Coming out of the cold

Simon Nurney and Gavin Gray explore a recent decision on the question of jurisdiction

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'The Court of Appeal found that the alleged conspiracy was manifestly more closely connected with Russia than with any other place.'

In the recent case of *Erste Group Bank AG London Branch v JSC 'VMZ Red October'* [2015], the Court of Appeal held that England was not the appropriate forum to determine what 'was overwhelmingly a Russian case'. This article considers the main points of general interest arising from that judgment.

Background

The claimant (the bank) was one of a syndicate of lenders which participated in a $80m loan to the first defendant, JSC 'VMZ Red October' (D1), which operated one of Russia's largest steel works. D1's obligations under the loan agreement were guaranteed by the second defendant, Red October 'Steel Works' (D2). Both the loan agreement and the guarantee were governed by English law and provided for arbitration in London or, at the lenders' option, for the exclusive jurisdiction of the English courts.

In July 2009 D1 failed to pay an instalment due under the loan agreement and both D1 and D2 subsequently went into liquidation in Russia. The bank alleged that D1, D2 and six other Russian defendants had entered into a conspiracy by which they had procured the transfer of assets out of D1 and D2 and manipulated the insolvency of those entities, such that they would be unable to meet their obligations under the loan agreement and the guarantee.

The bank issued proceedings in England. The claim form was served on D1 and D2 in England and the bank obtained permission to serve the claim out of the jurisdiction on six other Russian defendants. The third defendant, State Corporation for Assistance to Development, Production and Export of Advanced Technology Industrial Product 'Rosteckhnologii' (D3), and the fifth defendant, LLC RT-Capital (D5), filed acknowledgments of service indicating their intention to contest the jurisdiction of the English court and applied to set aside service of the proceedings. Prior to the hearing of the jurisdiction challenge, the bank obtained summary judgment against D1 and D2 on its contractual claims under the loan agreement and guarantee.

Service out of the jurisdiction

In order to obtain permission to serve proceedings out of the jurisdiction, a claimant must show that:

- there is a serious issue to be tried on the merits of the claim;
- there is a good arguable case that the claim falls within one or more of the jurisdictional gateways set out in CPR PD6B. The requirement to show a 'good arguable case' means that the applicant must show that it has 'much the better of the argument' on the material available; and
- England and Wales is clearly or distinctly the appropriate forum, and the court ought to exercise its discretion to permit service of the proceedings out of the jurisdiction.

At first instance, Flaux J found that each element of this test had been satisfied and dismissed the application to set service aside. D3 and D5 appealed.

The judge's findings, insofar as they are relevant to the appeal, are discussed below, but it is worth noting that Flaux J rejected the bank's claim that it would not receive a fair trial in Russia.

This can be contrasted with the earlier case of *Cherney v Deripaska* [2008], where the opposite conclusion was reached at first instance and upheld on appeal. The difference between the two cases was that, in *Cherney*, Mr Cherney was able to provide specific evidence of a risk that he would not receive a fair trial, whereas, in *Erste*, the bank was relying on a general perception that Russian courts are the subject of improper influence without any concrete evidence to that effect.

This serves as a reminder that the English court will be slow to conclude that it is not possible to obtain justice in other countries and will require positive and cogent evidence before doing so.

The appeal

The Court of Appeal held that none of the bank's claims fell within any of the jurisdictional gateways on which it sought to rely and that England was not the appropriate forum to determine the dispute. This article focuses on the following findings:

- there was not an issue between the bank and D1 and D2 which it was reasonable for the English court to try, with the result that the bank could not use D1 and D2 as 'anchor' defendants for its claims against D3 and D5 (who were the real targets of the claims);
- Russian law was the proper law of the alleged conspiracy claims;
- the bank had not sustained damage within the jurisdiction for the purposes of the tort gateway; and
- the first instance judge was 'plainly wrong' to conclude that England was the appropriate place in which to try the bank's claims.

Necessary or proper party

Paragraph 3.1(3) of PD6B provides as follows (with Gloster LJ's emphasis):

> (3) A claim is made against a person ('the defendant') on whom the claim form has been or will be served (otherwise than in reliance on this paragraph) and —
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> (a) there is *between the claimant and the defendant a real issue which it is reasonable for the court to try*; and
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> (b) the claimant wishes to serve the claim form on another person who is a necessary or proper party to that claim.

The Court of Appeal held that this provision requires a two-stage process.

The first stage, para 3.1(3)(a), not only requires a claimant to show that it has an arguable claim against an 'anchor defendant' but also that it is reasonable for the English court to try that claim.

Only at the second stage does the court go on to consider whether the foreign party is 'a necessary or proper party to that claim' (para 3.1(3)(b)).

The Court of Appeal held that Flaux J had not properly applied the first stage of this test and found that there was no real issue between the bank and D1 or D2 that it was reasonable for the English court to try. This was primarily because (reversing the first instance finding of Flaux J) the Court of Appeal found that, by participating in the Russian insolvency proceedings of D1 and D2, the bank had submitted to the jurisdiction of the Russian courts to determine all issues arising in the insolvencies, including the claims that the bank was attempting to bring in England.

Applicable law

The bank argued that the proper law applicable to its tort claims was English law. D3 and D5 said that Russian, or potentially New York, law applied to the alleged torts.

The relevant test is set out in the Rome II Regulation on the law applicable to non-contractual obligations ((EC) 864/2007) (Rome II). Article 4 provides:

> 1. Unless otherwise provided for in this Regulation, the law applicable to a non-contractual obligation arising out of a tort/delict shall be the law of the country in which the damage occurs irrespective of the country in which the event giving rise to the damage occurred and irrespective of the country or countries in which the indirect consequences of that event occur.
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> [...]
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> 3. Where it is clear from all the circumstances of the case that the tort/delict is manifestly more closely connected with a country other than that indicated in paragraphs 1 or 2, the law of that other country shall apply. A manifestly closer connection with another country might be based in particular on a pre-existing relationship between the parties, such as a contract, that is closely connected with the tort/delict in question.

The bank argued that, for the purposes of para 1 of Art 4, the place where the damage had occurred was England because the facility agent was required to transfer sums received from D1 and D2 to a London bank account. The Court of Appeal rejected this argument because D1 and D2's contractual obligation was to pay the facility agent in New York and they would obtain a good discharge by doing so. The facility agent's obligation to transfer sums received in New York to the bank's London account was merely an aspect of the agency relationship between those two entities. The loss, therefore, was suffered in New York.

The bank also argued that para 3 of Art 4 pointed towards England because the alleged conspiracy was closely connected with the loan agreement and guarantee, both of which were governed by English law, and contained English jurisdiction clauses. However, the Court of Appeal found that the alleged conspiracy was manifestly more closely connected with Russia than with any other place. The parties to the alleged conspiracy were based in Russia, the key events took place there and the purpose of the alleged conspiracy was to take advantage of Russian insolvency procedures.

No part of the claimant's claim would turn on the meaning and effect of the loan agreement or guarantee. It was, in the words of Gloster LJ, 'as Russian a conspiracy as it is possible to imagine'. On that basis, therefore, Russian law applied.

The para 3.1(9) gateway: tort

CPR PD6B 3.1(9) provides for service out of the jurisdiction where a claim is made in tort and 'damage was sustained within the jurisdiction'.

The Court of Appeal found that the claimant could not rely on this jurisdictional gateway because, as explained above, the loan agreement and guarantee required payments to be made in New York, which meant that the damage was sustained there and not in England.

Although not necessary for its decision, the Court of Appeal also considered some earlier first instance authorities on the scope of this jurisdictional gateway. Those authorities suggest that the phrase 'damage was sustained within the jurisdiction' extends to any type of damage including, for example, funeral expenses (*Booth v Phillips* [2004]) and loss of earnings (*Cooley v Ramsey* [2008]).

These authorities are at odds with the EU Judgments Regulation, which does not allow proceedings to be brought in a place where only the indirect consequences of a tortious act are suffered. As the Court of Appeal noted: if these decisions were correctly decided, this would make the tort gateway 'extraordinarily wide' and mean that a claimant who was injured in any part of the world (outside the EU), but who suffered a loss on their return to England, could rely on this gateway.

While expressing serious reservations about the correctness of those earlier authorities, the Court of Appeal declined to overrule them in this particular case. However, the comments of Gloster LJ will provide a good starting point for anyone who, in future litigation, wishes to argue that the English common law rules on service out of the jurisdiction should be brought in line with the Judgments Regulation.

Appropriate forum and discretion

As the Court of Appeal had held that none of the jurisdictional gateways applied, it was not strictly necessary for it to consider whether England was the appropriate forum to try the bank's claims. However, the Court of Appeal recognised that this was the 'predominant issue' in the case and it therefore decided to set out its views on the point.

The Court of Appeal noted that the 'first, and foremost' factor, relied upon by the judge in concluding that England was the appropriate place to try the bank's claims, was that the bank was proceeding against D1 and D2 in England, as it was entitled to do under the exclusive jurisdiction agreements in the loan agreement and the guarantee. The judge held that it would be 'verging on the perverse' to force the bank to pursue its conspiracy claims against the other defendants in Russia, which would result in it litigating the same complex issues of fact twice in two jurisdictions.

However, the Court of Appeal took the view that the chances of the conspiracy claims against D1 and D2 reaching trial in England were minimal. D1 and D2 showed no intention of playing a part in the English proceedings and it was obvious that they would not do so. Nor would it assist the bank to pursue the conspiracy claims in England because those claims would not, for a number of reasons, result in any greater recovery than the bank's contractual claims (on which the bank had already obtained summary judgment). In any event, it is established that it should not become standard practice for the English court to exert jurisdiction over foreign defendants simply to avoid the need for more than one suit in more than one jurisdiction (see, for instance, *AK Investment CJSC v Kyrgyz Mobil Tel Ltd* [2011] and *Golden Ocean Assurance Ltd v Martin (The Goldean Mariner)* [1990]).

Other factors, which the judge wrongly considered to be important, included his finding that English law applied to the conspiracy claims and the fact that the loan agreement and guarantee contained English law and jurisdiction agreements.

As explained above, the Court of Appeal overturned Flaux J's finding on the applicable law. It also held that the choice of law and jurisdiction clauses were irrelevant because D3 and D5 were not parties to those agreements and played no role in their formation; there was no issue concerning those agreements which would need to be determined under English law, and no aspect of the question whether D3 and D5's conduct was or was not unlawful could possibly turn upon any issue of interpretation of the loan agreement or guarantee.

Perhaps more importantly, the Court of Appeal held that Flaux J had taken the wrong approach in basing his conclusion on the 'technical' factors described above. Instead, he should have stood back and asked the practical question of where the fundamental focus of the litigation was to be found, which in this case was clearly Russia. This had led the judge to ignore, or pay insufficient attention to, the following 'critical' factors:

- the bank's conspiracy claims would involve a detailed investigation of the Russian insolvency procedures governing D1 and D2 and the manner in which those insolvencies had been conducted in Russia;
- all relevant documentation was located in Russia and written in the Russian language. All the relevant witnesses would be Russian-speaking and many of them were resident in Russia. It would be necessary to review decisions taken by Russian insolvency practitioners, against the background of their relevant Russian professional obligations, in order to decide whether the conduct of the defendants was unlawful; and
- the relationships between the defendants and other parties were all governed by Russian law.

Thus, in the words Gloster LJ:

> ... on any basis this was overwhelmingly a Russian case and (if there was one) a Russian conspiracy.

The first instance judge had taken the wrong factors into consideration and he was 'plainly wrong' to conclude that England was the appropriate place in which to try the bank's claims. ■

AK Investment CJSC v Kyrgyz Mobil Tel Ltd & ors
[2011] UKPC 7
Booth v Phillips & ors
[2004] EWHC 1437 (Admlty)
Cherney v Deripaska
[2008] EWHC 1530;
[2009] EWCA Civ 849
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[2008] EWHC 129 (QB)
Erste Group Bank AG London Branch v JSC 'VMZ Red October' & ors
[2015] EWCA Civ 379
Golden Ocean Assurance Ltd v Martin (The Goldean Mariner)
[1990] 2 Lloyd's Rep 215