Dispute Resolution

October 2012

DISPUTE RESOLUTION BULLETIN

Freezing orders: *once more unto the breach?*

In the latest judgment in the long running litigation between Kazakhstan's JSC BTA Bank (the Bank) and its former Chairman, Mukhtar Ablyazov (MA), the English Commercial Court has given useful guidance on what it will consider when deciding whether a freezing order has been breached and where there has been a breach what, if anything, can be done about it.

The Bank sought two declarations from the Court: first that MA had once again acted in breach of a worldwide freezing order (WFO) originally obtained in 2009; and second, that he had not disclosed all of his assets. The Bank also asked the Court to order MA to try to reverse certain pledges he had made to third party Russian banks involving the undisclosed assets.

MA is currently in hiding after being committed to 22 months' imprisonment for previous breaches of the WFO. He argued that the Court should grant permission for the pledges retrospectively on the basis that they did not conflict with the purpose of the WFO, namely to prevent any judgment eventually obtained by the Bank going unsatisfied due to MA dissipating his assets. According to MA, the transactions were not made to make any of his assets "judgment proof".

In his judgment on 21 September 2012, Mr Justice Teare had little difficulty in concluding that the transactions were a breach of the WFO. However, if the reasons for making the pledges did not conflict with the purposes of the WFO, the breach would be a technical one and would not justify an order to try and reverse them.

The Court's discretion in these circumstances is wide. In particular, the Court should look not only at whether the purpose of the transactions was at odds with the WFO, but also at all the circumstances of the case in an effort to do justice to both parties.

The Court granted the declarations of breach sought by the Bank. This was so that the Bank could, if it wished, inform the third party banks that

the pledges were made in breach of the English Court's WFO. In light of what it saw as gaps in MA's evidence as to the purpose of the pledges (not to mention his previous conduct in the litigation and current "fugitive" status), the Court refused MA's application to grant the transactions retrospective permission.

However, the Bank had advanced no evidence that the pledges were in fact made with the objective of circumventing the WFO. Neither had it identified any step that MA could take to try to unwind them. In addition, the Court must consider the interests of the third parties to the transactions. Taking all this into account, the Court declined to order that MA try to undo the pledges, but only that he use his best endeavours, should any enforcement proceedings be brought by the third party banks (one of which is now in administration), to inform the Russian court that the pledges were made in breach of the WFO.

The pledges remain in place. Should the third party banks seek to enforce them, it will be a Russian court that decides whether they can do so. The Russian court is not bound by the WFO, nor the fact that the pledges were made in breach of it.

For parties contemplating or involved in freezing order applications, this decision shows the Court's willingness to take account of the interests of unconnected third parties in transactions made under such an order – even in the face of previous contempt of court by the defendant. It is also important to remember that the purpose of freezing orders is not to obtain security but to prevent judgments going unsatisfied because of dissipated assets. Should a party seek the Court's help to reverse a transaction made under a freezing order they should provide evidence that it was made with the intention of evading the order.

For more information, please contact Luke Zadkovich, Associate, on +44 (0)20 7264 8157, or luke.zadkovich@hfw.com, or Ian Mathew, Associate, on +44 (0)20 7264 8035, or ian.mathew@hfw.com, or your usual contact at HFW.

Specifying the number of arbitrators in a tribunal

What happens when an arbitration clause does not specify clearly the exact number of arbitrators to be appointed? The English Court of Appeal recently handed down a judgment confirming the position under English law. The decision in *Itochu Corporation v Johann M.K Blumenthal GMBH & Co KG & Anr (24 July 2012)* is also a useful reminder of the principle that leave of the first instance court is required to appeal against judgments on arbitration claims.

The agreement between the parties contained an arbitration clause in the following terms:

"Any dispute … shall be submitted to arbitration held in London in accordance with English law, and the award given by the arbitrators shall be final and binding on both parties"

The parties disagreed as to whether the clause required the appointment of one or three arbitrators. Itochu argued that the Tribunal should be composed of three arbitrators given the reference to "arbitrators" in the plural. Blumenthal argued that the clause provided for a sole arbitrator and applied to the Court for an order under Section 18(3)(d) of the Arbitration Act 1996 (the Act) which allows the Court to appoint arbitrators where the appointment procedure has failed. The Court held that in the circumstances, section 15(3) of the Act applied. This provides that where there is no agreement between the parties as to the number of arbitrators, the Tribunal shall consist of a sole arbitrator.

The Court duly granted an order appointing a sole arbitrator and refused Itochu permission to appeal. Itochu applied to the Court of Appeal for permission to appeal, arguing that the Court at first instance was wrong to conclude that section 15(3) of the Act applied. Before considering whether the Court at first instance was wrong, the Court of Appeal had first to decide whether it had jurisdiction to hear the appeal at all.

Since the Court at first instance had made its decision under section 18 of the Act, the Court of Appeal held that section 18(5) applied. This provides that the permission of the Court is required for any appeal from a decision made under section 18. Permission had been refused by the Court at first instance and therefore the Court of Appeal did not have jurisdiction to hear the appeal. This is a clear demonstration of the well established approach of the English Courts that the grounds for giving permission to appeal will be interpreted narrowly.

That should have been the end of the matter. However, the Court of Appeal commented that in any event, it agreed with the conclusion reached by the Court at first instance. Section 15(3) had been included in the Act with a view to reducing the costs imposed on parties to arbitration. The Court of Appeal characterised this as a *"support*

for arbitration, not an unwanted infringement on party autonomy".

For parties who have English law arbitration clauses in their agreements, this case is instructive. Without an express, clear stipulation of the number of arbitrators they wish to appoint to resolve their disputes, a reluctant opponent can seize on any lack of clarity as an opportunity to delay proceedings and increase costs with expensive court applications.

For more information, please contact Alex Young, Associate, on +44 (0)20 7264 8021 or alexander.young@hfw.com, or your usual contact at HFW.

Practical considerations in novation of contracts (1)

In the current economic climate, it is increasingly important for the parties to a contract to be aware of how they can effectively restructure their agreements. One option is to substitute one party to the agreement for a third party through a novation of the contract. In the first of two articles, Damian Honey and Michael Buffham offer a practical guide to novation.

What is a novation?

A novation is used to transfer one party's rights and obligations under a contract to a third party. An assignment of contract can only be used to transfer rights, not obligations. The only way a contractual obligation can be transferred is if all the parties agree to a novation.

A novation is not strictly a transfer. In a novation, the original contract is extinguished and replaced with a new one, under which the third party assumes rights and obligations on the same terms as those of one of the parties to the original contract.

The formalities and requirements of a novation

Consent

Since a novation creates a new contract, it is essential that the consent of all parties is obtained, including the incoming party and all parties to the original contract, whether outgoing or continuing.

A novation does not necessarily need to be in writing. In the absence of a signed novation agreement, it is possible that consent to a novation can be inferred from the conduct of the parties, provided that the original contract does not impose conditions prohibiting this (for example, a term providing that novations are subject to the prior written consent of the existing parties).

In some circumstances, for example where the incoming party is unknown to the continuing party or appears to have fewer financial resources or assets against which to enforce a judgment in the event of a breach of contract, a continuing party will object to a novation. In order to avoid any risk that their consent may be inferred, it is advisable to record the objection in writing and to expressly refuse to deal with the incoming party.

Consideration

Since the original contract is extinguished and replaced with another in a novation, consideration for the new contract must be provided.

The various promises between the parties to a novation agreement are often regarded as being sufficient consideration for the new contract. By way of example, where a seller (S) contracts with a buyer (B) for the sale of goods, if S and B agree that a third party (T) will buy the goods instead of B, then:

- T provides consideration by agreeing to buy the goods from S.
- S provides consideration for T's promise to buy the goods by agreeing to release B from the original contract.
- B provides consideration for S's promise to release him by providing the new buyer, T.

In order to avoid any potential disputes about the adequacy of consideration, the parties may decide to:

- Novate the contract under a deed.
- Include some nominal monetary consideration for the promise.

Conditions on novation

If the original contract contains a non-assignment provision and it is drafted to cover all purported transfers of the contract, then it will apply to novations. Such clauses often impose certain formalities, for example a requirement to obtain prior written consent. In those circumstances, novation will be effective so long as it fulfils any relevant conditions. (As contractual terms, conditions can be waived either through agreement or by conduct.)

The effect of a novation

Unless agreed otherwise, a novation releases the outgoing party from all future liabilities under the contract. The parties should therefore make clear provision for who is to be responsible for pre-novation obligations. In the event that no such provision is made in the novation agreement, the outgoing party is usually held to retain any pre-novation liabilities. Ultimately, this depends upon the intention of the parties. It is therefore advisable to record the division of liabilities clearly in the novation agreement.

If the outgoing party retains any pre-novation liabilities, the incoming party should consider seeking an indemnity from the outgoing party for breaches of contract occurring before novation took place. Likewise, the outgoing party should consider seeking an indemnity from the incoming party for any liabilities the incoming party agrees to adopt.

Key points to consider when drafting a novation agreement

The key considerations in drafting a novation agreement are as follows:

- Has the consent of all the parties, whether continuing or outgoing, been obtained and documented?
- Has sufficent consideration been provided for the new contract? Would it be advisable for the contract to be executed as a deed?
- Does the novation agreement comply with all relevant conditions on novation in the original contract? Have such conditions been waived through agreement or conduct?
- Have the parties clearly documented who is to be responsible for pre-novation liabilities?
- Have the parties sought indemnities in respect of liabilities accepted by another party?

Next month's article will consider in more detail whether partial novation is possible under English law.

For further information, please contact Damian Honey (pictured below), Partner, on +44 (0)20 7264 8354, or damian.honey@hfw.com, or your usual contact at HFW. Assisted by trainee Michael Buffham.

Conferences & Events

HFW Seminar: The Eurozone crisis and the impact of state bankruptcy
HFW Geneva
(22 October 2012)
Matthew Parish

C5 Fraud, Asset Tracing & Recovery Conference
Eden Roc Hotel, Miami
(22-23 October 2012)
Noel Campbell

Anti-Corruption Compliance Seminar
Serbia
(8 November 2012)
Alexis Kyriakoulis

"Have the parties sought indemnities in respect of liabilities accepted by another party?"

Lawyers for international commerce hfw.com

HOLMAN FENWICK WILLAN LLP
Friary Court, 65 Crutched Friars
London EC3N 2AE
United Kingdom
T: +44 (0)20 7264 8000
F: +44 (0)20 7264 8888