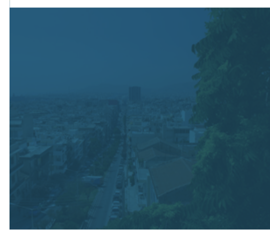
Dispute Resolution

November 2014



Welcome to the November edition of our Dispute Resolution Bulletin.

In our first article this month, Associate Clare Chyb considers the implications of the recent decision in *Unaoil Limited v Leighton Offshore Pte Limited*. In its judgment, the English Commercial Court refused to enforce a liquidated damages clause because following a supplementary agreement between the parties to reduce the overall contract price, it no longer constituted a genuine pre-estimate of loss.

Next, Professional Support Lawyer Sîan Knight reflects on how to make effective use of court support for arbitration, particularly in Hong Kong and England.

Finally, Associate Michael Harakis reflects on the decision in *Starlight Shipping Company v Allianz Marine & Aviation Versicherungs AG* and in particular, the interpretation and drafting of settlement agreements.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

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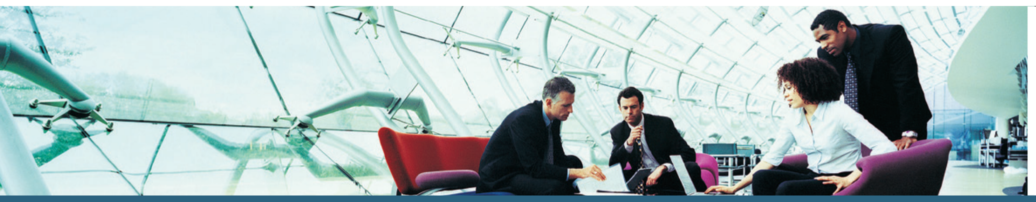

Liquidated damages provisions in jeopardy: an unexpected consequence of amending the contract

When a contract price is lowered by agreement between the parties, this may have an unexpected effect on the enforceability of any liquidated damages provision in the contract.

...because the parties had not adjusted down the liquidated damages provision when they entered into the supplementary agreement which reduced the contract price significantly, it could not find that US$40 million was a genuine pre-estimate of Unaoil's loss at the time the MOA was amended, which was the relevant time.

CLARE CHYB, ASSOCIATE

In *Unaoil Ltd v Leighton Offshore Pte Ltd* (12 September 2014), the English Commercial Court would not allow a claim for liquidated damages on the basis that, whether by intention or mistake, the parties did not adjust the liquidated damages provision in the contract when they agreed to lower the contract price, with the result that the provision no longer constituted a genuine pre-estimate of loss.

When deciding whether a liquidated damages provision is a penalty, the Court should take a view as at the date of the contract. Recognising that there was no previous authority to this effect, the Court held that it should follow and is consistent with this general principle that where the contract is amended "in a relevant respect", the relevant date should be the date of the amended contract.

The defendant (*Leighton*) entered into a Memorandum of Agreement (MOA) with the claimant (*Unaoil*) under which Unaoil would supply certain onshore services as sub-contractor for an oil pipeline project in Iraq in return for a contract price of US$75 million. Leighton was bidding to be the main contractor on the pipeline in a tender process with the Iraqi state-owned oil company South Oil Company (SOC or Client).

The MOA contained the following liquidated damages provision:

"If LEIGHTON OFFSHORE is awarded the contract for the PROJECT by the Client, and LEIGHTON OFFSHORE does not subsequently adhere to the terms of this MOA and is accordingly in breach hereof, LEIGHTON OFFSHORE shall pay to UNAOIL liquidated damages in the total amount of USD 40,000,000 (Forty million US dollars). After careful consideration by the Parties, the Parties agree such amount is proportionate in all respects and is a genuine pre-estimate of the loss that UNAOIL would incur as a result of LEIGHTON OFFSHORE's failure to honour the terms of the MOA."

In an attempt to make Leighton's bid more attractive to SOC, both Leighton and Unaoil recognised that they would need to reduce their prices and the parties entered into a supplementary agreement under which the contract price payable to Unaoil was reduced from US$75 million to US$55 million.

Leighton's tender succeeded and the main contract with SOC was executed. However, Leighton did not enter into a formal sub-contract with Unaoil. Unaoil continued to prepare for the project and submitted an invoice for the advance payments. Leighton failed to pay and eventually engaged a third party to carry out a large portion of the intended sub-contract works. Unaoil commenced court proceedings in England under the MOA claiming the advance payments, damages for repudiatory breach of contract and liquidated damages in the sum of US$40 million.

Leighton denied any liability.

Under the terms of the MOA, Unaoil was entitled to receive non-refundable advance payments. The Court held this entitlement was not void or invalid simply because Unaoil was not approved as a sub-contractor. Leighton's defence that the MOA was, in effect, terminated was not relevant because Leighton's obligation to pay had already arisen. Unaoil succeeded in its claim for the advance payments.

In relation to the claim for repudiatory breach, the Court recognised that it was very difficult to calculate Unaoil's loss (including loss of profit) in such

circumstances, but noted that this should not deprive Unaoil of a remedy. The Court awarded damages to Unaoil which were then credited against its successful debt claim, so that its total overall recovery did not increase.

In relation to its liquidated damages claim, Unaoil did not succeed. The Court applied the "modern test," as set out in the recent Court of Appeal decision of *Talal El Makdessi v Cavendish Square Holdings* (26 November 2013), namely that the party seeking to assert that a liquidated damages provision is penal must demonstrate that provision is *"extravagant and unconscionable with a predominant function of deterrence"* and that there is no other commercial justification for the clause.

The Court would have accepted that US$40 million was a genuine pre-estimate of Unaoil's loss at the time of the original MOA, but because the parties had not adjusted down the liquidated damages provision when they entered into the supplementary agreement which reduced the contract price significantly, it could not find that US$40 million was a genuine pre-estimate of Unaoil's loss at the time the MOA was amended, which was the relevant time.

When varying a contract, particularly in relation to the price to be paid, quantity of goods to be supplied or level of services to be provided, it is important to review any contractual liquidated damages provisions to ensure that, as at the date of the amendment, the amount payable to one party in the event of the other's default still constitutes a genuine pre-estimate of that party's loss.

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hfw Troubleshooting an ADR process: arbitration and effective court support

The international business community is well aware of the many potential benefits of resolving commercial disputes in arbitration. Even so, there can be hurdles to the smooth progress of a reference. Difficulties can begin at the earliest stage of seeking to hold a counterparty to the arbitration agreement. Procedural and jurisdictional issues and challenges can arise during the arbitral proceedings. Once an award has been made, issues can arise in relation to recognition, enforcement and recourse.

Arbitration does not sit in isolation and effective arbitration is conducted with the support of the court. Understanding the nuances of the relationship between the courts and the tribunal in a given jurisdiction is a challenging, multi-dimensional task which can bring significant advantages to the arbitral process.

A tribunal derives its authority from the arbitration agreement, from any institutional rules that may apply to the proceedings and in respect of procedural matters, from the law of the seat of the arbitration. Without usurping powers legitimately and appropriately held by the arbitral tribunal, a court has jurisdiction to intervene where expressly provided for in the applicable national law. This should provide for an intelligent use of the court's powers to overcome obstacles in the arbitral process. In practice, the court can assist to resolve practical problems and uncertainties that arise during the conduct of an arbitration, particularly ad hoc international arbitration.

At the initial stage in an arbitration, a party may need to turn to the court to stay an action commenced in defiance of an arbitration agreement[1] or to seek an anti-suit injunction prohibiting another party from pursuing or continuing court proceedings in another jurisdiction[2]. In arbitration-friendly jurisdictions such as Hong Kong, the court has no choice other than to uphold an arbitration agreement unless it is satisfied that the agreement is null and void, inoperative or incapable of being performed[3].

Similarly the court can rule on a challenge to the tribunal's determination that it has jurisdiction to hear a dispute[4]. If the tribunal has not been appointed within the contractual timeframe, an application to the court can potentially 'save' an arbitration by securing a time extension[5]. In certain jurisdictions, if the mechanism for the appointment of the arbitrator(s) does not work, the court may also be the default appointing authority to avoid the arbitration failing at the outset[6].

1 UNCITRAL Model Law on International Commercial Arbitration 1985 with amendments as adopted in 2006 (Model Law) Art.8

2 The Hong Kong Court has power to grant anti-suit injunctions in appropriate circumstances - s.21L and s.21M, High Court Ordinance Cap.XX

3 Cap.609 s.20

4 Cap.609 s.34

5 Cap.609 s.58

6 Cap.609 Art.11 provides that the HKIAC is the default appointing authority in Hong Kong. See para.6.017 Arbitration in Hong Kong A Practical Guide.

In international arbitration, court support can cross national boundaries. The Hong Kong Court has jurisdiction, on the application of any party, to grant interim measures of protection, including interim measures to assist foreign arbitral proceedings[7]. Incorporating Model Law Art.27, it can assist in the taking of evidence, including ordering a party to attend proceedings to give evidence or to produce documents or other evidence[8]. It also has special powers to direct the preservation and inspection of property relevant to the arbitration proceedings, in parallel to powers accorded to the tribunal. Similar provisions can be found in other national laws, including the English Arbitration Act 1996.

Effective use of court support can assist a tribunal to manage interlocutory issues robustly, for example if an arbitrator is faced with a recalcitrant respondent who ignores directions and has no wish to defend a claim. Where there has been an initial failure to comply with a procedural order without sufficient cause, it may be open to a tribunal to issue a peremptory order[9] to the same effect, setting out a time for compliance. National laws may accord significant power to a tribunal to impose sanctions for non-compliance with a peremptory order, such as drawing adverse inferences from the non-compliance[10]. A national court may also have the 'power of last resort' to enforce peremptory orders made by an arbitral tribunal[11].

Courts in arbitration-friendly jurisdictions such as Hong Kong and England regularly provide strong support for the recognition and enforcement of awards. The English Arbitration Act 1996 permits only limited grounds for challenge of or appeal against an arbitration award[12] and the English Court is robust in refusing challenges and appeals which do not qualify on these grounds.

The UNCITRAL Model Law allows very limited scope to appeal and only in situations where there has been a breach of natural justice.

Effective court support for the arbitral process is a balance of minimum intervention with maximum efficacy. When used appropriately, it can add an additional level of sophistication and strength to the arbitration.

HFW Partner Andrew Johnstone and Associate Fergus Saurin will be presenting on 'The role of the Courts in the Arbitration Process – an International Trade Perspective', at an industry series seminar to be held in conjunction with the HKIAC in Hong Kong early in 2015.

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SIÂN KNIGHT, PROFESSIONAL SUPPORT LAWYER

7 S.45 Cap.609. See also Model Law Art.9 *"It is not incompatible with an arbitration agreement for a party to request, before or during arbitral proceedings, from a court an interim measure of protection and for a court to grant such measure"*.

8 S.55 Cap.609

9 Familiar as the 'unless' order in a litigation context, and provided for S.41(5)-(7) AA '96 and S.53 Cap.609

10 See S.53(4) Cap.609

11 For Hong Kong, see S.61(1) Cap609. An order or direction made by the tribunal is enforceable in the same manner as an order or direction of the Court that has the same effect with leave of the Court. See also s.42 AA'96.

12 S67-69 Arbitration Act 1996

The *Alexandros T:* a new decision

This case was the subject of an article in our December 2013 Dispute Resolution Bulletin. There has now been a further judgment of the English Commercial Court, in *Starlight Shipping Co v Allianz Marine & Aviation Versicherungs AG and Others* (26 September 2014).

The *ALEXANDROS T* sank on 3 May 2006. The vessel was insured under three policies. The first policy was underwritten by a number of companies (CMI). The second was placed in the Lloyds market (LMI). The third was insured by the Hellenic Hull Mutual Association PLC (Hellenic). All were subject to English Law. The CMI and LMI policies contained an English jurisdiction clause. The Hellenic policy contained an arbitration clause.

Claims for the loss were made against CMI and LMI in the English Commercial Court. Arbitral proceedings were commenced against Hellenic.

The cases were fought very hard and then settled. However, following the settlement agreements, the insured sued again in a different jurisdiction, Greece, for losses relating to allegations of skullduggery that were not capable of being pursued in England. These claims were brought not only against the insurers, but also their employees and others involved in acting against them. Eventually, the English Supreme Court held that the settlement agreements prevented those different causes of action being pursued in Greece. Further details in relation to this aspect of the case can be found in the December 2013 article http://www.hfw.com/Dispute-Resolution-Bulletin-December-2013.

The insured did not leave it there and the most recent issue before the English Court was whether parties who were not signatories to the settlement agreements (the employees and officers of CMI, LMI and Hellenic, Charles Taylor Consulting and Mr Elliott) could be protected by them.

The Hellenic settlement agreement expressly provided that it covered claims made against *"underwriters and/or against any of its servants and/or agents"*. It was plain that these words were apt to cover the employees, officers and legal representatives of Hellenic.

The CMI and LMI settlement agreements were slightly different. They named the first party as *"Overseas Maritime Inc and Starlight Shipping Company as managers and/or owners and/or Associated and/or Affiliated Companies for their respective rights and interest in the ship"*. In each settlement agreement the second party was named as "Underwriters" and in each case went on to name the CMI and LMI companies represented. Employees and agents were not themselves party to any of the settlement agreements.

The English Court found, nevertheless, that all the settlement agreements precluded the claims against the employees. It held that there was an intention for a "clean break". If suit were possible against their employees and officers, then the insurers would find themselves legally or morally responsible to defend them. This would prevent finality.

There is also a principle in English law to the effect that where there is a joint cause of action by two or more persons, a discharge as against one operates as a discharge against all. In this case, a discharge as against one of the insurers would act as a discharge against the others. The insured was deemed to know and/or to have understood this principle of English law and with the settlement agreement to have agreed to release the others.

It remains to be seen whether this decision will be challenged further. In the meantime, the following conclusions can be drawn:

1. Settlement agreements should expressly cover not only the immediate parties to the agreement, but also other persons who have acted for and/or on behalf of those parties.
2. A party releasing another from liability should consider whether expressly to reserve a right to sue a different party who would have been jointly responsible.
3. Insurers should not rely on the absence of an effective remedy for dealing with claims in bad faith under English law as a means of protecting themselves. Had the facts of this case been slightly different, the insured might have succeeded in a claim against persons to whom the insurers were legally or morally responsible with the result that the insurers would ultimately have had to pay. Policies of insurance ought to include provision for such eventualities.

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News

We are pleased to be working with the Hong Kong International Arbitration Centre (HKIAC) to establish a new industry seminar series, focused on international trade and commodities issues. The first seminar will take place early in 2015 at the HKIAC. Taking a practical approach, the seminar will cover appropriate and effective ways to use the Court to support the arbitral process in an international trade context. Legal analysis and insights will be provided by Andrew Johnstone and Fergus Saurin from HFW, Andrew Chow from Sinopec will add an industry perspective and Ruth Stackpool-Moore of the HKIAC will be our moderator.

hfw Conferences and events

HFW International Arbitration Seminar
HFW London
3 February 2015

Chartered Institute of Arbitrators Hong Kong Centenary Conference
Hong Kong
19–21 March 2015
Attending: Nick Longley

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