September 27, 2021

Oops, I forget my assets – The perils of unjust enrichment claims

By Ryan Deane

In the recent case of *Dargamo Holdings Ltd* v *Avonwick Holdings Ltd* [2021] EWCA Civ 1149, the English Court of Appeal considered when a claim in unjust enrichment can succeed where the parties' have made an allocation of risk under a valid and subsisting contract. This decision is interesting for what it says about the interaction between contractual obligations and restitution claims. The case also reminds those involved in the negotiation of commercial contracts of the benefits of reflecting the precise terms of their agreement, including any expectations or understandings between the parties about what the contract provides for, in a written and signed legal document.

Background

This case arises from the break-up of a business relationship between three Ukrainian businessmen, Vitali Gaiduk, Oleg Mkrtchan and Sergei Taruta. Mr Gaiduk controlled a company called Avonwick Holdings Ltd. Mr Taruta controlled a company called Dargamo Holdings Ltd. In 2009, Avonwick agreed to sell to Dargamo its interest in a company called Industrial Union of the Donbass. The sale was conducted via the sale of shares in a company called Castlerose Ltd, which held the relevant interest, for a consideration of US$950m.

It was common ground that the purchase price in the share purchase agreement (the "Castlerose SPA") represented not only payment for the shares in the company to be transferred, but also an advance payment for other assets (specifically, shares in other companies) to be transferred to Dargamo at a later date under contractual documentation to be agreed in due course. However, those further assets were not mentioned in the Castlerose SPA, which only referred to the sale and purchase of the shares in Castlerose Ltd. The parties came to dispute the exact terms on which the additional assets would be transferred, resulting in those assets never being transferred to Dargamo.

Dargamo subsequently brought a claim against Avonwick to recover part of the purchase price under the Castlerose SPA arguing that the price was attributable to assets that it never received. It advanced its claim on the basis that Avonwick had been unjustly enriched by virtue of maintaining those additional assets while Dargamo had paid for them. The High Court dismissed the claim at first instance, relying on the fact that the contract between the parties clearly stated what payment was to be made for which assets, and the court could not look behind those express terms. Dargamo appealed to the Court of Appeal, accepting that unjust enrichment could not override the terms of a contract in all cases where there is a separate understanding as to the basis of payment, but arguing that the doctrine should have that effect in this case, primarily because both sides accepted that US$82.5m was referable to assets not mentioned in the Castlerose SPA.

The 'Obligation Rule'

Lady Justice Carr, giving the leading judgment of the court, began by noting that the law of unjust enrichment has been the subject of widespread academic and judicial consideration, being perhaps "*one of the most theorised subjects in the private law of obligations*". Despite this, debate had persisted on the limits of the doctrine and on its relationship with the law of contract. One issue that was clear is the common law basis for an unjust enrichment claim: a claimant has a right to restitution against a defendant who is unjustly enriched at the claimant's expense. As Lord Reed once commented in *Investment Trust Companies* v *HMRC* [2017] UKSC

29, it "*reflects an Aristotelian conception of justice as the restoration of a balance or equilibrium which has been disrupted*".

The four elements a party needs to establish for an unjust enrichment claim are as follows:

(i) Has the defendant been enriched?;
(ii) Was the enrichment at the claimant's expense?;
(iii) Was the enrichment unjust?; and
(iv) Are there any defences?

It is important to note at this stage that the third of these factors (whether the enrichment is unjust) is not determined by a judge making a wide-ranging assessment of fairness or justice in the round. Instead, the claimant must point to an established 'unjust factor' in order to trigger the claim. One of these established unjust factors is a failure of consideration, which is the factor relevant to the *Dargamo* case and which will be discussed further below. Carr LJ remarked that the relationship between liability in contract and liability in unjust enrichment has been, and continues to be, problematic. In her analysis, the two play distinct but complementary roles in the private law of obligations. She referred to several cases decided at the inception of unjust enrichment in English common law which presumed that it was a prerequisite to such a claim that any relevant contract between the parties must have been discharged for breach, or have become void or unenforceable.

Carr LJ commented that this was an incorrect simplification of the position, as claims for unjust enrichment can be made where there is a valid and subsisting contract. However, the orthodox position remains that an unjust factor will not override a valid and subsisting legal obligation of the claimant to confer the benefit on the defendant. In other words, the obligations agreed by parties in a contract will normally take precedence over a claim in unjust enrichment which is incompatible with those obligations. Carr LJ called this the "Obligation Rule".

'Failure of Basis'

As we have seen, for a claimant to establish a claim in unjust enrichment, they must identify an established unjust factor. The unjust factor referred to as 'failure of consideration' is primarily concerned with the situation where there has been a failure of promissory consideration payable under a contract or a failure of contractual counter-performance. Carr LJ preferred to use the terminology 'failure of basis'. She noted that confusion was liable to result from using the word 'consideration', which has a different meaning in unjust enrichment claims than it does when considering whether there is sufficient consideration to support the formation of a contract. In any event, the core concept of failure of basis is that a benefit has been conferred on a joint understanding that the recipient's right to retain it is conditional. If the condition is not fulfilled, the recipient must return the benefit. This was the core of Dargamo's argument. There was a joint understanding that part of the contract payment had been conditional on receiving certain other assets, and when those assets were not transferred, the part of the payment relating to those assets should be returned.

As an aside, this was not a case where Dargamo could bring a claim of rectification, which applies when the parties are agreed on the terms of a contract but there is a mistake in the drafting, meaning that the parties' shared intention is not reflected in the contract. In this case, it was also common ground that the parties had deliberately chosen not to refer to the other assets in the Castlerose SPA. The reason for this was never explored at trial. In support of its argument, Dargamo relied heavily on two cases. Dargamo's contention was that these two cases demonstrated the courts' willingness to depart from the Obligation Rule and uphold an unjust enrichment claim where there was a valid and subsisting contract between the parties.

The first of these was *Roxborough* v *Rothmans of Pall Mall Australia Ltd* [2001] HCA 68, a decision of the High Court of Australia. In *Roxborough*, tobacco retailers ("Roxborough") bought tobacco products from licenced wholesalers ("Rothmans") under a series of contracts on terms that the invoiced 'cost' comprised the wholesale price of the products and a further discrete amount, representing a licence fee, imposed by State law.

The prices charged by Rothmans to Roxborough involved payments to the wholesaler in anticipation of the licence fees which were to be incurred at a future date. Roxborough had a direct interest in Rothmans' payment of these fees, since it relieved Roxborough of a corresponding liability to pay. Roxborough in turn passed on the cost of the licence fees in the prices that it charged to its customers.

The licence fee was subsequently held to be a duty of excise, and the relevant legislation rendered it invalid on the basis that the imposition of excise duties is reserved to the Federal Australian legislature. Amounts which had been paid by Roxborough to Rothmans in the expectation that Rothmans would pass them on to the revenue authorities were not in fact passed on. They were retained by Rothmans. Although Roxborough had passed on the cost of the licence fees to its customers in the prices that it charged, it claimed to be entitled to repayment of the sums representing the licence fee payments that had not been remitted to the revenue authorities from Rothmans. In *Dargamo*, Carr LJ described this dispute as being between two undeserving parties: a wholesaler which had received the tax and not paid it on to the revenue and a retailer which had already charged the tax to and recovered it from the consumer.

In *Roxborough*, a majority of the Australian High Court held that there had been a failure of a distinct and severable part of the consideration for the purchase of the goods, and that there was a total failure of that consideration in relation to that part. The amount claimed was recoverable under the principles of unjust enrichment. This was so notwithstanding that the contract between the parties did not provide that the amount would be repaid if the licence fee was subsequently rendered invalid. One judge, however, dissented. In his view, Roxborough's obligation to Rothmans was to pay the price of the goods in full: this was a single aggregate amount referable to each occasion of supply. He rejected the submission that some part of the basis could be separately identified, apportioned and then seen as having failed. His reasoning was as follows:

> "*In light of the then understanding of the obligations of the Act, it borders on the surreal to suggest that the wholesaler "promised" the retailers that it would pay the licence fees to the government, in default of which payment there would be a failure of consideration in respect of that part of the price paid. Not only does this hypothesis defy the express terms upon which the parties trade with each other. It also contradicts the historical fact that the obligation of the wholesaler to pay the tax was an obligation imposed on the wholesaler not by private contract but by the terms of the Act.*"

He concluded:

> "*In the foregoing circumstances, it is impossible to assert that there has been a total failure of consideration. The individual contracts between the wholesaler and the retailers were uncontestably valid. They were not ineffective. Nor were they terminated. Far from attempting to terminate the contracts for the supply of goods by the wholesaler, the retailers actually accepted the goods in every case. They onsold them to consumers, thereby recovering the component for licence fees about which they now complain. The law of restitution only rarely operates in the context of an effective contract. The present, in my opinion, is not a case that falls within one of the recognised exceptions.*"

The second case that Dargamo relied on was *Barnes* v *Eastenders Cash & Carry plc* [2014] UKSC 26. That was a decision of the English Supreme Court concerning a receivership order which provided for the

remuneration of the receiver to be paid out of the defendants' assets. When the receivership orders were quashed, the Supreme Court ordered that the receiver was entitled to receive his remuneration from the CPS under the law of unjust enrichment. There had been a total failure of consideration in relation to the receiver's rights over the assets, which was fundamental to the basis on which the receiver had agreed to act in accordance with the CPS' request.

Carr LJ noted that, again, the basis which failed in *Barnes* was not a promissory condition. Instead, there was a common assumption that the receiver agreed to accept the burden of the management of the companies on the basis that he would be entitled to take remuneration and expenses from the companies' assets. That state of affairs, which had failed to sustain itself, was fundamental to the basis on which the receiver was requested by the CPS and had agreed to act. The basis was evident from and consistent with the terms of the contract. Although the CPS had fulfilled its contractual obligations to the receiver by ensuring that the order appointing it conformed with the terms of the underlying agreement between them, the receiver was nevertheless entitled to recover his proper remuneration and expenses from the CPS. This was because the work done and expenses incurred by the receiver were at the request of the CPS and there had been a failure of the basis on which the receiver was asked and agreed to do so.

An unjust factor?

In *Dargamo*, Carr LJ began by noting the strange circumstance that all parties were agreed that the price paid for the Castlerose SPA was intended to include payment for assets not referred to in the agreement. At the same time, the parties had deliberately omitted any reference to those assets in the Castlerose SPA. On the face of the contract, however, the bargain that the parties struck was that Avonwick was obliged to transfer the relevant shares set out in the Castlerose SPA in return for the payment of US$950 million. The parties had in fact performed those contractual obligations. Dargamo had paid US$950 million under the Castlerose SPA and Avonwick had duly transferred the shares in Castlerose Ltd.

In Carr LJ's judgment, the fundamental reason why Dargamo's claim in unjust enrichment could not succeed was clause 2.4 of the Castlerose SPA, which provided:

> "*2.4 The consideration for the sale of the Shares shall be US$950,000,000 (the Consideration).*"

That was the express basis of payment agreed by the parties to the contract, the validity of which had not been challenged. In such circumstances, there was no scope for the law of unjust enrichment to intervene by reference to a basis which directly contradicted the express contractual terms.

Carr LJ acknowledged that fluid commercial negotiation between parties could be said to be commonplace, but held that the proposition contended for by the claimant was extreme. Dargamo was essentially arguing that they should be entitled at common law to recover monies on the basis of an understanding which runs directly contrary to an express agreement contained in a valid and subsisting contract.

Neither did the cases of *Roxborough* and *Barnes* provide support for the unjust enrichment claim. While Carr LJ did not go as far as to call *Roxborough* wrongly decided, she did say it was a controversial decision, and quoted the leading textbook on unjust enrichment, *The Law of Unjust Enrichment* (9th ed.) by Goff & Jones, which considers the decision is wrong:

> "*Those who have criticised the decision argue that the contract allocated the risk of the tax becoming unconstitutional to the retailer, because it made no provision for the payment to be returned. On the other hand, it has been argued that because the amount paid for the tax was fixed from the outset, and*

> *was not the product of any negotiation between the parties, it was no subversion of the contract to allow that sum to be recovered in unjust enrichment. On balance, the former view is more convincing. Whilst it is quite true that the parties had not negotiated about the sum payable in respect of the licence fee, and the unjust enrichment remedy coincided with the value that the parties had agreed, the fact remains that, by requiring its repayment in the absence of any contractual term, the court reallocated the risk to the wholesaler.*"

Importantly, even those who consider it rightly decided do so on the basis that it did not upset the parties' contractual allocation of risk. It is therefore not to be seen as authority for the proposition that an unjust enrichment claim can succeed in circumstances where it contradicts that allocation.

Roxborough was in any view a very different case to *Dargamo*, because the licence fee was externally imposed by statute and non-negotiable. By contrast, in *Dargamo*, the other assets not mentioned in the agreement were very much within the parties' understanding and discussions at the time of the Castlerose SPA, and the price for the shares in the Castlerose SPA was freely negotiated between the parties. The unjust enrichment claim could therefore be seen to interfere impermissibly with the parties' contractual allocation of risk. It sought not to complement but to override the Castlerose SPA.

Similarly, the facts of *Barnes* were highly unusual. Again, in granting the unjust enrichment claim the Supreme Court was not interfering with the parties' contractual allocation of risk. The contractually allocated risk was that of the corporate assets being insufficient to meet the receiver's costs and expenses under the receiver's lien, not the risk of the lien not existing at all in the first place. The agreement between the parties made no provision as to what would happen if the receiver's lien were held to be invalid altogether. By contrast, under the Castlerose SPA, Dargamo very much agreed to take the risk of not receiving any interest in the other assets, despite paying US$82.5 million to Avonwick for them.

Carr LJ did not close the door on any unjust enrichment claims being made where there is a valid and subsisting contract. She stated that, as a matter of principle, it may be legitimate for a court to look beyond the terms of the contract for a wider understanding in the context of an unjust enrichment claim, even though there is a valid and subsisting contract. The underlying rationale for a claim in unjust enrichment differs from that of a contractual claim, and different policy considerations will arise. That said, she made clear that there is no proper scope for making an unjust enrichment claim that is plainly contrary to the express terms of a contract freely agreed between the parties.

For those reasons the Court of Appeal found that there was no failure of basis amounting to an unjust factor, and thus no trigger to an entitlement on the part of Dargamo to recover any part of the US$950 million paid by Dargamo under the Castlerose SPA. The parties were simply being held to the express terms of the contract into which they chose to enter. The law of unjust enrichment did not provide a means of subverting that agreement.

Comment

This decision shows that where there is a valid, subsisting contract between parties the law of unjust enrichment will have a limited role to play. The cases of *Roxborough* and *Barnes* were framed as special cases limited to their particular facts. Parties will seldom be able to circumvent a contract's clear terms by claiming they have not received all consideration they expected.

The court's decision may seem strange at first glance, given that the seller had expressly admitted that part of the money paid was for assets that were never ultimately transferred. However, the parties remained free to

negotiate the terms of their agreement, and the court was simply giving effect to the express terms chosen by the parties.

The situation may have been different had the SPA been worded differently (for example, if its terms had been unclear or if it had specifically noted that part of the price was attributable to other assets). In that case, the court might have allowed a claim in unjust enrichment to proceed alongside, and complementary to, the terms of the SPA.

As such, there are some practical lessons for parties to learn from the court's decision. First, parties should ensure that all assets are accounted for in their transactions. In circumstances where there are good reasons for a contract not to cover particular assets, those alternative assets should be dealt with by another instrument or agreement that is executed at the same time as the primary contract.

Second, it is good practice to specifically apportion the price in any agreement. Where multiple assets are to be bought and sold, it is sensible to provide a breakdown of the purchase price and apportion specific amounts to specific assets. This is common, for example, where the sale of a business is structured as the transfer of assets and goodwill, rather than shares in a company.

Third, parties should clarify what happens if assets are not ultimately transferred. Generally, it is wise to ensure title to assets is transferred at the time payment is made, but this is not always possible. It will always be easier to enforce an express contractual right to be repaid as part of the purchase price than to bring a claim for unjust enrichment. Parties should, therefore, expressly provide for what should happen if the purchase price is paid but certain assets are ultimately never transferred.