies have the protection of legal professional privilege in European Commission investigations depends on whether they receive internal or external legal advice.

Facts of Case

The case concerned a dispute about the status of documents seized by the European Commission during a dawn raid of an Akzo Nobel subsidiary in the UK. The raid was carried out to search for evidence as part of an investigation into suspected breaches of competition law.

The Disputed Documents

The first two documents (labelled by the court Set A documents) consisted of:

- a memorandum by the general manager to his superior for the purpose of seeking external legal advice; and
- a photocopy of the memorandum with additional handwritten notes relating to contacts with an external lawyer.

The other three documents (Set B documents) comprised:

- a number of handwritten notes relating to the preparation of the above mentioned memorandum; and
- e-mails between the general manager and Akzo's in-house lawyer.

The Court of First Instance Decision

The CFI held that documents will be privileged for the purposes of EU Competition Law if they are:

- communications made for the purpose of a company's right of defence sent to

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or received from an independent (not in-house) lawyer;

- documents made for the exclusive purpose of seeking this advice; or
- documents made for the exclusive purpose of reproducing this advice.

The Court ruled that the Set A documents were incapable of being privileged, as they were not documents prepared for the sole purpose of seeking external legal advice. The documents in Set B were also found not to be privileged as they were communications made with an in-house lawyer, who is not to be considered independent.

Procedure Where the Status of a Document Is Disputed

The Court also gave useful guidance as to the powers of the Commission when conducting an investigation. If during a raid a company claims that a document is privileged, it may be justified in refusing to allow the European Commission investigators to take even a cursory glance at the document, although it must give reasons for such a refusal. If the Commission feels that the documents are not privileged it may use the "sealed envelope procedure". This allows the investigators to place a copy of the document, which they are not initially allowed to review, in a sealed envelope until its non-privileged status can been confirmed. An independent member of the Commission, not involved in the investigation, will make an initial judgement. If the company disagrees with the outcome it will be able to appeal it before the EU courts.

Significance of the Decision

Although this decision reaffirmed the European Court of Justice's conclusion in the 1982 case of *AM&S Europe*, the Commission has come under increasing pressure over the years to reconsider its position, particularly since many member states have extended legal privilege to in-house lawyers under their national laws.

Under English law however, in-house lawyers can usually claim privilege over their communications with officers of their company. However, this privilege will not apply during investigations by the European Commission.■

Akzo Nobel Chemicals Ltd and another v European Commission (Cases T-125/03 and T-253/03) [2007] All ER (D) 97 (Sep)

The Fraud Act Applied

The Fraud Act 2006, which came into force at the start of this year, introduced for the first time a new general offence of fraud. The Court of Appeal has recently explored one of the provisions of the Act which will be of relevance to victims of fraud and creditors generally.

The law has traditionally recognised the right of a defendant in civil proceedings to refuse to answer questions put to him, if answering would expose him to a risk of prosecution for a criminal offence. This is the so-called privilege against self-incrimination which, while it is a fundamental right, can produce very unfair results for a claimant. If, for example, a company has been defrauded by one of its employees and attempts to locate its assets by way of civil proceedings against someone who might have that information, the respondent has previously had the right not to answer any questions, if he would risk prosecution.

This imbalance has been chipped away by various pieces of legislation, and numerous judges have called for more sweeping reforms. At last, in the area of fraud offences, the position seems set for a change. The introduction of Section 13 of the new Fraud Act 2006 provides that a person cannot refuse

to answer questions put to him in proceedings relating to property on the basis that doing so would expose him to a risk of prosecution for fraud offences, or offences involving fraudulent conduct or purpose. However, any statement or admission he makes may not be used in evidence against him.

The first Court of Appeal decision on this important provision came in *Kensington International v Republic of Congo and Vitol Services Limited and others*. The claimant ("K") was a judgment creditor of the Republic of Congo. K applied to the Court for an order compelling the respondents ("V") to disclose documents and information relating to payments made by V to Congolese officials by way of bribes. V claimed the privilege against self-incrimination, on the basis that if such information were disclosed, it would expose them to a risk of prosecution for corruption offences and/or offences under the Proceeds of Crime Act 2002. Both the Court at first instance and the Court of Appeal held that the provisions of S.13 prevented V from claiming the privilege.

Among the key points in the judgments are the following:

- Parliament has clearly chosen to abrogate the privilege in relation to a specific class of offences, and has provided for a balance of competing interests. Courts do not need to take a further, particularly strict approach to construction.
- 'Proceedings relating to property' should not be constrained artificially as a phrase, and can include proceedings for recovery of a debt.
- Separate proof of dishonesty is not necessary in order to show that an offence involves fraudulent conduct or purpose.

This is a robust judgment and an important one, in that it adds significantly to the weapons in the armoury of victims of fraud or claimants seeking to recover a debt. The Court has shown for some time that it is willing to assist such litigants, and Parliament has at last provided it with the tools to do so.

Dechert acted for the successful claimant. V have petitioned the House of Lords for permission to appeal the judgment.

Kensington International Limited v Republic of Congo and Vitol Services Limited and others [2007] EWCA Civ 1128

Boost for Arbitration

Many contracts, including investment banks' agreements and terms of business include arbitration clauses. The House of Lords has recently upheld an earlier decision marking a liberalisation in the way arbitration clauses are interpreted by the courts which will interest those agreeing to such provisions. The decision has confirmed that the courts support the concept of "one stop" arbitration; once the parties have agreed to submit disputes under a contract to arbitration, so far as possible all issues in dispute are to be resolved by arbitration rather than the court.

Facts

In *Fiona Trust & Holding Corp v Yuri Privalov & Ors*, eight charterparties were concluded by shipowners in the Russian Sovcomflot fleet. The charterparties contained provisions which according to an expert report, were "unbelievably generous" and "completely inconsistent with market practice". It was alleged that the contracts had been procured by bribery.

The charterparties contained a "law and litigation" clause, which provided that any dispute arising under the contracts would be decided in an English court but also entitled either party to refer any dispute to arbitration in London.

The shipowners issued court proceedings to seek confirmation that the contracts had been rescinded as being invalid. However, the charterers commenced arbitration proceedings. To decide which set of competing proceedings should take precedence the court had to decide two key issues:

- Interpretation – did a claim that the contracts had been rescinded for bribery fall within the arbitration clause?

- Separability – did the challenge to the validity of the contract also challenge the validity of the arbitration clause?

Interpretation

The House of Lords held that the dispute as to whether the contract could be set aside for bribery did fall within the arbitration clause. In the context of international commercial contracts, the ambit of any arbitration or jurisdiction clause should be liberally construed due to the comparative ease with which one party could expressly exclude particular issues as falling within the arbitration clause. The starting assumption is that commercial parties who include an arbitration clause intend all disputes relating to that agreement to be dealt with by arbitration.

The Lords confirmed that a line should be drawn under previous case law, which had introduced fine distinctions depending on the precise wording of the relevant clause (lawyers have previously enjoyed arguing whether an arbitration clause covering disputes "arising out of a contract" was wider than one covering disputes "arising under a contract").

Separability

The Lords held that an arbitration agreement that is intended to form part of another agreement shall not be regarded as invalid, non-existent or ineffective because that other agreement is invalid. It is a separate contract which survives the destruction of the main contract.

In this case, for the arbitration clause to be challenged, it was not enough to say that the bribery impeached the contract as a whole. The court required (but did not find) some special reason for why the bribery impeached the arbitration clause in particular. Therefore, although the shipowners were arguing that the contracts were rescinded, they had to determine this issue under the mechanism set out in the arbitration clause within those contracts.

Implications

The decision indicates an awareness of the commercial reality of the way these agreements are intended to work. Where parties intend that arbitration should not be an option in certain circumstances, those exceptions should be set out plainly in the agreement.■

Fiona Trust & Holding Corporation and others v. Privalov and Others [2007] UKHL 40

Disclosure Obligations and the FSA

The important decision of the Court of Appeal in *Real Estates Opportunities Ltd v Aberdeen Asset Managers Jersey Ltd and others* tackles the relationship between disclosure obligations and confidentiality provisions in Sections 348 and 391 of the Financial Services and Markets Act 2000 (FSMA). This guidance is welcome because a breach of Section 348 is a criminal offence.

The FSA's Powers

The FSA's powers include the ability to require an authorised person to provide to the Authority information or documents. FSA investigators may require an individual to answer questions during an interview. As part of this process, confidential information may be put to the individual and that information may then appear as part of a warning notice issued to the individual, his or her employer or both.

Broadly, S.348 FSMA 2000 provides that confidential information obtained from the FSA must not be disclosed to others without the consent of the FSA or the person to whom the information relates. Confidential information is defined as information which relates to the business or other affairs of any person and which was received by the FSA in the performance of its functions. S.391 prohibits the publication of a warning notice or any details about it.

The Facts

Real Estate Opportunities Ltd (REO) floated with a split capital structure in 2001. Later that year, the splits market collapsed and REO sued Aberdeen and UBS for negligence and breach of contract in connection with the flotation. The FSA investigated the splits collapse. During the investigation, it interviewed employees of Aberdeen and UBS. Both companies were later provided with transcripts of these interviews and disclosed their existence to REO in the litigation. REO asked to inspect the documents.

Aberdeen and UBS withheld inspection on the grounds that:

- despite the fact that the documents did no more than record information provided by employees of Aberdeen and UBS to the FSA, disclosure was prohibited pursuant to S.348; and

- even if documents could be redacted and then disclosed, the redaction would be so extensive as to render inspection disproportionate.

REO challenged this and successfully applied to the court for an order that inspection be permitted.

Aberdeen and UBS appealed the decision.

The Issues

- *Did Aberdeen and UBS "obtain" the information in documents received from the FSA, even if it already has that information?*

  No. A person cannot be said to "obtain" information from the FSA for the purposes of S.348 if he already has that information. The judge at first instance had noted in his judgment that the purpose of S.348 was to protect sources of information and encourage whistleblowing and that this would not be affected in this situation as the whistleblower would already be known to the employer. "No obvious purpose [is] served by restricting the disclosure of information already known to a person simply because it is recorded in a document supplied by the FSA".

- *Is information known by a company's employees also deemed to be known by the company?*

  Yes. The Court of Appeal said that the normal rules of "attribution" apply. Thus, an employer is deemed to know all the information learnt by its employees during the course of their employment.

- *Was the High Court Judge mistaken in ordering that the documents be inspected subject to redaction?*

  No. The Court of Appeal agreed with the original judge, who held that the balance between the likely value of the documents as against the problems caused by redaction favoured an order for inspection. He further noted that the company would have a defence to any criminal proceedings arising out of breach of S.348 so long as it exercised reasonable precautions and due diligence.

- *Would the order for the inspection of warning notices result in publication of them contrary to S.391 FSMA 2000?*

  No. A court could take the relevant steps to ensure that references to warning notices in proceedings are not made in public.

The Court of Appeal dismissed the appeals.

Conclusion

This decision has significant consequences for companies who may be subject to FSA investigations. In the context of interviews with employees, most if not all the information supplied by that employee to the FSA will have been learned during his employment. This means that this information is:

- deemed to be known by the employer;
- outside the scope of S.348; and
- if relevant, therefore open for inspection.

Unfortunately, potential litigation is not the only cause for concern. Complying with S.348 requires careful consideration of each document, and companies will not be surprised to learn that putting in place the "reasonable precautions" required by S.348, including the redaction of documents when appropriate, may be costly. But with a criminal penalty, the cost of failure to take reasonable precautions could be even greater.

Real Estates Opportunities Ltd v Aberdeen Asset Managers Jersey Ltd and others [2007] EWCA Civ 197

Recovery of Compound Interest

We reported in the last issue of *In Dispute* ("Recovering Mistaken Tax Payments") the House of Lords' decision in *Deutsche Morgan Grenfell Group PLC v HM Commissioners of Inland Revenue and another* that certain companies that paid advanced corporation tax as a consequence of a mistake of law were able to recover those payments from the Treasury. In a further blow to the Treasury, the House of Lords in *Sempra Metals Limited v HM Commissioners of Inland Revenue and another* held that those companies are also able to recover compound interest in respect of the mistaken payments. This significant decision is not only relevant to restitutionary claims but has much broader implications.

The Lords ruled that the courts had power to award compound interest in a claim for restitution. However, there was no unanimity of view as to the basis on which the interest on restitution claims was to be recovered and calculated and difficult issues remain to be explored in future cases.

Perhaps more importantly, although not strictly a binding part of their decision, the Lords all agreed that compound interest is recoverable as damages for breach of contract or in a claim in tort. Any claims for compound interest would have to be specifically pleaded and the loss proved and shown not to be too remote. Accordingly compound interest is more likely to be claimable in a sophisticated refinancing transaction than in a case where a householder pays a builder's bill late (where the parties are unlikely to have contemplated that compound interest would be payable).

Accordingly, in many cases it will remain appropriate only to claim simple interest. Claimants will still be entitled to claim pre-judgment interest under Section 35A of the Supreme Court Act 1981 or under the Late Payment of Commercial Debts Act 1998, which do not allow for compounding but which are easier to recover.

However, the decision allows, in appropriate cases, claims for compound interest as damages which will allow commercial claims to reflect more closely the actual losses suffered.

Sempra Metals Limited v HM Commissioners of Inland Revenue [2007] UKHL 34

Cap on Financial Ombudsman Awards

The High Court earlier this year determined that the Financial Ombudsman Service (FOS) does not have the power to make directions which require a payment in excess of £100,000.

The Statutory Framework

The FOS was established under the Financial Services and Markets Act (FSMA) as a means by which disputes could be resolved quickly and with the minimum formality. Under FSMA, the FOS has the ability to make "money awards" and/or directional awards. There is a maximum cap on money awards set, from time to time, by the FSA, which is currently £100,000. Above this level, awards made are not binding on the respondent, although the FOS can recommend the respondent comply with them.

The prevailing view, prior to the High Court decision was that the cap had no application where FOS made a direction as opposed to a money award. For example, a direction that a firm take steps to purchase an annuity for a client was not treated as being subject to the £100,000 cap notwithstanding the fact that the effect of the direction was to require the firm to pay money for the benefit of the complainant.

The Facts

In the relevant case, the FOS had given directions which, if followed, would have resulted in a financial penalty to the respondents in excess of the cap on money awards. Both the complainants had received unsuitable advice regarding the transfer of their occupational pension benefits upon leaving their former employers. Both respondents were directed

by the FOS to make redress for their incorrect guidance.

The directions in this case would have resulted in a liability of £228,055 and £1.9 million respectively. The respondent firms paid the Claimants £100,000 but refused to comply with directions to the extent that they required them to expend costs in excess of the cap. The Claimants sought injunctions to enforce the directions. Their applications were refused.

The Decision

The court ruled that when making awards, it was the substance of the award, not the form it was expressed in which determined whether it was a money award or a directional award. If the award resulted in a payment being made to advantage of the complainant then it would be seen as a money award, regardless of how it was expressed. FOS does not have the power to make a direction that would require a firm to make a payment that exceeds £100,000.

If the costs of compliance with a direction are unknown at the time the direction is made, it is subject to the implicit limitation that will not be enforceable once the £100,000 limit is reached. The court pointed out that it was open to the FSA to increase the cap if it was felt it was necessary to do so. The FSA consulted publicly on whether the £100,000 cap for money awards was sufficient and found "no case for change".

The court also held that the firms were not precluded from running this argument as a result of their failure to challenge the original order by way of judicial review.

Bunney v Burns Anderson plc and Cahil v Timothy James & Partner [2007] EWHC 1240 (Ch)

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