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Commercial Dispute Resolution

Legal Update

**OLSWANG**



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### The "credit crunch": a force majeure event? – *Tandrin Aviation Holdings Ltd v Aero Toy Store LLC* [2010] EWHC 40 (Comm)

The recent Commercial Court decision in *Tandrin Aviation Holdings Ltd v Aero Toy Store LLC* considered the topical issue of whether the credit crunch, described by the judge as the "unanticipated, unforeseeable and cataclysmic downward spiral of the world's financial markets" constituted a force majeure event entitling the claimant to back out of a contract. The court was also required to determine whether a clause allowing for forfeiture of the defendant's deposit paid under the agreement was an unenforceable penalty clause, or an enforceable obligation for payment of liquidated damages.

The case concerned an aircraft sale agreement for a new Bombardier jet, under which the first defendant was to pay US\$31.75 million in total to the claimant, with US\$3 million paid to an escrow agent as a deposit. Following payment of the deposit, the claimant took delivery of the aircraft from the original vendor at a price of US\$26.5 million; by this time however, the market had declined significantly and the defendant buyer refused delivery of the aircraft. The claimant purported to terminate the agreement and sought payment of the US\$3 million deposit held in escrow as liquidated damages payable by reason of the defendant's breach. Following a failure by the claimant to obtain payment of the deposit, the claimant issued proceedings against the defendant and the escrow agent (the second defendant). The buyer filed a defence claiming that forfeiture of the deposit was a penalty clause and therefore unenforceable, and further that the global economic crisis had triggered the force majeure clause in the agreement, thereby discharging the buyer from liability. The buyer failed on both counts, and was ordered to pay over the deposit and costs.

#### Enforceable liquidated damages or unenforceable penalty?

It is well established that the courts distinguish between liquidated damages clauses, which represent the genuine pre-estimate of loss, and penalty clauses, which are designed to discourage a party from deliberately defaulting on a contractual obligation. Where a clause is held to be a penalty clause it will not be enforceable over and above the amount of actual loss suffered; instead, the courts will apply the normal rules for assessment of damages, so the "innocent" party will need to prove actual loss and satisfy questions of remoteness.

In *Tandrin*, the court restated the test as summarised in *Chitty on Contracts*, namely:

*"a clause providing for liquidated damages is enforceable if it does not exceed a genuine attempt to estimate in advance the loss which the claimant would be likely to suffer from a breach of the obligation in question".*

The court determined that deposit clauses were common in aircraft sales agreements, and further that the amount of the deposit was not unusual in comparison with other agreements or an "unconscionable and extravagant amount" in comparison with the greatest loss sufferable by the claimant. It held that the US\$3 million deposit was a reasonable pre-estimate of loss and was in fact far less than the claimant's actual loss. Therefore, on the particular facts, the court held that the forfeiture of deposit clause was enforceable, and did not constitute a penalty.

#### Force majeure

Force majeure is not a term of art and therefore its precise scope needs to be defined in the particular agreement. The particular drafting of a force majeure clause, and the events included within that clause, are critical for establishing the risk allocation between the parties and the respective liability following a breach. Many force majeure clauses are drafted by defining "force majeure" events using a definition such as "events beyond the reasonable control of the party prevented from performing its obligations, including strikes, fires, flood, acts of God, etc.". This leaves an element of doubt over whether "beyond the reasonable control" qualifies the potentially wider class of events listed after "including". If that qualification does not apply, a party may find itself exposed to a wide range of events which its counterparty may seek to rely on to excuse itself from performance, not confined to the type of extraneous events which might suffice for the related doctrine of frustration.

The agreement in *Tandrin* included a mutual force majeure clause and the decision turned on whether the global financial crisis excused the purchaser from liability by falling within the category of events described as "any other cause beyond the Seller's reasonable control". Hamblen J quoted from and affirmed a succession of cases concerning economic circumstances and force majeure, and concluded that it is well established that a change in market conditions affecting the profitability or ease of performance of the contract is not regarded as a force majeure event under English law.

Further, the court examined the wording of the force majeure clause itself, with particular regard to the listed events "act of God or the public enemy; war; insurrection or riots; fires; governmental actions; strikes or labour disputes; inability to obtain the aircraft materials, accessories, equipment or parts from the vendor". The court stated that there might not be a requirement to apply the *eiusdem generis* rule, i.e. the rule of construction that dictates that the meaning of a general word or phrase is restricted to the meaning of the preceding words

or list and does not expand beyond the subjects or classes of the preceding words. However, if the construction of the subsequent phrase *"any other cause beyond the Seller's reasonable control"* was restricted to the meaning of the preceding list of events, it was *"telling"* that none of the events listed had anything to do with the market conditions or the financing of the transaction. In addition, there was no reference to the purchaser's reasonable control and the wording referred only to events beyond the seller's reasonable control; therefore an alleged inability by the purchaser to obtain finance could not be construed as being beyond the seller's reasonable control. It was held that, in the context of the clause in question, extreme economic circumstances did not give rise to force majeure and the defendant could not avoid liability for breach.

The Commercial Court's decision is perhaps not surprising given the traditional reluctance of the courts to allow changes to a party's economic circumstances to be used as the basis for pleas of either frustration or force majeure. The credit crunch has not shifted the Commercial Court's position on that established principle. However, the fact that there was even an issue to be determined should be a warning to drafters of force majeure clauses to use the phrase *"any other events beyond the reasonable control"* with caution.

## The implications of "immediately" – Tarkin AG v Thames Steel UK Ltd [2010] EWHC 207

In *Tarkin AG v Thames Steel UK Ltd*, the Commercial Court considered the meaning of *"immediately"* in the context of a delivery obligation in a sale of goods contract, with reference in particular to whether the failure to deliver by the date in question gave rise to a right to terminate the sale contract.

The defendant was the owner of Georgian Steel JSC, a Georgian company that produced and sold steel scrap. Georgian Steel and the claimant (Tarkin) entered into a contract, under which Georgian Steel agreed to sell to Tarkin 20,000 metric tonnes of steel for \$11,600,000. The contract provided that *"the schedule for arrival of material in the port to be as required by the Buyer. Material is to be delivered in the port immediately upon the Buyer's request"*. The defendant (Thames Steel) entered into a deed of guarantee under which it agreed to be the guarantor for Georgian Steel in the event that Georgian Steel did not perform certain obligations under the contract.

Georgian Steel also issued a "Holding and Title Certificate" on the same date as the sale contract, which provided that upon receipt of a pre-payment of \$5,800,000, full title to the goods would transfer to Tarkin. Under the Certificate, Georgian Steel confirmed

that it was holding the goods in a secure location at the plant and separately to any other goods on the premises. Accordingly, Tarkin made a payment of \$5,800,000 and transfer in title duly passed to Tarkin.

The sale contract provided that the goods were to be delivered by 30 August 2008. However, as a result of a number of factors (including war breaking out between Georgia and Russia), 30 August 2008 passed without shipment of the goods being arranged. Notwithstanding this, both parties worked on the basis that the sale contract remained on foot.

On 8 March 2009, Tarkin sent Georgian Steel an email asking for the goods to be delivered by 31 March 2009. Georgian Steel responded the next day to say that instead it wanted to make delivery in April and May 2009, requiring a reasonable time to effect delivery. Tarkin took this as a repudiatory breach of contract, accepted the repudiation and claimed damages.

The point of interest in this case lies in why the mere use of the word *"immediately"* made time of the essence. Although in the end there was little analysis of the point because Thames Steel accepted in argument what was eventually the judge's conclusion, it is worth considering further.

To recap on existing law, time will be of the essence in a contract when either:

- the parties expressly state that time is of the essence, or stipulate that the time fixed for performance must be complied with exactly; or
- the circumstances or nature of the contract indicate that the date contained within it must be complied with.

If time is of the essence and there is a failure to perform by the stipulated date, this of itself entitles the aggrieved party to terminate the contract and claim loss of bargain damages. Where time is not of the essence, it will not be possible for the contract to be terminated on the basis that there has been a failure to perform within the required time frame, unless and until the delay itself satisfies the test for repudiation which applies more widely, i.e. that the breach must deprive the innocent party of substantially the whole benefit of the contract (see *Peregrine Systems Ltd v Steria Ltd* [2005] EWCA Civ 239).

In claiming that Georgian Steel was in repudiatory breach of the sale contract, Tarkin appears to have turned to the delivery clause in the contract and submitted that by use of the word *"immediately"*, the parties had made time of the essence. The judgment refers to Thames Steel having accepted this in argument, correctly in the view of the judge, Mr Justice Blair.

The only comment made by the judge on this related to the

commercial background: he noted that under the Holding and Title Certificate, title to the goods had already passed to Tarkin and the goods were stored separately at the plant. This may of itself have been the reason for the parties having made time of the essence, i.e. with title having passed and Georgian Steel having agreed to deliver immediately on Tarkin's request, the stipulation as to time was viewed as sufficiently strict to give rise to a right of termination as soon as it was breached.

Underlying this may also be the principle that in a mercantile contract for sale of goods, a fixed delivery date will often be construed as a time of the essence provision. With commodity prices constantly fluctuating, it will be of importance to the buyer to be in a position to terminate rapidly rather than be exposed to the uncertainty of whether the seller will eventually deliver and of when delay may reach the point of repudiation. The Tarkin decision might at first glance be seen to go further, in construing the "*immediately*" provision as being one of time of the essence, which would be harsh to a seller who does not know when the buyer will call for delivery. However, that would be to lose sight of the specific circumstances of this case: that title had passed and the goods were being stored separately.

The mere use of the word "*immediately*" should not therefore be regarded as making time of the essence in a contractual provision. Parties will need either to stipulate for time to be of the essence, or there will need to be some specific circumstances such as those in *Tarkin v Thames Steel* to give rise to that conclusion as a matter of construction.

## The bounds of "substantially" – *Venture North Sea Gas Ltd v Nuon Exploration & Production UK Ltd* [2010] EWHC 204 (Comm)

The Commercial Court in *Venture North Sea Gas Ltd v Nuon Exploration & Production UK Ltd* held that a condition precedent to completion in a sale and purchase agreement ("SPA") which stipulated that certain agreements should be entered into "*in substantially the form*" of a draft agreement was a matter of the substance of the obligations in question. Any differences between the draft and the executed version of the agreement were to be considered objectively and taking into account their legal and commercial impact as a whole rather than on an individual basis.

The parties had entered into an SPA in June 2009, under the terms of which Venture had agreed to sell a number of interests in UK petroleum production licences to Nuon. Venture brought a claim against Nuon alleging that the latter had breached its contractual obligation under the SPA to complete the transaction in December 2009. Nuon defended the case on the basis of

conditions precedent which it said had not been satisfied. The claim related to only two of those licences, which were distinguishable from the others by virtue of being jointly owned by both Venture and other third parties, rather than wholly owned by Venture. The SPA provided that Nuon would purchase half of Venture's interest in these two licences and, consequently, Venture and Nuon agreed on a draft form of joint operating agreement ("JOA") which was appended to the SPA. It was agreed that it was a condition precedent of the SPA that prior to completion the third parties would become party to a JOA which was "*in substantially the form*" of the draft agreement. In the event, the third parties entered the JOAs but a dispute arose between Venture and Nuon as to whether these were substantially in the required form.

In considering this question, Mr Justice Gross set out some principles which may be of assistance for the future in this commonly occurring scenario of contracts requiring particular documents to be executed in "*substantially*" the form of an agreed draft:

1. The key test in comparing the draft and the executed version is one of substance, not form, and this is to be determined objectively (see also *Yewbelle Ltd v London Green Developments Ltd* [2006] EWHC 3166 (Ch)). The two versions have to be considered as a whole and with regard to the relevant factual matrix. This means considering the differences between the two individually and then assessing their cumulative effect. This must, however, be done with caution in that a significant number of trivial differences may well be unlikely to produce a significant cumulative effect.
2. The word "*substantially*", in this context, attracts its ordinary dictionary meaning, "*essentially, intrinsically*" or "*actually, really*" (taken from the Short Oxford Dictionary). If changes between a draft and an executed version are "*material*", the latter would not be substantially in the same form as the former.
3. The relevant comparison "*is and must be between the contractual rights and obligations, the bundle of rights and obligations created by the two agreements*".
4. However, it is necessary to go further and consider the commercial effects and realities of the difference, meaning in particular the question of whether the parties might be expected to act in a particular way to address the consequences of an apparently significant difference. Nevertheless, caution will obviously be needed before assuming that a party would act other than in accordance with its rights and obligations as set out in the executed form.

In this particular case, although there were a number of changes to the draft JOA identified by Nuon, there were two areas in particular which led Mr Justice Gross to find that the executed

JOAs were not "*substantially in the same form*" as the draft in the Schedule to the SPA. The first of these was that the process of authorisation of the Operator by the Participants to act on their behalf was reversed in the executed version, to require the majority of the Participants to give specific authorisation (whereas in the draft form the Operator was authorised unless there was a vote to the contrary). The judge found that this amendment went to the very heart of the JOA. The second area was that the executed JOA contained new clauses which imposed a requirement for unanimity in approval of certain budgetary and expenditure proposals; this was found to be prone to causing delays in execution of the project, particularly in January and February, a crucial time of year in the gas production market.

Those examples illustrate that the heart of the question will be the interplay between items three and four on the judge's list of principles. It will not simply be a question of measuring the extent of the differences as a matter of language, but a deeper one of considering the practical commercial effects of those differences.

## Without prejudice negotiations not admissible for the interpretation of settlement agreements – *Oceanbulk Shipping & Trading SA v TMT Asia Ltd* [2010] EWCA Civ 79

The Court of Appeal decision in *Oceanbulk v TMT Asia* in February considered the circumstances in which statements made during without prejudice negotiations could be admissible in evidence. Underlying the question was whether the principles on contractual construction emerging from last year's House of Lords decision in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] AC 1101 justify allowing such a statement to be admitted.

Longmore LJ gave the leading judgement, with Stanley Burnton LJ agreeing with him, which affirmed the importance of the without prejudice rule and held that evidence which was without prejudice should not be admitted in order to assist with the interpretation of a settlement agreement. However, the position remains far from straightforward: Ward LJ dissented in emphatic terms and it remains to be seen whether the decision will stand the test of time.

Oceanbulk and TMT had entered into a number of forward freight agreements ("FFAs"). As a result of these contracts TMT owed Oceanbulk around \$40.5 million. A settlement agreement was reached between the parties in respect of this debt. The agreement stipulated that, with regard to any FFA open contracts between the parties, the first 50% should be "*crystallised*" by a certain date and the parties should co-operate to close out the balance of 50% against the market on the best terms achievable by another date.

Oceanbulk claimed that TMT did not co-operate to close out the remaining 50% of the FFAs. In relation to the question of what co-operation meant for the purpose of the second 50%, TMT wanted to adduce evidence that Oceanbulk had represented during the settlement negotiations that these transactions were "*sleeved*" positions (meaning that Oceanbulk had made them back-to-back with a third party).

The judge at first instance, Andrew Smith J, had found that the evidence was admissible for four reasons, each of which Longmore LJ dealt with in turn:

1. The distinction between identifying the terms of an agreement (a ground on which without prejudice evidence may be admitted) and interpreting them was extremely fine.
2. *Admiral Management Services Ltd v Para Protect Europe Ltd* [2002] 1 WLR 2722 provided authority for admitting the evidence in question.
3. Evidence of without prejudice exchanges is admissible if there is a plea of rectification and it would therefore be illogical not to admit it for the purpose of construction.
4. A court which is deprived of evidence of the background against which an agreement was made would be less well equipped to discern the parties' intentions and less likely to construe the contract in accordance with them.

Longmore LJ opened by noting that there are undoubtedly some occasions on which without prejudice statements can be referred to in evidence. He referred here to *Unilever Plc v Proctor and Gamble* [2000] 1 WLR 2436, where Robert Walker LJ set out three such circumstances in which without prejudice evidence can be admitted:

1. When the issue is whether without prejudice communications have resulted in a concluded compromise agreement.
2. Where the evidence shows that an agreement apparently concluded between the parties during the negotiations should be set aside on the grounds of misrepresentation, fraud or undue influence.
3. Where there is no concluded compromise agreement but a statement which is made by one party to negotiations and on which the other party is intended to act and does in fact act may be admissible as giving rise to estoppel.

Longmore LJ also referred to the House of Lords decision from last year, *Ofulue v Bossert* [2009] UKHL 16, noting comments made there on the public policy consideration that parties should be able to negotiate freely in without prejudice discussions without worrying about statements being used against them subsequently.

Turning then to each of the reasons relied on by Andrew Smith J, Longmore LJ held that:

1. He did not find that the distinction between identifying the terms of the agreement and the interpretation of them was usually a fine one. Allowing evidence such as that proposed to be admitted would make arguments about implied terms more prevalent, which was to be discouraged.
2. *Admiral Management* did not go as far as to decide that without prejudice correspondence would be admissible in relation to a background fact which was not part of the terms of the settlement. The decision to admit evidence in that case arose only because the document in question had been referred to as part of the settlement agreement.
3. On the question of whether there was an inconsistency between allowing without prejudice evidence for pleas of rectification but not allowing it for the construction of terms, Longmore LJ was clear that there was not. If a case of rectification is made then the court is being asked to ascertain the true terms of the contract but it is not considering the background facts to ascertain the contract's meaning.
4. The final consideration was the balancing of competing policy considerations: the need for parties to be able to negotiate freely on the one hand and the court's need to have all relevant information before it on the other. Longmore LJ came down firmly in favour of the former, noting that the comments in *Ofulue v Bossert* tended to indicate that the policy behind the without prejudice rule should trump the more general policy of enabling the court to have the maximum possible assistance in ascertaining the parties' intentions.

Ward LJ dissented in brief but emphatic terms. He questioned why, since case law had clearly established that you can use antecedent negotiations to prove an agreement, to rescind it or to rectify it, they should not be used to establish the truth of what the concluded contract means. Of this, he commented "*Not to do so would strike my mother as 'barmy'. Perhaps I should simply say it strikes me as illogical*".

He went on to add that there was a distinction to be drawn between the application of the without prejudice rule to discussions which did not conclude with a settlement and instances where a settlement was reached. Of the latter, he said that once the public interest in the "*cloak of secrecy*" had been served and an agreement reached, there was no justification for continuing to wrap the negotiations in the same cloak any further.

The principle decided by the case is clear, namely that statements in without prejudice discussions will not be admitted in evidence to assist construction. However, the difference in view between Longmore LJ and Ward LJ suggests that the case may not be the final word on the subject.

## Quantum of damages for breach of duty of care in relation to swap transactions – *Haugesund Kommune v Depfa ACS Bank (Wikborg Rein & Co as Third Party) (No. 2) [2010] EWHC 227 (Comm)*

This recent Commercial Court decision arose out of swap transactions which the defendant bank ("Depfa") entered into with the claimant Norwegian municipalities ("Haugesund"). In a previous judgment in the case in September last year, Mr Justice Tomlinson had held that:

1. Haugesund were entitled to declaratory relief to the effect that they were not contractually bound by the swap transactions. However, they were liable to make restitution to Depfa.
2. Haugesund's partial defence of change of position failed, so that they were liable to reimburse Depfa for the principal sums advanced with interest.
3. Depfa's solicitors, Wikborg Rein, who had been joined as a third party to the action, were in breach of their contractual duty to exercise reasonable skill and care in that they had failed to advise that the swaps were prohibited loans as a matter of Norwegian law. If Depfa had been advised that the swaps were prohibited, Depfa would not have entered into the transactions.

In the current hearing, Depfa sought judgment against Wikborg Rien that Depfa was entitled without more to recover its outstanding loss in full from Wikborg Rein, regardless of whether or not Haugesund might in the future pay the balance of such loss to Depfa.

The need for this arose because, following the first judgment of the court, Haugesund had successfully applied, pending an appeal to the Court of Appeal on the change of position defence, for a stay of execution on the judgment against them insofar as it exceeded reimbursement of the net proceeds of sale of the failed investments – i.e. they refused pending appeal to honour the judgment that they should make full restitution of all sums which they had received from Depfa.

Depfa contended in the current hearing that its loss as against Wikborg Rein was to be assessed independently of the possibility of further recoveries from Haugesund. It asserted that it had no obligation to pursue its rights in restitution against Haugesund and that it was entitled to recover its outstanding losses in full against Wikborg Rein.

Wikborg Rein denied that there was any such basis upon which Depfa could recover outstanding losses from Wikborg Rein. It accepted that, if Haugesund succeeded in their appeal on

the change of position point, then Depfa would be entitled to judgment against Wikborg Rein, since Depfa would have no right to recover in restitution over and above the recoveries already made. However, this would be a matter for the Court of Appeal to decide in due course and Wikborg Rein contended that pending that appeal, the judgment sought against it by Depfa should not be given.

Tomlinson J held that, although the contract between Depfa and Wikborg Rein was governed by Norwegian law, the duties owed by Wikborg Rein to Depfa were the same as those under English law, except that there was no concurrent non-contractual duty owed. It therefore followed that Depfa's cause of action against Wikborg Rein arose at the date of breach, but this left the question of when the relevant loss arose.

As to this, Depfa contended that its loss arose as soon as it parted with the money paid to Haugesund in reliance upon Wikborg Rein's negligent advice. Tomlinson J agreed with this. The essence of Depfa's complaint against Wikborg Rein was that, as a result of the advice given by Wikborg Rein upon which Depfa relied, there was no valid transaction under which any valuable rights were acquired. The loss was incurred when money was paid away pursuant to this non-existent transaction and the measure of that loss was the whole amount advanced together with the cost of funding.

Tomlinson J went on to consider various cases cited to him by Depfa's counsel in support of the submission that Depfa had no obligation to pursue Haugesund before pursuing Wikborg Rein. In particular, he referred to *The Liverpool (No.2)* [1963] P 64, which provides the principle that when a claimant has claims against two tortfeasors for the same loss, he is free to choose from whom to recover compensation and, in so doing, is not obliged to give credit for the amounts which he might recover from the other tortfeasor. He noted, however, that the current case was not on all fours with that situation, in that Depfa did not have two available claims in tort, but its contractual negligence claim against Wikborg Rein and its restitutionary claim against Haugesund.

In this context, he made clear that there was a distinction to be drawn between circumstances where a transaction takes place which gives rise to a debt claim and a transaction which is in fact void, as was the case here, such that the value of rights acquired was nil. The current case was therefore to be distinguished from negligent valuation cases, where the value of the contract entered into has to be taken into account when assessing what credit is to be deducted from recoverable losses (see *Nykredit Mortgage Bank plc v Edward Erdman Group Ltd (No.2)* [1997] 1 WLR 162). In Tomlinson J's view, it would be surprising if Depfa's loss recoverable from its negligent lawyers fell to be reduced by a value which the court had to attribute to Depfa's claim in restitution. Only actual diminution of losses fell to be brought into account. A similar conclusion had been reached in *Niru Battery Manufacturing Co. v Milestone Trading Ltd (No.1)* [2002] EWHC

1425 (Comm) (where the claimant buyer had claims both in restitution against the seller's bank which had received funds from a letter of credit and for negligence against an inspector which had issued an inspection certificate despite the seller not yet having the goods in its control).

The result may seem harsh for Wikborg Rein, which finds itself liable for an amount which may yet prove recoverable from Haugesund, who received funds under the transaction. The answer may lie in Wikborg Rein having a claim against Haugesund in subrogation, recoupment or contribution. However, there is a hint in the last paragraph of this latest judgment that there may be difficulties in bringing such a claim. It may well be the next chapter to emerge in the saga.

## Beneficial owners entitled to recover for economic loss – *Shell UK Ltd v Total UK Ltd* [2010] EWCA Civ 180

It has long been established authority that only a person who is the legal owner or has the immediate right to possession of property has the right to claim damages for economic loss which is consequential on the negligent loss of or damage to the property. As the House of Lords held in *Leigh and Silavan Ltd v Aliakmon Ltd (The Aliakmon)* [1986] AC 785, it is not enough that the person has "only contractual rights in relation to such property". However, the door was left open to beneficial owners by a comment in that case by Lord Brandon that they could claim, provided that the legal owner was adjoined as a party to the proceedings.

Quite what this means in practice was determined in the Court of Appeal in March in *Shell UK Ltd v Total UK Ltd: Total UK Ltd v Chevron Ltd*. The court held that joining the legal owner to proceedings in respect of damage to property would be sufficient to enable the beneficial owner of the property to recover for all the loss which it had suffered, including consequent economic loss. Further, it did not matter that the beneficial owner was not in possession of the property.

The case arose out of the explosion at the Buncefield oil depot. The explosion was caused by the negligent overfilling of a fuel storage tank and destroyed or seriously damaged fuel storage tanks, pipelines and associated equipment, including tanks and pipeline facilities used by Shell UK Ltd to store and deliver fuel to its customers. The legal title to the tanks and pipelines was vested in two vehicle companies which held that title on trust for Shell and other participants in the site as beneficial joint owners and tenants in common.

As a result of the devastation, Shell suffered substantial losses and brought a claim against Total UK Limited for damages in negligence. Total conceded that damage to Shell's property

was a reasonably foreseeable consequence of its negligence. However, it denied any liability for the loss of profit which Shell claimed to have flowed from the damage to the tanks and pipelines, on the ground that only a legal owner or someone with an immediate right to possession had the right to claim damages for associated economic loss. Total's argument found favour with the judge, who dismissed Shell's claim. Shell appealed against the decision.

On appeal, Shell relied on the statement of Lord Brandon in *The Aliakmon* that in order for an equitable owner who merely had beneficial title to the property to sue in tort for negligence, he had to "join the legal owner as a party to the action, either as co-plaintiff if he is willing or as co-defendant if he is not". Shell had joined the legal owners of the tanks and pipelines as parties to the action and maintained that this was sufficient to enable it, as a beneficial co-owner, to recover for the significant economic loss it had suffered as a result of the explosion, through its reduced ability to supply fuel to its customers. It further pleaded that the rule requiring a claimant to have a legal or possessory title before it could recover for economic loss had always been subject to exceptions (such as the well-known exception for negligent misstatement set out in *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465) and that justice required a further exception to be made to fit the facts of the present case.

Total argued in response that Shell's view of Lord Brandon's statement was too simplistic and submitted that the point of requiring the legal owner to be a party to the proceedings was to enable recovery to be made for physical loss or damage to the property and not to enable a claim for negligent infliction of economic loss suffered by the beneficial owner.

The Court of Appeal accepted that the statement in *The Aliakmon* did not resolve the issue in this case, and in order to do so it would be necessary to examine the exclusionary rule and the rationale for it. As the court observed, there would be little point in requiring the beneficial owner to join the legal owner to the action if the beneficial owner could then only recover his physical loss and not his consequent economic loss.

The exclusionary rule provides that a defendant who negligently damages property belonging to a third party does not owe any duty to a claimant who suffers loss because of a dependence upon that property or its owner. Its basis lies in the courts' desire to prevent claims for economic loss being brought by persons with a mere contractual interest. To hold otherwise would, in the words of the editors of *Clerk and Lindsell on Torts* "lead to unacceptable indeterminacy because of the ripple effects caused by contracts and expectations". Mindful of the floodgates argument, the courts limited their powers to providing redress for only the proximate and direct consequences of wrongful acts. It followed that a special relationship of proximity between the parties, going beyond mere contractual or non-contractual dependence on the damaged property, was required to establish liability. This led to

the decisions in cases such as *The Aliakmon*, and before it *Cattle v Stockton Waterworks Company* (1875) LR 10 QB 453, that economic loss will only be recoverable by the person having a legal or possessory title to the property in question.

In *Shell v Total*, the Court of Appeal concluded that beneficial ownership of the damaged property, such as Shell's beneficial ownership (with others) of the tanks and pipelines, constituted such a special relationship, noting that it was in many ways a closer relationship than that of a bare trustee having no more than legal title. Total's argument that it did not owe a duty to Shell (who merely had a contractual right to have its fuel loaded into, carried and discharged from the tanks and pipelines) would be understandable if Shell were a complete stranger to the transaction. However, it did not apply on the facts of the case where Shell was a beneficial co-owner of the tanks and pipelines and its contractual right to use them was merely an incident of that beneficial ownership. As a result, the court determined that it would be "legalistic to deny Shell a right of recovery by reference to the exclusionary rule" in circumstances where Shell was, after all, "the 'real' owner, the 'legal' owner being little more than a bare trustee".

In view of this reasoning, the Court of Appeal held that a duty of care "is owed to a beneficial owner of property (just as much as to a legal owner of property) by a defendant, such as Total, who can reasonably foresee that his negligent actions will damage that property", adding that "provided that the beneficial owner can join the legal owner in the proceedings, it does not matter that the beneficial owner is not himself in possession of the property". As the House of Lords in *The Aliakmon* had not settled the argument about an equitable owner's ability to recover for economic loss once the legal owner had been joined, it was open to the Court of Appeal to resolve the point. The court reversed the judge's decision on this aspect of this case, concluding that, notwithstanding the underlying merit of the exclusionary rule, "it would be a triumph of form over substance to deny a remedy to the beneficial owner... where the legal owner is a bare trustee for that beneficial owner".

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