<u>CONSTRUCTION AND ENFORCEABILITY OF SETTLEMENT AGREEMENTS: REVIEW OF MODERN CASE LAW</u>

<u>Zurich Insurance v Hayward</u> has drawn attention to the scope for parties to re-open settlements when new evidence disproving the other side's case later emerges. Craig Orr QC considers this and other issues concerning the construction and enforceability of settlement agreements, by reference to modern English and Commonwealth authority.

<u>EXECUTIVE SUMMARY</u>

The key points emerging from the case law may be summarised as follows:

(1) The same principles of construction apply to settlement agreements as apply to other contracts, with two caveats:

> (i) First, the court will be very slow to conclude, in the absence of clear language, that a party intended to surrender rights and claims of which it was unaware and could not have been aware at the time of the settlement. This is not a rule of law but a "*cautionary principle*" which informs the approach the court adopts to construction of a settlement agreement.[1]
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> (ii) Second, the courts are reluctant to find that claims for fraud are within the scope of a settlement agreement, except where the language or context of the agreement demonstrates very clearly that was the parties' intention. In this respect, the courts have adopted by analogy the same approach as applies to construction of exclusion clauses, which will generally not be interpreted as excluding liability for fraud unless clear and specific words to that effect are used.

(2) There is an equitable principle of uncertain scope whereby a party may be prevented from relying upon the ordinary meaning of a settlement agreement where it would be unconscionable for that party to do so. Unconscionability of this kind might arise where a party obtains a general release of claims from another party in circumstances where the first party knew that the other party had a claim and knew that the other party was not aware of that claim.

(3) As with any contract, a settlement agreement may be set aside or avoided on grounds of misrepresentation, mistake or duress.

(4) In *Zurich Insurance v Hayward*,[2] the Supreme Court set aside a settlement which had been induced by fraudulent misrepresentations made by a party in its statements of case, witness statements and other materials produced for the purposes of its claim. This decision, if generally applied, could risk any settlement being re-opened if evidence later emerges demonstrating the falsity of the other side's case. However, the Supreme Court did not analyse the contractual allocation of risk inherent in the settlement agreement, which was effected in that case by a short-form Tomlin order. It is arguable that where the settlement agreement makes clear that a party agrees not only to assume the risk of evidence subsequently coming to light which disproves the other side's case but also not to challenge the settlement if that happens, then that party should

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[1] *BCCI v Ali* [2002] 1 AC 251 (HL) at [10] and [17], Lord Bingham.
[2] [2017] AC 142 (SC)

be held to its bargain and not entitled to resile from the agreement when new evidence later emerges. It is unclear whether non-reliance clauses could be used to prevent a party from resiling from a settlement agreement when evidence of the other side's fraud subsequently comes to light.

(5) Settlement agreements are not contracts of the utmost good faith. There is consequently no general duty of disclosure owed by one settling party to another. However, it is unclear whether a company director (or other fiduciary) owes a duty of full disclosure to the company (or other principal) when negotiating a settlement agreement. There is some authority suggesting that no such duty is owed, but the contrary is arguable.

I. INTRODUCTION

Settlement agreements are essential to the proper administration of justice. The vast majority of disputes settle rather than go to trial. Parties who do settle therefore need to have confidence in the validity and effect of their agreements.

The problem that not infrequently arises is that a new claim or allegation emerges following a settlement that was not known to, or suspected by, one or other party at the time of the settlement. The question then becomes whether that claim or allegation should be allowed to proceed in the face of the settlement agreement. The new claim or allegation may result from discovery of new factual evidence or a change in the law.

For example, liquidators supervising the winding up of an insolvent company may settle claims the company has against its former CEO but then subsequently discover, in the course of ongoing investigations, that he embezzled huge sums from the company prior to its insolvency, of which they were previously unaware.[3] Or a company that has settled a claim by an employee for an injury suffered at work may discover that the employee fraudulently exaggerated the extent of his injuries, thereby obtaining more by way of settlement than he was lawfully entitled.[4] In such situations, issues of both construction and enforceability of the settlement agreement may arise.

As regards construction, the question typically will be whether the settlement agreement, upon its true construction, covers (and thereby precludes) the new claim or allegation?

As regards enforceability, the question will typically be whether, assuming the new claim or allegation is covered by the agreement, is there any basis for impeaching or otherwise circumventing the agreement?

The latter question in turn may raise issues as to application of equitable principles of unconscionability and avoidance of the settlement agreement for fraudulent misrepresentation, mistake, duress or non-disclosure.

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[3] Cf. *Ting v Borelli*, Supreme Court of Bermuda, 5.12.2007; Bermuda Court of Appeal, 28.11.2008; [2010] UKPC 21; 79 WIR 204 (PC)
[4] Cf. *Zurich Insurance v Hayward*

II. CONSTRUCTION

So far as construction is concerned, there are two main points to note.

First, the same principles of construction apply to settlement agreements as apply to other contracts.

Second, the court will be very slow to conclude, in the absence of clear language, that a party intended to surrender rights and claims ***of which he was unaware and could not have been aware*** at the time of the settlement. This is not a rule of law but a cautionary principle which informs the approach the court adopts to construction of settlement agreements.

BCCI v Ali

The leading case on construction of settlement agreements remains *BCCI v Ali*,[5] which arose out of the collapse of the Bank of Credit & Commerce International in October 1991. At the time, the Bank was the 7th largest private bank in the world. After its collapse it became apparent that the Bank had been run in a thoroughly corrupt and dishonest manner for many years.

In 1990, just over a year before the Bank collapsed, it made some 900 of its staff in England redundant. The redundancy package offered to those staff included a release whereby each of the employees taking redundancy released the Bank from claims that the employee had or might have against the Bank. The release was in wide terms. It provided:

> "*The [employee] agrees to accept the terms set out in the documents attached in full and final settlement of all or any claims whether under statute, common law or in equity of whatsoever nature that exist or may exist and, in particular, all or any claims rights or applications of whatsoever nature that the [employee] has or may have or has made or could make in or to the industrial tribunal, except the applicant's rights under [the bank's] pension scheme*."

Following the Bank's collapse, the question arose as to whether these releases prevented the employees who had signed them from suing the Bank for what came to be known as 'stigma' damages. These were damages to compensate former BCCI employees for the stigma they faced when subsequently seeking new employment by reason of the fact that they had formerly worked for an organisation that was shown to have been thoroughly corrupt, even though they were not themselves complicit in that corruption.

When the redundancy releases were signed, stigma damages were unknown to English law: *Addis v Gramophone Co*[6] was generally understood to preclude a claim for such damages. However, *Addis v Gramophone* was over-ruled in this respect by *Mahmud v BCCI*,[7] where the House of Lords held that an employee could claim damages for loss of that kind.

The question in *BCCI v Ali* was whether the employees who had taken redundancy before the Bank collapsed could bring claims for stigma damages, given the terms of the releases they had signed. The House of Lords held (by a majority) that they could.

[5] [2002] 1 AC 251 (HL)
[6] [1909] AC 488 (HL)
[7] [1998] AC 20

Lord Hoffmann, who dissented, said (with some force) that the language of the release showed that "*the draftsman meant business*" and that he had "*gone to some trouble to avoid leaving anything out*". However, the employees argued that the release could not sensibly be construed as applying to a claim of which ***neither they nor the Bank*** were, or could have been, aware at the time of the release: the parties should not therefore be taken to have intended to settle such claims. A majority of the House of Lords agreed.

Lord Bingham, giving the leading speech for the majority, confirmed that the same principles apply to construction of releases as apply to other contract terms. However, he said that this was subject to a 'cautionary principle', which he expressed as follows:

> "*[10] … a long and in my view salutary line of authority shows that, in the absence of clear language, the court will be very slow to infer that a party intended to surrender rights and claims of which he was unaware and could not have been aware. …*
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> *"[17] I think these authorities justify the proposition advanced in paragraph 10 above and provide not a rule of law but a cautionary principle which should inform the approach of the court to the construction of an instrument such as this. … the judges I have quoted expressed themselves in terms more general than was necessary for decision of the instant case, and I share their reluctance to infer that a party intended to give up something which neither he, nor the other party, knew or could know that he had.*"

On the facts of *BCCI v Ali*, this cautionary principle applied because ***neither*** party knew or could have known about claims for stigma damages: they were at the time of the releases unknown to English law. As a result, they were not claims which the parties could reasonably be taken to have intended to compromise by the release.

Lord Bingham's 'cautionary principle' is frequently relied upon. It is a cardinal principle to which one should have regard when addressing the construction of any settlement agreement.

<u>Subsequent Case Law</u>

Subsequent application of Lord Bingham's cautionary principle may be illustrated by comparing the decision of the Court of Appeal in *Kazeminy v Siddiqi*[8] with the decision of Eder J in *Khanty-Mansiysk Recoveries Limited v Forsters LLP*.[9] In both cases, the claimant sought to bring a claim against the defendant which the defendant said was compromised by an earlier settlement agreement. In *Kazeminy*, the Court of Appeal applied Lord Bingham's cautionary principle to find that the claim was outside the scope of the settlement. By contrast, in *Khanty-Mansiysk*, the court found that despite Lord Bingham's cautionary principle, the subsequent claim was within the scope of the settlement agreement.

Kazeminy v Siddiqi

In *Kazeminy*, the claimant and defendant had settled claims between themselves arising out of the financing of a commercial venture for the exploitation of certain technology developed by the defendant. The claimant had invested in, and provided finance to, the venture. A dispute arose between

[8] [2012] EWCA Civ 416

[9] [2016] EWHC 583 (Comm). See also *Priory Caring Services v Capita Property Services* [2010] EWCA Civ 226 (subsequent claims not precluded by the settlement); and *Marsden v Barclays Bank* [2016] EWHC 1601 (QB) (subsequent claims precluded).

the claimant and defendant which led to the claimant suing the defendant for repayment of its loans.

Finance had also been provided to the venture by another investor, Mr Grano. At the time of the trial, Mr Grano had intimated claims against the defendant, but he was not a party to any proceedings.

The claimant's action was settled in the course of the trial, in November 2010. The following year, the claimant acquired by assignment the claims which Mr Grano had against the defendant arising out of the same venture. The question was whether the settlement agreement precluded the claimant from pursuing those claims against the defendant. The settlement agreement was widely worded. It covered:

> "*all and any claims … that the Claimants have or may have against the Defendants, whether past, present or future and whether or not known or contemplated at the date of this Settlement Agreement arising under or in any way connected with … any dealings between the parties concerning loans to or investments in [the commercial venture] by the Claimants or by any person whatsoever*".

On the face of it, the claim acquired from Mr Grano was a claim 'concerning loans to the commercial venture' by a person other than the claimant and was therefore caught by the settlement. The fact that the Claimant had only acquired this claim after the settlement and had not known of the claim at the time of the settlement was, the Defendant said, irrelevant. The settlement expressly covered ***future*** claims, and claims which were ***not known or contemplated*** at the date of the settlement.

The Court of Appeal, however, said that there was nothing in the background leading up to the settlement to indicate that the parties even turned their minds to the possibility of either side subsequently acquiring claims by assignment from a third party; if the parties had intended the settlement to cover such claims, they would have expressly provided for that in the agreement. In the Court's view, the context showed that the parties were directing their minds at the time of the settlement solely to claims arising between them "*as original parties*". Claims acquired by assignment were not therefore within the scope of the settlement agreement.

Khanty-Mansiysk v Forsters LLP

In *Khanty-Mansiysk*, Forsters solicitors had undertaken work for Khanty-Mansiysk in connection with Khanty-Mansiysk's acquisition of a Russian oil exploration entity known as Yugra. A dispute arose over payment of fees charged by Forsters. The amount in dispute was about £75,000.

Khanty-Mansiysk claimed that the time billed by Forsters had not been spent on work for them but on work for another entity connected to the same venture. There was no allegation of wrongdoing or negligence by Forsters. The dispute was simply about the proper allocation of time between Khanty-Mansiysk and the other participant in the venture. Forsters sued for their fees. The claim was compromised in December 2012. The settlement agreement compromised:

> "*any claim … whether known or unknown, suspected or unsuspected, however and whenever arising … whether or not such claims are within the contemplation of the Parties at the time of this Agreement arising out of or in connection with the [settled action] or the [solicitors' invoice for work allegedly done]*".

Two months later, in February 2013, Khanty-Mansiysk discovered that it had never effectively acquired the shares in Yugra as a matter of Russian law. It claimed to have lost its investment in the project as a result and sued Forsters for negligence, claiming damages in excess of £70 million. Forsters argued that the claim was precluded by the settlement agreement.

Khanty-Mansiysk relied on Lord Bingham's cautionary principle. It argued that when construed in the context of the dispute about the solicitors' bill, it was plain that a claim for negligence was wholly outside the contemplation of the parties. Eder J rejected this argument. He held that the wide words of the settlement agreement could not be cut down by Lord Bingham's cautionary principle. Whilst the claim which materialised was not known or suspected at the time of the Settlement Agreement, "*the objective bystander could not and would not have said that a claim for damages for breach of contract and/or negligence [against the solicitors] was impossible*"; this was therefore "*not a case like <u>BCCI</u> where the claim was, in effect, an 'unknown unknown'*".[10]

<u>Fraud Claims</u>

The case law shows that the courts are generally more reluctant to find that claims for fraud are within the scope of a settlement agreement, except where the language or context of the agreement makes that very clear.

This is a salutary lesson to bear in mind when drafting settlement agreements. If a party wishes to ensure that a settlement agreement covers claims for fraud or dishonesty, it should spell that out in the agreement, even if the context arguably suggests that claims for fraud are to be covered. There is otherwise a risk that claims for fraud will be construed as falling outside the scope of the agreement.

In this regard, the courts have adopted by analogy the same approach that applies to construction of exclusion clauses. The general rule in respect of exclusion clauses is that they will not be interpreted as excluding liability for fraud unless clear and specific words to that effect are used. As Lord Bingham said in *HIH Casualty and General Insurance v Chase*, "*fraud is a thing apart*"; and as a result, when seeking to exclude liability for fraud:[11]

> "*General words, however comprehensive the legal analyst might find them to be, will not serve: the language used must be such as will alert a commercial party to the extraordinary bargain he is invited to make*".

It follows that unless clear and specific language is used, ostensibly wide words of settlement will generally <u>not</u> be taken to encompass claims for fraud.

The two main English decisions in this area are *MAN v Freightliner* [2005] EWHC 2347 (Comm) and *Satyam Computer Services v Upaid Systems* [2008] EWCA Civ 487. In each of these cases, the settlement agreement contained a generally worded release of all current, past and future claims. However, in neither case was the agreement found to cover claims for fraud which later emerged.

In both cases, the settlement agreements had been made in order to settle commercial disputes arising out of business dealings between the respective parties. There was nothing in the background to either agreement specifically raising the question of fraud. In that context, the court said in each case that the ostensibly wide words of the settlement agreement should not be construed so as to encompass claims for fraud.

This is not to say that claims for fraud will <u>never</u> be caught by a settlement agreement unless the agreement states in express terms that such claims are covered. However, in the absence of express language to that effect, there must be some other clear indication from the agreement or its context that

[10] At [41].
[11] [2003] 2 Lloyd's Rep 61 at [16]

claims for fraud are covered.

Tchenguiz v Grant Thornton UK LLP[12] is an example of a case where claims for deliberate wrongdoing were held to be covered by a settlement agreement even though express words to that effect were not used in the agreement. This case arose out of the long-running dispute between the Tchenguiz brothers and Kaupthing Bank.

In 2014, Vincent Tchenguiz brought claims for conspiracy and malicious prosecution against Mr Johannsson, a senior member of the winding-up board of Kaupthing Bank, and Grant Thornton, who had acted as advisers to Kaupthing Bank. Prior to bringing these claims, Mr Tchenguiz had (in 2012) settled a previous set of proceedings by him against Kaupthing Bank arising out of dealings between his family trusts and the Bank. The parties covered by that settlement included not only Mr Johannsson but also Grant Thornton.

After Mr Tchenguiz had commenced his first set of proceedings against Kaupthing Bank, he had been arrested by the SFO and his home and offices had been searched in connection with his dealings with the Bank. The search warrants obtained by the SFO were subsequently quashed and the SFO's investigation was terminated. Mr Tchenguiz's claims against Kaupthing Bank were settled after he had commenced judicial review proceedings against the SFO, but before the Divisional Court had handed down its judgment quashing the search warrants.

Following the quashing of the warrants and termination of the SFO's investigation, Mr Tchenguiz commenced proceedings against Mr Johannsson and Grant Thornton, alleging that they had conspired to cause him loss by dishonestly providing false information to the SFO with a view to putting commercial pressure on him to settle his claims against Kaupthing Bank. These proceedings were held to be covered by the settlement agreement, and could not therefore be pursued.

The settlement agreement provided for the compromise of (among other things) claims arising out of "*investigations carried out or actions taken by the authorities in relation to any of the [Tchenguiz parties] or the affairs of [Kaupthing Bank] or its counterparties*". Mr Tchenguiz argued that these words did not cover claims for deliberate wrongdoing (akin to fraud), as he was seeking to assert.

Knowles J rejected that argument. Although the settlement agreement did not expressly refer to claims for deliberate wrongdoing, it was clear from the context in which the agreement was concluded that the 'investigations' referred to in the agreement included the SFO's investigation into Mr Tchenguiz and his dealings in relation to Kaupthing Bank. Whilst the parties had chosen to use language directed to subject area rather than cause of action, their intention to compromise claims of the kind that Mr Tchenguiz was seeking to assert was clear from the context in which the settlement agreement had been made.[13]

III UNCONSCIONABILITY

If a later claim is covered by a settlement agreement, the question arises whether equitable principles may preclude the putative defendant from relying upon the settlement agreement to prevent the claim being pursued.

[12] [2016] EWHC 865 (Comm); [2016] EWHC 3727 (Comm).
[13] [2016] EWHC 865 (Comm) at [40]-[49]

In *BCCI v Ali*, the Court of Appeal held that claims for stigma damages were on the true construction of the releases within their scope, but went on to hold that the Bank was precluded from relying upon the releases because that would have been *unconscionable* in circumstances where the Bank knew the facts giving rise to the employees' claims, i.e. the Bank's own dishonesty and corruption, and knew also that the employees did <u>not</u> know those facts. The principle was most clearly stated by Chadwick LJ, as follows:[14]

> "*I would hold that, where (i) the releasee, say A, knows of facts which give rise to a claim (whether or not he believes that claim to be well founded as a matter of law), (ii) A deliberately conceals those facts from the releasor, say B, in circumstances where A knows or believes that B cannot discover them for himself, and (iii) B does not know of those facts, then A cannot rely on a general release from B as a defence to a claim based on those facts, notwithstanding that as a matter of construction the words of the release would include all unidentified claims. A cannot rely on the general release because, in the circumstances described, it would be unconscionable for him to do so*."

Sir Richard Scott V-C reached the same conclusion by applying a 'comparable approach' to that adopted in cases of equitable estoppel; if the Bank was allowed to rely upon the ordinary meaning of the releases, it would obtain an 'unconscionable advantage' from the employees' ignorance of the relevant facts, which equity would not permit.[15]

In the House of Lords, only Lord Nicholls and Lord Hoffmann considered the unconscionability principle. Lord Nicholls, who concurred with Lord Bingham on the construction of the releases, went on to say *obiter* that different considerations might arise where one party took advantage of another party's ignorance of a claim. He said:[16]

> "*Materially different is the case where the party to whom the release was given knew that the other party had or might have a claim and knew also that the other party was ignorant of this. In some circumstances seeking and taking a general release in such a case, without disclosing the existence of the claim or possible claim, could be unacceptable sharp practice. When this is so, the law would be defective if it did not provide a remedy*."

The principle was considered in more detail by Lord Hoffmann, who said:[17]

> "*[70] In principle, therefore, I agree ... with Chadwick LJ, that a person cannot be allowed to rely upon a release in general terms if he knew that the other party had a claim and knew that the other party was not aware that he had a claim. I do not propose any wider principle: there is obviously room in the dealings of the market for legitimately taking advantage of the known ignorance of the other party. But, both on principle and authority, I think that a release of rights is a situation in which the court should not allow a party to do so. On the other hand, if the context shows that the parties intended a general release for good consideration of rights unknown to both of them, I can see nothing unfair in such a transaction*.
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> "*[71] It follows that in my opinion the principle that a party to a general release cannot take advantage of ... what would ordinarily be regarded as sharp practice, is sufficient to deal with any unfairness which may be caused by such releases. There is no need to try to fill a gap by giving them an artificial construction*."

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[14] At [81]
[15] At [5] and [33].
[16] At [32]
[17] At [70]-[71]

Subsequent Case Law

The precise juridical nature and scope of this principle remains unclear. The Court does not generally police the fairness or conscionability of contractual bargains;[18] it is not immediately apparent why settlement agreements should be any different. The principle has nevertheless been recognised in several subsequent cases, although it has not yet been applied in England so as to enable a party actually to escape from the consequences of a settlement agreement freely entered into.[19]

In *Tchenguiz v Grant Thornton*, Mr Tchenguiz relied, in the alternative to arguments of construction, on the unconscionability principle derived from *BCCI v Ali*. He argued that at the time of the settlement agreement, the Kaupthing and Grant Thornton defendants knew, and knew that he did not know, that he had good claims against them that would be compromised by the settlement agreement. By concealing their knowledge from him, they had (he argued) acted unconscionably and could not therefore rely upon the settlement agreement to prevent the claims being pursued.

Knowles J rejected this argument, on the ground that the unconscionability principle only applied to a 'general release' and not, as in the case before him, a specific release of claims in the context of settlement of a particular dispute. As Knowles J observed, both Lord Nicholls and Lord Hoffmann had confined their words in *BCCI v Ali* to a <u>general</u> release. It was only in such a situation that the law might have to recognise a limit to the freedom of contract by applying a doctrine of unconscionability.[20] The present case was different; it involved a "*specific release of claims*" where:

> "*Each party, with the benefit of legal advice, took the risk that they might be giving up a claim that another party knew of but they did not. The law allows that freedom where the release is not a general release*."

In *Brazier v News Group Newspapers*,[21] Mann J similarly held that Lord Hoffmann's unconscionability principle only applied to a general release, and not to compromise of specific disputed claims. This decision arose out of the telephone hacking activities of the News of the World. Mr Brazier was of interest to the tabloid press due to his relationship with Jane Goody, of Big Brother fame. The hacking of his phone was first revealed as a result of a police investigation, known as 'Operation Weeting', into the activities of Mr Mulcaire, a private investigator who carried out phone hacking for the News of the World. As a result of the police making known the outcome of Operation Weeting, Mr Brazier and many others sued News Group Newspapers ("NGN"). NGN adopted a strategy of attempting to settle as many of these cases as possible. In December 2012, they settled the claim brought by Mr Brazier.

After that settlement, the police made known the outcome of a separate investigation known as 'Operation Pinetree', which focussed not on the activities of Mr Mulcaire, but rather activities of various journalists at the News of the World. As a result of evidence uncovered in that investigation, Mr Brazier sought to bring a second claim against NGN. He argued that this claim was not covered by the 2012 settlement, on its true construction. Mann J rejected that argument.

[18] *Cavendish Square v Talal* [2016] AC 1172 at [16], Lords Neuberger and Sumption.
[19] In addition to *Tchenguiz v Grant Thornton* and *Brazier v News Group Newspapers*, considered below, see also *Gamatronic (UK) Ltd v Hamilton* [2013] EWHC 3287 (QB) at [21]-[23], where Andrew Smith J accepted on a summary judgment application that the unconscionability principle arguably applied to a general release given by a company director on his departure from the company.
[20] [2016] EWHC 3727 (Comm) at [57]; see also [2016] EWHC 865 (Comm) at [58].
[21] [2015] EWHC 125 (Ch), Mann J.

In the alternative, Mr Brazier relied upon unconscionability. He argued that it would be unconscionable to allow NGN to rely upon the 2012 settlement because it had concealed the phone hacking activities which he was now relying upon to found his claim. Mann J also rejected this argument. He held, first, that the unconscionability principle only applied to general releases. Second, he said that the principle could not anyway assist Mr Brazier because he had been aware before the settlement agreement of NGN's concealment of its phone hacking activities. That had been an integral part of the claim that Mr Brazier had pleaded in his first action.

Mann J agreed that NGN's concealment of its phone-hacking could itself be branded as 'sharp practice', but it was not sharp practice ***in relation to the compromise***. That compromise had been made against the background of Mr Brazier knowing of NGN's concealment. In those circumstances, NGN's concealment was 'all part of the compromise'; it could not therefore constitute sharp practice entitling Mr Brazier to avoid the compromise.

The distinction between a 'general release' and other forms of settlement agreement is not necessarily easy to draw. A compromise of specific claims will often include a widely-worded general release of claims between the parties, in which case the unconscionability principle could still arguably apply.

IV. SETTING ASIDE/AVOIDANCE

As with any contract, a settlement agreement may be set aside or avoided on grounds of misrepresentation, mistake or duress.

Zurich Insurance v Hayward

The leading decision in England is *Zurich Insurance v Hayward,*[22] where the Supreme Court set aside a settlement of a personal injury claim for fraudulent misrepresentation. The defendant, Mr Hayward, had brought a claim against his employer for personal injury suffered in an accident at work. He claimed some £419,000, alleging that he was suffering from continuing physical disabilities and was fit for only light work. The employer's insurers, Zurich, conducted the employer's defence. They admitted liability but contested quantum. Relying on video surveillance evidence, they pleaded that Mr Hayward had exaggerated the extent of his injuries for personal financial gain.

Shortly before the issue of quantum was to be tried, the parties reached a settlement under which Zurich agreed to pay Mr Hayward £134,973. The settlement was made by way of a Tomlin order, which simply stated (in a schedule) that the claimant accepted the sum of £134,973 in settlement of his cause of action and that upon payment of that sum, the defendant was to be discharged from any further liability to the claimant.

Two years later, Mr Hayward's next door neighbours snitched on him to Zurich. They told Zurich that they believed that Mr Hayward's claim to have suffered a serious back injury was dishonest and that he had in fact made a full recovery from his injury at least a year before the settlement.

Zurich commenced proceedings against Mr Hayward, claiming damages in deceit or alternatively rescission of the settlement agreement and repayment of the settlement sum. The claim was brought on the basis of the falsity of statements made by Mr Hayward about the extent of his injuries in the course of his proceedings against the employer. Those statements were contained in Mr Hayward's pleadings,

[22] [2015] EWCA Civ 327 (CA); [2017] AC 142 (SC)

in his witness statements and in the accounts given by him to medical experts: Zurich alleged that they constituted fraudulent misrepresentations which had induced it to settle Mr Hayward's claim for £134,973.

The misrepresentations said to found a right to avoid the settlement were some of the very averments of fact made by Mr Hayward in advancing his claim. This was therefore not a case of what might be termed 'collateral' representations directed to the settlement itself, which is the more usual basis for seeking to set aside a settlement agreement for misrepresentation. Thus in *Gilbert v Endean*,[23] one of the early cases on avoidance of a settlement agreement, the defendant's solicitor made a misrepresentation about the defendant's lack of means at the meeting at which a settlement agreement was made. The Court of Appeal held that the misrepresentation was material and had induced the settlement, which could therefore be avoided. Zurich, by contrast, was relying upon statements made by the claimant in and for the purpose of the proceedings themselves in order to found its deceit claim.

Those statements, however, had not been believed by Zurich or otherwise relied on by it in the normal way. On the contrary, Zurich disputed the truthfulness of the statements, asserting in its Defence that Mr Hayward had exaggerated the extent of his injury for financial gain. Zurich nevertheless argued that it had been induced by Mr Hayward's statements to enter into the settlement agreement because it believed that there was a risk that his statements might be believed <u>by the Court</u>. The statements had therefore influenced Zurich and caused it to act to its detriment by agreeing to settle Mr Hayward's claim for £134,973.

The trial judge accepted this argument and set the settlement aside. He found that Mr Hayward was entitled only to damages for his injury in an amount of £14,720, and consequently ordered him to repay the settlement sum less that amount. The Court of Appeal, however, held that Zurich could not set the settlement aside because it was aware of Mr Hayward's fraudulent exaggeration of his injury at the time of the settlement. This decision was then overturned by the Supreme Court, which restored the judgment of the trial judge. The key issue addressed by the Supreme Court was whether inducement can be established for the purposes of deceit where the misrepresentee did not believe the misrepresentation(s) to be true.

Lord Clarke, giving the lead judgment, said that inducement required the misrepresentee to have been influenced by the misrepresentation, not that he believed it to be true. Inducement is concerned with causation; provided the misrepresentee can establish a causal connection between the misrepresentation and the subsequent conduct said to have caused him loss, his claim in deceit will be established. For this purpose, it suffices that the misrepresentation had 'an impact on the misrepresentee's mind' or an 'influence on his judgment'. That was the case here because Zurich had been influenced by Mr Hayward's misrepresentations to settle his claim for £143,739, even though it did not believe the truth of those misrepresentations.[24] Lord Toulson gave a concurring judgment.[25]

<u>Implications of Zurich Insurance v Hayward</u>

The Supreme Court's decision has been warmly welcomed by the insurance industry. The case serves as stark warning to claimants that fraud will not be tolerated, even following settlement. That is clearly

[23] (1878) 9 Ch D 259 (CA); and see *Foskett on Compromise*, 8th edn, at [4-37] and [4-42] to [4-50].
[24] Lord Clarke at [23]-[47]
[25] Lord Toulson [58]-[72]

an important message to convey when the problem of fraudulent insurance claims is escalating at an alarming pace.[26]

Commentators have also argued that the effect of the Court of Appeal's decision was to discourage settlement and deter full and proper pleading by defendants, whereas on the Supreme Court's approach, early settlement is encouraged because insurers can be confident of recovering overpayments if fraud is later established; and full and proper pleading is not deterred because some prior investigation of the claimant's claim will not preclude insurers avoiding a settlement if better evidence later comes to light.[27]

However, the Supreme Court's decision does give rise to potentially serious difficulties. It operates as a deterrent to settlement of fraud actions because defendants will be wary of settlements later being re-opened on the ground that their denial of the claimant's fraud allegations constituted misrepresentations which induced the settlement.

The Supreme Court did not consider in any detail the contractual impact of the settlement agreement upon the insurers' right to avoid. Lord Clarke addressed the point obliquely, when saying that he found it difficult to envisage any circumstances in which mere suspicion that a claim was fraudulent would preclude unravelling a settlement when fraud is subsequently established.[28] However, that must (at least arguably) depend upon the true meaning and effect of the settlement agreement.

Lord Toulson observed (by reference to *HIH Casualty*) that 'fraud is a thing apart' which 'unravels all'.[29] However, *HIH Casualty* concerned a contractual clause purporting to exclude <u>prospective</u> liability for fraud, and not the compromise of liability which had already attached prior to the agreement being entered into.

The importance of distinguishing between exclusion of prospective liability and compromise of an accrued liability has been recognised in the context of statutory provisions prohibiting a company from exempting a director from liability that would otherwise attach to the director in respect of a breach of duty (as found e.g. in s.232(1) of the Companies Act 2006). In *Ting v Borelli*,[30] the Bermudan Supreme Court and the Bermuda Court of Appeal held that the provision in the Bermuda Companies Act to that effect did not preclude a company from compromising claims, including claims for fraud, against a director. In the view of the Bermudan courts, the section prohibited only prospective arrangements and not those entered into *ex post facto*. As Auld JA said:[31]

> "*Any other approach would deny a company or its liquidators of the opportunity, when circumstances commercially dictate, to act in its best interests by compromising disputes with directors or other officers whom they know or suspect have been fraudulent in their conduct of its affairs*."

In the same way, the rules limiting a contracting party's ability to exclude prospective liability for fraud should not be taken to exclude altogether the parties' ability to compromise claims and allegations of fraud. The cases considered above demonstrate that such claims and allegations can indeed be

[26] Fraudulent insurance claims have been estimated to cost the UK insurance industry in excess of £1.3 billion per year: see ABI analysis at www.abi.org.uk/products-and-issues/topics-and-issues/fraud.
[27] Lindeman, *Unravelling settlements made with 'eyes wide open'* [2017] CJQ 273 at 278-9; Clyde & Co case alert, 27 July 2016.
[28] At [48]
[29] At [53]
[30] Supreme Court of Bermuda, 5.12.2007; Bermuda Court of Appeal, 28.11.2008.
[31] *Ting v Borelli*, Bermuda Court of Appeal, 28.11.2008, at [83]

compromised, provided the parties make their intention to do so clear. As Sir Richard Scott V-C said in *BCCI v Ali*:[32]

> "*The law cannot possibly decline to allow parties to contract that all and any claims, whether known or unknown, shall be released. The question in a case such as the present is to ascertain, objectively, whether that was the parties' intention*".

In *Zurich v Hayward*, the Court of Appeal concluded that allowing the insurers to avoid the settlement would be contrary to the parties' intentions as embodied in the settlement agreement. Underhill LJ reasoned that when a party settles a case, it takes the risk that the statements made by the other side in pleadings, witness statements etc are untrue (or would not be proved at trial) and pays a sum commensurate with its assessment of that risk; it thereby foregoes the opportunity to proceed to trial to disprove the statements in question. In contractual terms, that party "*necessarily implicitly agrees not thereafter to seek to have [the settlement agreement] set aside on the basis that the statements made in support of the claim were false*".[33] To similar effect, Briggs LJ said that where a defendant had alleged from the outset that the claimant's case was false, the defendant could not resile from a settlement agreement because he later obtains better evidence of that which he already believed.[34] According to Briggs LJ:

> "*The contract is made [by the defendant] with his eyes open about the probable untruth of the [claimant's case]. His contract is a form of risk management, and there is no reason why he should be enabled to walk away from it merely because that risk later diminishes or disappears*."

By contrast, the Supreme Court implicitly found that Zurich had not agreed to forego its right to challenge the settlement agreement in the event that further evidence of exaggeration of Mr Hayward's injury came to light following the settlement. That is an understandable interpretation of the settlement agreement in that case, which did not spell out in terms who bore the risk of new evidence emerging and whether if such evidence came to light, insurers retained the right to re-open the settlement. However, where the settlement agreement makes clear that one party not only assumes the risk of new evidence subsequently coming to light but also agrees not to challenge the settlement if that happens, then that party should be kept to its bargain. It should therefore be possible to settle fraud claims, effectively and finally, by making the parties' intentions clear in the settlement agreement.

It may also be possible to include non-reliance clauses of the kind commonly used in banking and financial contracts in a settlement agreement. Such clauses may prevent a party from contending that representations have been made by the other party or that it has relied upon any representations as may have been made by the other party, even if the contrary was in fact the case.[35] As Moore-Bick LJ said in *Peekay Intermark v Australia & New Zealand Banking Group*:[36]

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[32] [2000] ICR 1410 at [11]. See also *Tchenguiz v Grant Thornton* [2016] EWHC 865 (Comm); at [49], where Knowles J said, in relation to settlement of claims for deliberate wrongdoing: "*It is important for it to be possible for parties to be able, if this is what they wish, to achieve a compromise that puts the past behind them and gains certainty for the future*".
[33] [2015] 1 CLC 581 at [16]-[17]
[34] [2015] 1 CLC 581 at [32]-[33]
[35] See e.g. *Springwell Navigation v JP Morgan Chase* [2008] EWHC 1186 (Comm); [2010] EWCA Civ 1221; *Raiffeisen Zentralbank Osterreich AG v Royal Bank of Scotland* [2010] EWHC 1392 (Comm) and *Titan Steel Wheels v Royal Bank of Scotland* [2010] EWHC 211 (Comm).
[36] [2006] 1 CLC 582 at [56]-[57]

"*[56] There is no reason in principle why parties to a contract should not agree that a certain state of affairs should form the basis for the transaction, whether it be the case or not … Where parties express an agreement of that kind in a contractual document neither can subsequently deny the existence of the facts and matters upon which they have agreed … The contract itself gives rise to an estoppel*. …

[57] … I can see no reason in principle why it should not be possible for parties to an agreement to give up any right to assert that they were induced to enter into it by misrepresentation, provided that they make their intention clear, or why a clause of that kind, if properly drafted, should not give rise to a contractual estoppel."

It has been doubted whether such clauses can effectively exclude claims for fraudulent misrepresentation, on the grounds that public policy does not permit a contracting party to exclude liability for his own fraud in inducing the contract.[37] However, in *Deutsche Bank v Unitech*,[38] Teare J considered it arguable that non-reliance clauses do not exclude liability but rather prevent any representation being made, which is "*a logically prior question to the question whether liability for a misrepresentation which has been made has been excluded*". On that basis, non-reliance clauses may help to prevent settlement agreements being re-opened when new evidence later emerges disproving the truth of one party's case.

<u>Ting v Borelli</u>

The contractual implications of setting aside a settlement agreement were closely considered in the Bermudan case of *Ting v Borelli*,[39] where a company's liquidators sought to set aside a settlement agreement they had concluded with the company's former CEO, on the grounds that the CEO had allegedly failed to disclose his own fraudulent breach of duty to the company when negotiating the settlement agreement.

Ting v Borelli arose out of the collapse in 1999 of Akai Holdings, the parent company of a major conglomerate listed on the HK Stock Exchange. At the time, this was the largest corporate collapse in Hong Kong's history; the group's estimated net deficiency exceeded more than $1 billion.

In December 2002, Mr Ting (the former CEO, and a significant shareholder, of Akai) entered into a settlement agreement with the group's liquidators, following a dispute with them about a scheme of arrangement which they were seeking to implement in order to raise funds to enable them to continue their investigations into the collapse of the group. In return for Mr Ting withdrawing his objections to the scheme, the liquidators compromised all claims that they and Akai had or might have against Mr Ting, whether known or unknown, arising out of or in connection with Akai. Following conclusion of the settlement, the liquidators were able to implement the scheme, secure the funds they needed and continue their investigations. That enabled them *inter alia* to commence claims against Akai's auditors, which ultimately led to substantial recovery for the group's creditors.

[37] *FoodCo UK LLP v Henry Boot Developments* [2010] EWHC 358 (Ch) at [166], Lewison J.
[38] [2013] EWHC 2793 at [173]
[39] Supreme Court of Bermuda, 5.12.2007; Bermuda Court of Appeal, 28.11.2008; [2010] UKPC 21; 79 WIR 204 (PC)

Three years after the settlement, the liquidators sought to commence proceedings against Mr Ting in Hong Kong for breach of fiduciary duty and fraud arising out of his alleged embezzlement of sums in excess of US$400m from Akai. Mr Ting said that these claims were compromised by the settlement agreement. The liquidators argued that the claims were (as a matter of construction) outside the scope of the settlement agreement or alternatively that they were entitled to set aside the settlement agreement for Mr Ting's fraudulent non-disclosure of his wrongdoing when negotiating the settlement.

It is well-established that settlement agreements are not contracts of the utmost good faith.[40] However, the liquidators argued in reliance on the decision of the English CA in *Item Software v Fassihi*[41] that Mr Ting owed a duty, as a director of Akai, to disclose his own wrongdoing to Akai, which duty (they said) extended up to, and beyond, the time of negotiation of the settlement agreement.

In *Item Software*, the Court of Appeal had expressly left open the "*difficult question*" of whether the rule requiring a director to disclose his own wrongdoing applied to negotiation of a settlement agreement between the director and the company. Arden LJ cited (but without confirming its correctness) a passage from *Horcal v Gatland*,[42] where Goff LJ said that:

> *"[the company's] argument, that a director is under a duty to disclose any breach of duty on his part before an agreement of the kind in the present case was entered into, could lead to the extravagant consequence that a director might have to make what [the director's counsel] called a 'confession' as a pre-requisite of such an agreement*".

Consistent with this observation, Nicholas Strauss QC (sitting as a Deputy Judge of the High Court) held in *Item Software* at first instance that no such duty of disclosure was owed by a director.[43] This ruling was followed by David Donaldson QC (sitting as a Deputy Judge of the High Court) in *Re Amba Carpet Servicing Ltd*.[44] The point nevertheless remains a vexed one.[45]

In *Ting v Borelli* at first instance, the Chief Justice of Bermuda accepted the liquidators' arguments on both construction and non-disclosure. His judgment was overturned by the Bermuda Court of Appeal. Auld JA, giving the lead judgment, held that objectively construed, the settlement agreement precluded the claims sought to be made by the liquidators against Mr Ting. The background leading up to the settlement agreement made abundantly clear that the liquidators believed that Mr Ting had been guilty of deliberate misconduct and wrongdoing towards Akai, including possible embezzlement; they could not therefore resile from the settlement when further evidence of embezzlement emerged. It was nothing to the point that the scale of the embezzlement which the liquidators later believed they had uncovered was very much greater than anything they had foreseen at the time of the settlement.

Auld JA further held that the liquidators' claim to set aside the settlement agreement for non-disclosure could not stand in the face of the clear terms of the settlement agreement. At the time of entering into

[40] *Turner v Green* [1895] 2 Ch 205; and *Wales v Wadham* [1977] 1 WLR 199.
[41] [2005] ICR 450
[42] [1984] IRLR 288 at 290
[43] [2002] EWHC 3116 (Ch)
[44] [2004] EWHC 638 (Ch)
[45] Note also *Gray v New Augarita Porcupine Mines* [1952] 3 D.L.R. 2, where the Privy Council refused to set aside a compromise agreement made between a director and the company's board where the director had not disclosed his own wrongdoing to the board, but nevertheless held that the director was liable (by reason of his non-disclosure) to account to the company for the profit he had made from the compromise agreement, namely the difference between the settlement sum and the true extent of his liability to the company. Lord Radcliffe, giving the judgment of the board, said that the director was required to make a declaration so that his colleagues were "*fully informed of the real state of things*" (at 14).

the agreement, Mr Ting could not have owed any duty to disclose his alleged wrongdoing to Akai or its liquidators if, on the true construction of the agreement, the objective intention (i.e. the mutual contemplation) of the parties was that, in exchange for Mr Ting withdrawing his objection to the scheme, the liquidators were to give up all known and unknown claims against Mr Ting, including claims for fraud and other deliberate wrongdoing. If that is what the settlement agreement meant, it could not, according to Auld JA, "*reasonably have been understood by the parties as leaving the Liquidators free to ignore that undertaking on later discovering undisclosed causes of action*."[46] Auld JA added:[47]

> "*In my view, if parties enter into a compromise agreement under which A, as a matter of construction, effectively releases B from potential "any and all claims of any kind or nature whatsoever" unknown to A in exchange for valuable consideration from B, there is no legal room for A to avoid that contract by claiming a breach by B of a duty of disclosure as to any such claim*."

On the liquidators' appeal to the Privy Council,[48] the case was decided on the grounds of economic duress, which had not been raised either at trial or in the Court of Appeal. The Privy Council found that the settlement agreement had been procured by Mr Ting exerting illegitimate pressure upon the liquidators amounting to economic duress. This vitiated the liquidators' consent, with the result that they were entitled to set the agreement aside.

This vitiating factor was separate to, and independent of, the underlying fraud and wrongdoing giving rise to the liquidators' claims for embezzlement against Mr Ting. It was therefore not precluded by the compromise contained in the settlement agreement. Lord Saville, giving the judgment of the Board, added that it was not in any event "*possible, by the use of illegitimate means, to obtain a binding agreement from which the party subject to duress cannot withdraw*".[49]

Notwithstanding the Privy Council's determination of the case on a different basis, the analysis by Auld JA of the effect of the settlement agreement upon the liquidators' entitlement to set the agreement aside for Mr Ting's alleged non-disclosure of his wrongdoing remains compelling. It shows why settlement of a fraud claim should be capable of binding the parties even if new evidence of fraud later emerges.

If the party alleging fraud compromises the case on the basis that it agrees not only to assume the risk of evidence subsequently coming to light which proves the fraud but also that it will not challenge the settlement if such evidence comes to light, there can (to adopt the words of Auld JA) be "*no legal room*" for that party later to avoid the settlement by re-opening the fraud issue which it has undertaken not to re-open. New evidence of fraud cannot be said to 'unravel all' where the possible emergence of such evidence, and the consequences of it emerging, are the very subject matter of the parties' agreement. The key is for the parties to make clear in the agreement that they intend the settlement to be binding even in the face of new evidence of fraud.

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46 Auld JA at [61]
47 At [62]
48 [2010] UKPC 21; 79 WIR 204
49 At [40]