December 2014 Vol. 29 – No. 11

Butterworths Journal of International Banking and Financial Law

What is payment in the 21st century?

Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions

Liability for international banks for financing terror: current cases and risk management

In Practice

Cross-collateralisation arrangements in French portfolio deals

The interpretation of contracts relating to financial transactions: postscript

Fraud and illegality exceptions to banks' obligations to pay under letters of credit

Cases Analysis

One Essex Court reports on the latest banking law cases

Market Movements

DLA Piper UK LLP reviews key market developments in the banking sector

Contributors to this issue

Gerard McMeel is a barrister at Guildhall Chambers, a door tenant at Quadrant Chambers and Professor of Commercial Law at the University of Manchester. Email: gerard.mcmeel@guildhallchambers.co.uk

Paul Marshall is a barrister practising in commercial and company law from No 5 Chambers, Salisbury Court, London. Email: pma@no5.com

Gregory Mitchell QC practises in commercial law from 3 Verulam Buildings, Gray's Inn (3vb.com). Email: gm@3vb.com. Tel: 020 7831 8441

GJ Tolhurst is Professor of Commercial Law at the Faculty of Law, University of Sydney, and a consultant at Herbert Smith Freehills. Email: gregory.tolhurst@sydney.edu.au

JW Carter is Professor Emeritus at the University of Sydney, a consultant at Herbert Smith Freehills and general editor of the Journal of Contract Law. Email: john.carter@sydney.edu.au

Dr Magda Raczynska is Lecturer in Law at the University of Bristol and Deputy Executive Director of the Secured Transactions Law Reform Project. Email: magda.raczynska@bristol.ac.uk

John RWD Jones QC is a barrister at Doughty Street Chambers. He is head of Doughty Street International in The Hague, and head of Doughty Street's international criminal law team. Email: j.jones@doughtystreet.co.uk

Katie O'Byrne is a barrister at Doughty Street Chambers and former commercial solicitor, specialising in extradition, international law, public law and human rights. Email: k.obyrne@doughtystreet.co.uk

Ishfaq Ahmed is a barrister practising from Stone Chambers, Gray's Inn, London. Email: ishfaq.ahmed@stonechambers.com

Professor Jonathan Harris is a practising barrister at Serle Court Chambers, London. Email: jharris@serlecourt.co.uk

Claudio Medeossi is director for capital markets, corporate trust and Islamic finance in the London office of Clifford Chance LLP. Email: claudio.medeossi@cliffordchance.com

Debashis Dey is a partner in the Dubai office of Clifford Chance LLP and a leading expert on structuring and advising on *sukuk* issuances. Email: debashis.dey@cliffordchance.com

Emily Tearle is a professional support lawyer for the Dispute Resolution department at Travers Smith LLP. Email: emily.tearle@traverssmith.com

Simon Buckingham is a professional support lawyer for the Finance department at Travers Smith LLP. Email: simon.buckingham@traverssmith.com

Marc Trinkaus is a partner at Linklaters LLP in Frankfurt. Email: marc.trinkaus@linklaters.com

Steffen Schellschmidt is a managing associate at Linklaters LLP in Frankfurt. Email: steffen.schellschmidt@linklaters.com

David Mayes is Professor of Banking and Financial Institutions and Director of the New Zealand Governance Centre at the University of Auckland and a member of the Australia and New Zealand Shadow Financial Regulatory Committee. Email: d.mayes@auckland.ac.nz

Oliver Cain is a senior associate with boutique litigation firm SC Andrew LLP. Email: oliver.cain@scaontier.com. Web: www.scaontier.com

Butterworths Journal of
International Banking and Financial Law

Vol. 29 No. 11 December 2014

Spotlight

What is payment in the 21st century? 675
Gerard McMeel: The law remains unclear.

Features

Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions 679
Paul Marshall: Doubtful jurisprudential basis of contractual estoppel.

To advise or not to advise? 686
Gregory Mitchell QC: A way out for the customer?

Prohibitions on assignment: contract or property? 692
GJ Tolhurst and **JW Carter**: The flaws in the contract approach to prohibitions on assignment.

A new model law of secured transactions: worldwide modernisation in the making? 697
Dr Magda Raczynska: English law may fall behind if it does not reform.

Liability for international banks for financing terror: current cases and risk management 701
John RWD Jones QC and **Katie O'Byrne**: Three key concerns arising from recent cases.

Jurisdiction agreements, declarations, damages and compatibility with Regulation 44/2001 705
Ishfaq Ahmed: Are remedies for breach of exclusive jurisdiction clauses compatible with EU law?

The recast Judgments Regulation: imminent reform of the rules of jurisdiction and enforcement of foreign judgments in the EU 709
Professor Jonathan Harris: A material improvement but more should have been done.

Recent trends and new perspectives in global Islamic fixed income capital markets 713
Claudio Medeossi and **Debashis Dey**: The potential for use of asset backed legal structures for non-sovereign issuances is significant.

FHR European Ventures v Cedar Capital: a decision with wider implications for the loan market? 717
Emily Tearle and **Simon Buckingham**: The importance of defining duties contractually.

Acquisition financing for the Sausalitos group: the creation of a cleared unitranche acquisition and capex bond 720
Marc Trinkaus and **Steffen Schellschmidt**: Unitranche capex bond adds another element to the toolkit of "non-bank lenders".

In Practice

Cross-collateralisation arrangements in French portfolio deals 723
Eric Fiszelson: Managing the prohibition on financial assistance under French law.

The interpretation of contracts relating to financial transactions: postscript 724
Charles Kerrigan: The longer term changes in technology.

Fraud and illegality exceptions to banks' obligations to pay under letters of credit 725
Jamie Curle; **Linos Choo**; **James Carter**; and **Sophie Payton**: Scope of exceptions remain tightly circumscribed.

Regulars

FSLA Update by Tim Aron and Tim Frazer 726
Book Review by Mark Walsh and David Howe 728
Cases analysis by One Essex Court 730
Regulatory Update by Norton Rose Fulbright 734
Market Movements by DLA Piper UK LLP 738
Deals 740
International Briefing – Spain by Javier Ruiz-Cámara; Jon Armendariz Román of Uría Menéndez 741

Online Features

THIS SECTION IS ONLY AVAILABLE ONLINE IN LEXIS LIBRARY TO SUBSCRIBERS OF THE LEXIS LIBRARY SERVICE

JIBFL-only subscribers will be able to access these features one month after publication at http://blogs.lexisnexis.co.uk/loanranger/

Bank structure and resolution [2014] 11 JIBFL 743A
Professor David Mayes: Large diversified financial groups benefit from internal bail-in.

Banking fraud: the standard of proof and the cogency nostrum [2014] 11 JIBFL 743B
Oliver Cain: Despite recent decisions of the Commercial Court, there remains some uncertainty in this area.

Butterworths Journal of International Banking and Financial Law

Consultant Editor
John Jarvis QC

Editor
Amanda Cohen
aamanda.cohen@gmail.com

Managing Editor
Elsa Booth

Acting Editorial Manager and International Briefings Editor
Sarah Grainger
sarah.grainger@lexisnexis.co.uk

Director of Content
Simon Collin

Editorial Office
Lexis House, 30 Farringdon Street,
London EC4A 4HH
Tel: +44 (0) 20 7400 2500
Fax: +44 (0) 20 7400 2583

The journal can be found online at:
www.lexisnexis.com/uk/legal

Subscription enquiries (hard copy)
LexisNexis Butterworths Customer Services
Tel: +44 (0) 845 370 1234
Fax: +44 (0) 2890 344212
email: customer.services@lexisnexis.co.uk
Electronic product enquiries
Butterworths Online Support Team
Tel: 0845 608 1188 (UK only) or
+44 1483 257726 (international)
email: electronic.helpdesk@lexisnexis.co.uk

Annual subscription
£946 hard copy

Printed in the UK by Headley Brothers Ltd, Invicta Press, Queens Road, Ashford, Kent, TN24 8HH

This product comes from sustainable forest sources

Butterworths Journal of International Banking and Financial Law (ISSN 0269-2694) is published by LexisNexis, Lexis House, 30 Farringdon Street, London EC4A 4HH – Tel: +44 (0) 20 7400 2500. Copyright Reed Elsevier (UK) Ltd 2014 (or individual contributors). All rights reserved.No part of this publication may be reproduced in any material form (including photocopying or storing in any medium by electronic means and whether or not transiently or incidentally to some other use of this publication) without the written permission of the copyright owner except in accordance with the provisions of the Copyright, Designs and Patents Act 1988 or under the terms of a licence issued by the Copyright Licencing Agency Ltd, 90 Tottenham Court Road, London, England W1P 0LP. Applications for the copyright owner's written permission to reproduce any part of this publication should be addressed to the publisher. The views expressed in this journal do not necessarily represent the views of LexisNexis, the Editorial Board, the correspondent law firms or the contributors. No responsibility can be accepted by the publisher for action taken as a result of information contained in this publication.

EDITORIAL BOARD

Ioannis Alexopoulos, DLA Piper, London;

Jeffery Barratt, Norton Rose Fulbright, London;

Mr Justice Blair, Royal Courts of Justice, London;

Mr Justice Cranston, Royal Courts of Justice, London;

Geoffrey G Gauci, Bristows, London;

Sanjev Warna-Kula-Suriya, Slaughter and May, London;

William Johnston, Arthur Cox, Dublin;

Richard Obank, DLA Piper, Leeds;

James Palmer, Herbert Smith Freehills, London;

Geoffrey Yeowart, Hogan Lovells, London;

Susan Wong, WongPartnership LLP, Singapore;

Hubert Picarda QC, 9 Old Square (top floor), Lincoln's Inn, London;

Stephen Revell, Freshfields Bruckhaus Deringer, London;

Brian W Semkow, School of Business and Management, Hong Kong University of Science and Technology;

Philip Wood QC (Hon), Allen & Overy, London;

Schuyler K Henderson, consultant, lecturer and author;

Professor Colin Ong, Dr Colin Ong Legal Services, Brunei;

Michael J Bellucci, Milbank, New York;

Robin Parsons, Sidley Austin LLP, London; visiting lecturer at King's College, London;

Gareth Eagles, White & Case, London;

Jonathan Lawrence, K&L Gates, London;

Kit Jarvis, Fieldfisher, London.

PSL ADVISORY PANEL

Rachael MacKay, Herbert Smith Freehills, London;

Jaya Gupta, Allen & Overy, London;

Julia Machin, Clifford Chance, London;

Paul Sidle, Linklaters, London;

Michael Green, Allen & Overy, London;

Anne MacPherson, Kirkland & Ellis LLP, London.

CORRESPONDENT LAW FIRMS

ASEAN CORRESPONDENT: Dr Colin Ong Legal Services

ARGENTINA: onetto, Abogados

IRELAND: Arthur Cox

AUSTRALIA: Allens

ITALY: Allen & Overy

AUSTRIA: Wolf Theiss

JAPAN: Clifford Chance

BELGIUM: Allen & Overy

NETHERLANDS: Nauta Dutilh

CENTRAL&EASTERNEUROPE: Noerr

CHINA: Allen & Overy

RUSSIA: Clifford Chance

DENMARK: Gorrissen Federspiel

SCOTLAND: Brodies

FINLAND: Roschier

SINGAPORE: WongPartnership LLP

FRANCE: Jeantet Associés

SOUTH AFRICA: Bowman Gilfillan

GERMANY: Noerr

SPAIN: Uria Menendez

HONG KONG: Johnson, Stokes & Master

SWEDEN: Cederquist

INDIA: Global Law Review

US: White & Case; Millbank

MALTA: Ganado & Associates

KEY POINTS

- The meaning of payment in commercial transactions is a mixed question of law and banking practice, with the courts generally ready to admit evidence of the latter.
- Modern electronic payment methods, like all banking credits and debits, simply involves the movement on accounts, both of the parties and of the payor bank and payee bank.
- Following the recent decision of the Court of Appeal in *Tidal Energy v Bank of Scotland* the law remains unclear on the question of who bears the loss where a payor receives a fraudulent communication as to banking details and moneys are dissipated.

Spotlight

Author Gerard McMeel

What is payment in the 21st century?

A recent Court of Appeal case provides three different analyses of which party bears responsibility for misdirected payments via CHAPS where an incorrect sort code and account number has been provided as the result of a fraud on the payor. The decision is critically analysed in the light of the exiguous existing law on bank payments, and consideration is given to the Payment Services Regulations which had apparently been opted out of, but formed part of the majority's reasoning.

We operate in a world where retail banking customers are now accustomed to making instantaneous "electronic banking" payments by computer, tablet or smart phone. "Funds transfers" otherwise than by the physical delivery of notes, or by paper-based communication (cheques and negotiable instruments), have been common in commercial transactions for a number of decades, but the case law on payment is scanty and elderly. A recent decision of the Court of Appeal on misdirected electronic payments has failed to provide any clarity on where the loss lies where moneys are misdirected.[1] Remarkably the case provides five separate analyses of what the law should be in the case of a relatively straightforward, and not uncommon, fraud. The parties' own arguments were tersely rejected by the Court of Appeal, which in turn produced three distinct answers. Perhaps more remarkably, none of the three members of the court quite got to the bottom of the problem.

The fraud works like this. A payor firm receives a communication, apparently from one of its creditors, that its banking details have changed. Anecdotal evidence suggests that the fraudsters procure employees at payee firms to identify opportunities, such as where there has been a recent legitimate change in banking details. If the communicated banking details are not properly verified by the payor's people, and a payment is made to the account details provided in the fraudulent communication, the funds transferred will be dissipated almost immediately. The fraud is made easier by an apparent banking practice in respect of the well-known CHAPS payment system whereby the payor bank invites customers to include in their instructions at least three elements of identification for the intended payee – (1) payee name, (2) account number, and (3) sort code – but the payee bank generally relies only on account number and sort code when crediting the payee account.

THE ELEMENTS OF PAYMENT

In this note the terminology of "payment message" is used for the various communications. The relevant players are described as: (1) payor, (2) payee, (3) payor bank, and (4) payee bank. With this fraud "payee" conceals an ambiguity as there is both the named intended payee of the payor, and the payee – who is a party to or privy to the fraud – identified by the 14 digits of sort code and account number in the fraudulent communication to the payor.

Three key elements of payments through the banking system have been identified by Cranston. First, the payment message, being an unconditional instruction to effect a payment to a payee. Whilst the cheque was once the dominant mode of communication, in the 21st century the message is most likely to be communicated electronically. Secondly, and fundamentally, is the proposition that: "payment through the banking system… simply involves movements on accounts."[2] It is trite law that one does not own the notes and coins paid into, or other moneys transferred to, a bank account.[3] As the well-known case of *R v Preddy*[4] demonstrated, CHAPS transfers are misnomers: the correct legal analysis is that when the payor's account is debited there is a reduction or extinction of a thing in action (or increase in the obligation owed by the payor to the payor bank where an account is, or moves into, overdraft) and by the credit to the payee's account there is a corresponding increase in the thing in action owed by the bank to the payee (or a reduction or extinction of indebtedness where the account was overdrawn prior to the payment). Nothing physically changes hands. Accordingly it was held in that case that mortgage fraudsters did not "obtain property belonging to another".[5] However, as the well-known practitioner text notes, the "importance of *Preddy* extends far beyond the criminal law". It may be preferable to speak of a "transfer of *value*", rather than funds.[6]

The third element in payment is settlement, which is the payment between the banks themselves as a result of a payment. Typically this also involves the movement on the accounts held by the payor bank and payee bank at the central bank. In order to mitigate systemic risk CHAPS operates as a Real-Time Gross-Settlement System (RTGS)[7] – that is, banks settle up in full with each other for each transfer (there is no netting) the same day at the central bank – and CHAPS is one of the largest RTGSs in the world.

To like effect Goode identified three essential components of a developed national payment system. First, an online inter-bank communications network for the transmission of payment messages and other communications; this is a function performed internationally by the SWIFT messaging system.[8] Secondly, the clearing

Spotlight

house function, performed in relation to electronic funds in the UK principally by CHAPS and BACS. Thirdly, the involvement of the central bank providing the facilities for settlement by the clearing banks, as performed in the UK by the Bank of England.[9]

WHAT IS PAYMENT?

The broad question is what is payment? More narrowly, when is a payment complete? This was the question addressed in submissions for the payor in *Tidal Energy*, which was largely ignored by the Court of Appeal. There is only exiguous authority and a lack of clarity in the law on these questions concerning payment. Cases have arisen in different contexts (bank insolvency, rising freight rates, anti-money laundering requirements) which may have shaped the answers given. A threshold question is whether such questions are ones of law or of banking practice. An influential discussion by Kerr J in *Momm v Barclays Bank International Ltd*[10] suggested it was a question of law. Cranston suggested that: "The better view is that both must be considered."[11] It appears that banking practice alone, unknown to the customer, swayed the majority of the Court of Appeal in *Tidal Energy*.

> "It appears that banking practice alone, unknown to the customer, swayed the majority of the Court of Appeal in *Tidal Energy*"

Prior to *Tidal Energy* in the cases of payment there was authority for the proposition that a commercial contract requiring payment "in cash" could be construed in context as extending to funds transfers.[12] A slew of cases in the red-toothed and clawed arena of time charterparties established that payment by a certain date, meant midnight (not close of banking hours) in the jurisdiction of the payee.[13] It also appeared from *Momm v Barclays Bank* that it was not sufficient for the payee bank to receive the transfer, but that the payee bank must have taken steps to credit the payee's account for payment to be complete. However, notice to the payee was not required. In addition, Kerr J explicitly stated a requirement that the payment must be "credited intentionally and in good faith and not by error or fraud".[14]

CHAPS

Familiar to everyone who has bought a home as an additional cost, CHAPS (Clearing House Automated Payment System) has for two decades provided a same-day or near real-time electronic payment system for higher value payments.[15] It handled £70.1tn of funds transfers in 2013. That equated to £277bn each day, with CHAPS routinely processing sums equivalent to the UK's gross domestic product on a weekly basis.[16] As the most significant processor of high value payments CHAPS is an essential cog in the machinery of commerce and finance. It is the system employed for inter-bank transfers and a principal mode of discharging larger commercial debts. As such CHAPS routinely handles six-figure, seven-figure and even larger sums in sterling. It generally does so on the basis of matching 14 digits alone: that is, the payee's sort code and account number.

TIDAL ENERGY: THE FACTS

In *Tidal Energy Ltd v Bank of Scotland plc*[17] the CHAPS transfer form provided by the payor bank and completed by the payor uncontroversially required details of the payor, and the date and amount of the transfer – £217,781.57 on 31 January 2012. It also expressly requested the following details:

(1) the payee's sort code;
(2) the payee bank;
(3) the payee bank branch;
(4) payee account number; and
(5) the payee customer name.

The transfer form was completed by the customer with the name of its legitimate creditor and intended payee (Design Craft Ltd) and identified Barclays as the payee bank – but did not specify a branch – together with the sort code and account number fraudulently communicated to the payor.

The instruction was effected the very same day by: (1) the payor bank (Bank of Scotland) sending an electronic payment message containing all the details provided, including intended payee name, to Barclays Bank, and (2) a debit from the payor bank's account at the Bank of England, and (3) a corresponding credit to Barclays' account at the Bank of England. However, the account number and sort code related to an entity called "Childfreedom Ltd", and not the intended payee. Nevertheless Barclays, having verified that the account number and sort code corresponded to an account held with it, acknowledged receipt of the payor bank's payment message, and credited that account. Within a week the payor informed the payor bank that it had been duped, but the account of Childfreedom Ltd had been cleared of £217,000 on the same day as the CHAPS payment.

TIDAL ENERGY IN THE COURT OF APPEAL

Lord Dyson MR

The Court of Appeal was unanimous that the case raised an issue as to the construction of the CHAPS transfer form.[18] Lord Dyson MR, one half of the majority, posed the question: was the payor bank only entitled to debit the payor's account only when payment was made to an account matching four "identifiers" provided in the completed CHAPS transfer form (sort code, payee bank name, account number and customer name) or were the first three elements sufficient? The Master of Rolls held that three identifiers (sort code, payee bank name and account number) were sufficient. There was evidence from one of the payor bank's own employees as to CHAPS banking practice which

described a "system of account number and sort code primacy" intended to effect "straight-through processing" and achieving the goal of "near real-time" payments. The payee name was said only to be included to comply with anti-money laundering and anti-terrorist financing laws and regulations.[19] Lord Dyson considered that such evidence of banking practice[20] was admissible to assist in construing the CHAPS transfer form. Accordingly "a customer who uses CHAPS is taken to contract on the basis of the banking practice that governs CHAPS transactions." Not checking that the payee name coincided with the account number and sort code was a "clear and settled practice" adopted for "good commercial reasons".[21] These were time and cost. A commercially sensible construction of the CHAPS transfer form required the goal of speed – completion of payment within 1.5 hours – to be facilitated.

Lord Dyson quoted from industry guidance, issued by the Payments Council: "Payments executed via CHAPS are processed on sort code and account number – the 'unique identifier'."[22] Lord Dyson implausibly suggested that such guidance would have been reasonably available to any customer who wished to understand how CHAPS worked. However, that guidance related to compliance with the Payment Services Regulations, which were apparently largely opted-out of, and therefore not relevant to this case.[23] The terminology of "unique identifiers" is that of the Payment Services Directive and Regulations. The latter defines "unique identifier" as "a combination of letters, numbers or symbols" specified to the payor by the payor bank to "identify unambiguously" the payee or its account. Lord Dyson failed to note that this could embrace names, which can be as readily digitised as numbers in the payment message. Crucially, Lord Dyson does not go on to quote the immediately succeeding sentence: "This unique identifier must be specified in the framework contract." Again "framework contract" is part of the jargon of the Directive and Regulations.[24] There does not appear to have been any evidence before the court that the sort code and account number were the "unique identifiers" in the framework agreement between the payor and payor bank, which must in this context refer to Bank of Scotland's terms for business customer payment accounts. Accordingly this argument simply cannot work whether the Regulations applied or not. Lord Dyson's best point was that the payor bank had no control over the funds once the payee bank had itself been credited.

Floyd LJ's dissent

Floyd LJ dissented and would have allowed the appeal, awarding the customer summary judgment on its claim that the payor bank had wrongly debited its account. Floyd LJ asked in what circumstances, pursuant to the CHAPS transfer form, is the payor bank entitled to debit the payor's account? Floyd LJ did not consider that the evidence of banking practice was reasonably available to the customer, noting that the Payments Council's technical guidance was directed at its members. Floyd LJ could see no reason, having accepted that sort code, bank name and account number were essential identifiers, to exclude the fourth means of identification, namely the payee name. Indeed, from the payor's point of view it was the most important:

> "There is nothing whatever in the form, or the admissible background, to alert the reasonable person to the fact that, in routing the payment, account would be taken of some but not all of the identifiers, and in particular that no account would be taken of the name."[25]

On the evidence before the Court of Appeal, Floyd LJ's reasoning is the most persuasive, and certainly is most consistent with ordinary principles of contractual construction. Somewhat unattractively it makes the payor bank strictly liable for the payee bank's actions, but against that it can be pointed out that the payor bank had drafted the CHAPS form, had deliberately contracted out of the Regulations, and had not specified sort code and account number as the unique identifiers to its customer.

Tomlinson LJ

Tomlinson LJ agreed with the result reached by the Master of the Rolls, but for different reasons. Tomlinson LJ was surprised he had been asked to determine the question without sight of the CHAPS Scheme Rules which the payor bank refused to disclose on the spurious ground that they only governed the bank-to-bank relationship.[26] In contrast to Lord Dyson, his Lordship was not prepared to accept that the banking practice relied on was reasonably available to the customer. This led to his formulating a different ratio: the CHAPS transfer form "was an instruction to make a payment transfer in accordance with the current CHAPS Scheme Rules and as the CHAPS transfer system is currently operated in accordance with the usual practice".[27] With respect, this appears to be an unlikely reading of the contract by a reasonable person where it was accepted that the banking practice in question was not reasonably available to the customer.

OVERVIEW OF OUTCOME

Tomlinson LJ considered two identifiers were sufficient, and that the banking practice, whilst not reasonably available to the customer, was nevertheless incorporated by reference into the contract as an acceptable mode of performance. Lord Dyson MR considered that three identifiers were sufficient, and that the bank's practice was reasonably available to all customers. Lastly, Floyd LJ considered that all four identifiers had to match and that the banking practice was inadmissible in the process of construction. The possibility of five identifiers, adding in the payee bank branch as invited to do by the form, did not find favour. A differently constituted majority of the Court of Appeal rejected the payor bank's submission[28] that the CHAPS transfer form should be construed as an instruction to pay Barclays as the payee bank.[29] Whilst that submission may be too reductionist, it does better capture what

Spotlight

Biog box

Gerard McMeel is a barrister at Guildhall Chambers, a door tenant at Quadrant Chambers and the Professor of Commercial Law at the University of Manchester. He writes and practises in commercial law generally, with a particular interest in banking and financial services matters. The third edition of *McMeel and Virgo on Financial Advice and Financial Products*, which covers all aspects of retail conduct of banking and financial services business under the Financial Conduct Authority, was published by Oxford University Press at the end of 2014. Email: gerard.mcmeel@guildhallchambers.co.uk

lay in the power of the payor bank to do. How the payee bank acted on the payment message was a matter for it, as was accepted by the payor bank's witness: it could manually check every in-coming CHAPS instruction or check each over a threshold which it was free to set.[30] We are no wiser as to what a payment is as a matter of law. It is to be hoped that the Supreme Court has the opportunity to revisit this unsatisfactory outcome. In the meantime banks should invest in the technology to match names as well as numbers, to ensure safe and efficacious – as well as speedy – transfers, or at the very least make clear to customers that they will act on 14 digits alone. ■

1 *Tidal Energy Ltd v Bank of Scotland plc* [2014] EWCA Civ 1107; affirming [2013] EWHC 2780, [2013] 2 Lloyd's Rep 605, [2013] Bus LR 1379.

2 This follows R Cranston, *Principles of Banking Law* (2nd edn, 2002), ch 8.

3 *Foley v Hill* (1848) 2 HLC 28, 36, 9 ER 1002 (Lord Cottenham LC); *Libyan Arab Foreign Bank v Bankers Trust Co* [1989] 728, 748 (Staughton J).

4 [1996] AC 815 (HL). See also *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548, at p 574 (HL: Lord Goff), *Customs & Excise Commissioners v FDR Ltd* [2000] STC 672, para [37] (Laws LJ) and R Cranston, *Principles of Banking Law* (2nd edn, 2002), 131-32.

5 Within the meaning of s 15(1) of the Theft Act 1968; reversed by the Theft (Amendment) Act 1996. See now s 2 of the Fraud Act 2006.

6 M Hapgood QC (ed), *Paget's Law of Banking* (13th edn, 2007), paras 17.20 to 17.21.

7 CHAPS is a designated system for the purposes of Directive 98/26/EC on settlement finality in payment and securities settlement systems, as amended by Directive 2009/44/EC, as implemented in the UK by the Financial Markets and Insolvency (Settlement Finality) Regulations 1999, SI 1999/2979.

8 Society for Worldwide Interbank Financial Telecommunication. In 2007 it was estimated that the UK accounted for 17% of SWIFT messages: L John, "UK Payment Systems" (ch 9) in M Blair QC and G Walker (eds), *Financial Markets and Exchanges Law* (2007), para 9.29.

9 E McKendrick (ed), *Goode's Commercial Law* (4th edn, 2010), 501-2.

10 [1977] QB 790, 799.

11 R Cranston, *Principles of Banking Law* (2nd edn, 2002), 231.

12 *The Brimnes* [1973] 1 WLR 386; affd [1975] 1 QB 929.

13 *The Laconia* [1977] AC 850; *The Chikuma* [1981] 1 WLR 314; The Afovos [1983] 1 WLR 195; *Mondial Shipping and Chartering BV v Astarte Shipping* [1995] CLC 1011.

14 [1977] QB 790, 799-800. The case concerned the collapse of the German bank Herstatt, the origin of so-called "Herstatt risk". See also *Royal Products Ltd v Midland Bank Ltd* [1981] 2 Lloyds Rep 194.

15 The UK's other principal payment system, BACS (formerly Bankers' Automated Clearing Services), is typically used for lower value and more routine payments, such as standing orders, direct debits, salaries and social security benefits. A relative newcomer to the industry is the Faster Payments Scheme Ltd.

16 See http://www.chapsco.co.uk.

17 *Tidal Energy Ltd v Bank of Scotland plc* [2014] EWCA Civ 1107.

18 [2014] EWCA Civ 1107, paras [18-19] (Floyd LJ), para [48] (Tomlinson LJ) and para [52] (Lord Dyson MR).

19 Quoted at [2014] EWCA Civ 1107, paras [12-13] (Floyd LJ) and paras [54-55] (Lord Dyson MR). For more detail see [2013] EWHC 2780, [2013] 2 Lloyd's Rep 605, paras [14-23].

20 *Hare v Henty* (1861) 10 CB (NS) 65, 77, 142 ER 374 (Willes J *arguendo*: "A man who employs a banker is bound by the usages of bankers"); *Barclays Bank plc v Bank of England* [1985] 1 All ER 385, para [26] (Bingham J); *Tayeb v HSBC Banking plc* [2004] EWHC 1529 (Comm), [2004] 4 All ER 1024, para [57] (Colman J: CHAPS Rules).

21 [2014] EWCA Civ 1107, para [59].

22 The Payments Council, "Payment Services Regulations – Industry Best Practice [-] The UK Payment Schemes in the context of the PSRs conduct of business requirements" (June 2011), p 7. The current version of the guidance is available from: http://www.paymentscouncil.org.uk.

23 Payment Services Regulations 2009, SI 2009/209, implementing Directive 2007/64/EC, regs 33(4) and 51(3); the latter being a more limited right to opt out of specified conduct of business regulations. Financial Conduct Authority, "The FCA's role under the Payment Services Regulations [-] Our Approach" (June 2013), [8.6], [8.35] and [8.36]. Note the FCA's view that "for the customer to 'agree' [to what the FCA terms the 'corporate opt out'] it must be made clear to them which provisions are being disapplied." See G McMeel, "Conduct of banking business brought into the FSA fold" [2010] LMCLQ 431, 442.

24 Reg 2 (definitions). For the consequence of "incorrect unique identifiers" see reg 74.

25 [2014] EWCA Civ 1107, para [34].

26 [2014] EWCA Civ 1107, para [46]. Contrast *Tayeb v HSBC Banking plc* [2004] EWHC 1529 (Comm), [2004] 4 All ER 1024, where the CHAPS Rules were in evidence.

27 [2014] EWCA Civ 1107, para [48].

28 Submission of Raymond Cox QC, co-editor of M Brindle and R Cox, *Law of Bank Payments* (4th edn, 2010).

29 [2014] EWCA Civ 1107, paras [27-29] (Floyd LJ) and para [65] (Lord Dyson MR).

30 Quoted at [2013] EWHC 2780, [2013] 2 Lloyd's Rep 605, para [14].

Further reading

- Protecting the bank's position when customers fall hook, (on)line and sinker for vishing frauds [2014] 8 JIBFL 540
- Regulatory change in the payments sector: addressing the risks [2014] 2 JIBFL 127
- LexisNexis Financial Services blog: Mobile banking: working well for consumers?

KEY POINTS

- In *Crestsign* the judge considered an interest rate swap sold by Natwest and RBS, to their retail client, Crestsign, in 2008 – shortly after the amendments under the Conduct of Business Sourcebook (COBS) that gave effect to MiFID.
- Rejecting the banks' contentions otherwise, the judge found that an advisory role had been voluntarily assumed by the banks in recommending the swap. He further held that the banks had negligently advised Crestsign.
- Nevertheless, on the basis of the banks' documentation, that included standard form disclaimers, he held Crestsign was "estopped by contract" from claiming damages against the banks. A common law principle thus appears to facilitate breach of the prohibition and restriction under COBS 2.
- It is suggested that the application of the dubious "estoppel by contract" principle is an unsound basis for displacing what would otherwise have been the outcome in law.

Author Paul Marshall

Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions

In this Part 1, Paul Marshall questions the jurisprudential foundations underpinning the judge's finding in *Crestsign v Natwest and RBS* [2014] EWHC 3043 (Ch) that a bank's standard form disclaimer can exonerate it from liability for negligent advice. Part 2 will consider *Bailey and MTR Bailey Trading Ltd v Barclays Bank plc* [2014] EWHC 2882 (QB).

> And ductile dullness new meanders takes
> **Alexander Pope**

PRELIMINARY

Before Sigmund Freud was permitted the exit visa needed to leave Vienna in 1938, he was required to sign a document:

> "I, Prof. Freud, hereby confirm that after the Anschluss of Austria to the German Reich I have been treated by the German authorities and particularly by the Gestapo with all the respect and consideration due to my scientific reputation, that I could live and work in full freedom, that I could continue to pursue my activities in every way I desired, that I found full support from all concerned in this respect, and that I have not the slightest reason for any complaint."

Untruth exacted by power from weakness.

Where the state of the law is incoherent, lacking in principle, and in important respects rests on shallow and doubtful jurisprudential foundations, it might appear ungenerous, if not churlish, to be critical of judgments of judges loyally doing their best to apply the law as they find it. Nevertheless, criticism of the chaotic and uncertain state of the law is merited. Part of the problem lies in the difficulty that the courts have experienced in dealing with misuse of information, including data, as a wrong, this being the core issue in the mis-selling of OTC interest rate derivatives, specifically swaps. Further, increasing English judicial documentary fundamentalism,[1] or formalism, not shared by other common law jurisdictions,[2] creates its own difficulties and is at odds with the protective architecture of domestic and European regulatory law. Compounding these problems is the decline in the recognition in England and Wales of equity as a coherent independent source of legal obligations of application to commercial relationships[3] where these exhibit informational disparity, engineered dependence, and resultant vulnerability to exploitation and abuse.[4] If, as appears, fiduciary obligations respond to "legitimate expectations",[5] some would say that the role of equity in this area is merely dormant, with occasional episodes of somnambulism, rather than deceased. The implications lie well beyond this short discussion. Nonetheless, *Crestsign Ltd v Natwest and RBS*, is an important decision, albeit it is suggested, *per incuriam*, resting on modish "contractual estoppel". It is a vivid and important demonstration of the apparent collision between, on the one hand, a certain kind of fashionable contractual formalism, and, on the other, the strong public interest in protection of the mode of sale of complex and potentially toxic financial instruments such as interest rate derivatives. Responsibility for articulating the content of that public interest has been delegated by Parliament to the Financial Conduct Authority (FCA)[6] under the Financial Services and Markets Act 2000 (FSMA 2000). The FCA discharges its regulatory functions, in part, through rules made under its Conduct of Business Sourcebook (COBS)[7], rules that themselves reflect EU regulatory law, notably the Markets in Financial Instruments Directive[8] (MiFID)[9] and related legislation. *Crestsign* illustrates the instinctive preference of English judges for contractual formalism (and certainty – even if the certainty is one of an obviously unfair outcome) to the public policy of protection to which the COBS rules are intended to give effect. At some point the confusion at the interface between financial regulatory and common law will require to be untangled. Whether this is more likely to be by Parliament or the Supreme Court remains moot.[10]

Judgment in *Crestsign* in favour of the banks was given on 26 September 2014. The decision is of great interest because the judge, Tim Kerr QC sitting as a deputy judge of the Chancery Division of the High Court of Justice, held that the bank[11] had voluntarily assumed[12] an advisory role in recommending an interest rate swap to Crestsign Ltd and, further, that the bank was in breach of the obligations it had chosen to assume. He nonetheless held that the expressly agreed *basis* of the contractual relationship was that the bank was *not acting* in any advisory capacity. Thus, despite it being found by the judge to be negligent, the bank was not liable for breach,

either in contract or negligence, because of the agreed basis of the relationship, under bank standard-form documents. Although at the conclusion of his judgment the judge says that the bank had "*successfully excluded*"[13] liability, this was, in the judge's judgment, not in law an *exclusion* clause, which would have been subject to statutory control under the Unfair Contract Terms Act 1977, but a "*basis*" clause, which is quite different. A basis clause may have similar effects to an exclusion clause, but is significantly more effective because in theory it precludes the antecedent relevant duties from arising in the first place, and therefore, it is said, falls outwith statutory control and protection. While, as further discussed below, this might perhaps be confusing to an ordinary, intelligent person[14] in receipt of advice from a bank who might, accordingly, reasonably expect to benefit from protections that Parliament has found it expedient to provide, this is naturally of great comfort to banks. Whether it is good law, or indeed perhaps law at all,[15] is quite another thing. Contractual obligations may now, it seems, be classified as conditions, warranties, innominate (or intermediate) terms,[16] and, now, "basis clauses", the latter being non-obligations as a sort of legal anti-matter, or more elliptically, giving rise to "*contractual estoppel*" by which parties may agree to a parallel factual universe, that may be wholly at odds with reality and truth but nevertheless binding. But this species of estoppel is not an *estoppel* at all[17] as that concept is otherwise understood in law, requiring neither reliance nor detriment[18] but only decent drafting.[19] The label is thus a borrowed term that by neologism purports to clothe a novel concept with the respectability of principle – if not precedent (below).

The judge in his judgment makes no reference to the regulatory provisions under COBS 2 that *preclude* a firm, in *any communication* with their client, from excluding or restricting, or seeking to rely upon any exclusion or restriction of, any duty or liability that it has under the regulatory system (*viz* COBS).[20] Further, a regulated person *should not*, in any communication, seek to exclude or restrict any duty or liability, nor seek to rely upon any exclusion or restriction of any duty or liability to the client *other than under the regulatory system* unless it is "honest, *fair* and professional for it to do so"[21] (below).[22] The reason for this is that doing so is incompatible with the over-arching requirement for a regulated firm to act honestly, *fairly* and professionally in the *best interests of the client*.[23] These are MiFID requirements introduced in November 2007, to which, accordingly, a teleological interpretation is required to be given. Without explicitly referring to these provisions at all, the judge's conclusion suggests that, at common law, "contractual estoppel" may facilitate a firm's breach of the regulatory rules. This might be seen as unsatisfactory.[24]

CRESTSIGN LTD MIS-SOLD A SWAP

Crestsign is a family-owned property company, classified as a "retail client" for the purposes of COBS, that in 2008 required loan facilities of £3.5m. Natwest's credit committee supported a five-year facility subject to certain terms including a possible requirement to enter into an "interest rate management" product to be considered by RBS's Global Banking and Markets division. On 6 June 2008 Crestsign agreed a ten-year swap on a notional sum of £3.5m (against a five-year loan facility) with a one-way call option in favour of the bank in the last four and a half years. By 2010 the discounted fixed rate under the swap had become 5.65% whilst base rate stood at 0.5%. Mr Parker, director of Crestsign, wished to extricate the company from its relationship with Natwest and RBS and by November 2011 was in discussion with another bank. Unfortunately for the company the break costs were then (to Mr Parker's surprise and dissatisfaction) estimated at some £600,000. In May 2013 Crestsign issued proceedings. The claims were pursued only at common law.[25]

The decision is chiefly of interest and importance because of the careful approach the judge adopted to issues of advice that he found to have been given to Crestsign by the banks, and that he held to be negligently given, but for which the banks were nonetheless not in his judgment liable because: "*they successfully excluded any duty not to do so*".[26] The banks, he said: "*did not show themselves worthy of the trust Mr Parker had placed in them,*[27] *but unfortunately for Crestsign, the common law provides it with no remedy because the banks successfully disclaimed responsibility for the advice they gave*[28] *on the suitability of the swap, which was negligent but not actionable*."[29] The judge concluded his judgment with the comment that "*[w]hile the result may seem harsh to some, it is not the role of the common law and the court to act as a regulator*." A trite rejoinder might be that the court was not being invited to act as a regulator, but to provide redress for negligent advice that the judge found to have been given. The reason for the judge finding his hands tied by the terms of the contract might be thought profoundly unsatisfactory, whether or not the decision is correct as a matter of law, it being submitted that there are cogent reasons for the view it is not.

ADVISORY ROLE ASSUMED BY BANKS

Importantly for claims on similar facts, in identifying a duty of care on the part of the banks, the judge distinguished the Court of Appeal's rejection of a duty alleged against the bank in *Green v Rowley v RBS*[30] on grounds that the court was there concerned with the (different) contention that a duty was owed at common law co-extensive with the (then) COBS rules. The instant case involved the bank giving an explanation, tendering advice and providing information. The judge's conclusions as to the fact of the banks having assumed an advisory role, denied by the banks, are in trenchant terms that repay reading, given the judge's subsequent conclusion that liability was (in his words) "successfully excluded".[31] He found:

> **"… Indeed, I do not accept that Mr Gillard [for the bank] was concerned to ensure Mr Parker [director of the Company] fully understood the nature of the IRM products on offer. He wanted Crestsign to understand them sufficiently to sign up to one of them, on terms satisfactory to the banks. He was not concerned to ensure that Crestsign understood the products sufficiently to enable it to judge whether they were objectively suitable, or which was the most suitable.[32] His priority was to conclude the deal, benefit the banks financially and thereby enhance his position with his employer. His priority was not to benefit Crestsign."**

> "… I would readily conclude that Mr Gillard gave advice to Crestsign and not merely information… I accept… that Mr Gillard knew Mr Parker looked to him for expert assessment of the available products, Mr Parker having professed his ignorance of them in the first telephone conversation between them, and Mr Gillard having been brought in specifically in the role of an expert on those products, with the task of explaining them…"

The judge went further and accepted that the requirements for voluntary assumption of duty of care of the kind identified in *Hedley Byrne v Heller & Partners*[33] were satisfied. On breach of duty the judge concluded[34] that, but for his conclusion on "contractual estoppel" he: "… *would find a clear breach of the duty in recommending [the relevant structures] as suitable products*[35]…"

NO LIABILITY FOR BREACH

The reason the claim failed was because the judge gave effect to standard terms in the banks' documentation as excluding liability. Among a variety of provisions to similar effect, the following (familiar) provisions were, in his judgment, key:

> "You are acting on your own account and will make an independent evaluation of the transactions entered into and their associated risks, and you have the opportunity to seek independent financial advice if unclear about any aspect of the transaction or risks associated with it and you place, or will place, no reliance on us for advice or recommendations of any sort."

The Risk Management Paper further provided:

> "[It]… is intended for your sole use on the basis that before entering into this, or any related transaction, you will ensure that you fully understand the potential risks and return of this, and/or any related transaction and determine it is appropriate for you given your objectives, experience, financial and operational resources, and other relevant circumstances…"

> "[RBS] will not act and has not acted as your legal, tax, accounting or investment adviser or owe any fiduciary duties to you in connection with this, or any related transaction, and no reliance may be placed on RBS for advice or recommendations of any sort…"

> "[The company] has made its own independent decisions to enter into the Transaction and as to whether the Transaction is appropriate or proper for it based on its own judgment and upon advice from such advisers as it has deemed necessary. It is not relying on any communication (written or oral) of the Bank as investment advice or as a recommendation to enter into the Transaction; it being understood that information and explanations related to the terms and conditions of the Transaction shall not be considered investment advice or a recommendation to enter into the Transaction…"

In the face of these provisions (the temporal sequence of which was not closely examined), the judge found himself:

> "unable to resist the conclusion that the banks successfully disclaimed responsibility for any advice that Mr Gillard might give and (as I have found) did give. The risk management paper and the two sets of terms of business were unequivocal; they defined the relationship as one in which advice was not being given."[36]

In a passage not entirely easy to follow, the judge explained that one consequence of the successful exclusion of any advisory duty was that:

> "In my judgment, [Mr Gillard] came under a duty to explain fully and accurately the nature and effect of the products in respect of which he chose to volunteer an explanation, but I do not think he came under a duty to explain fully other products that Crestsign might have wanted to purchase but which he did not wish to sell, such as an interest rate cap product. An explanation of such other products, for the purpose of presenting a balanced picture, would be the territory of an advice-giving duty, which was excluded on the documents as I have already found. The absence of such an explanation was part of the selective presentation of information which led me to conclude that advice was given (but without any duty arising for the reasons given above)."[37]

The finding of duty under the first limb seems as inconsistent, as a matter of simple logic, with the successful exclusion of duty, as the (second) duty to explain the alternative products that Crestsign might have wanted and that might well have been more suitable. If the parties had, as the judge found, agreed to a parallel factual universe in which the agreed facts were wholly at odds with reality, on one view it mattered not how careless, wrong or misleading the advice or recommendation given by the bank. This represents an unexpected resurgence of the liberal doctrine of *caveat emptor* into the mode of contracting,[38] as incongruous, in this particular regulatory context, as a stripper at a clerical sherry party.

It might be thought, at first blush, that the judgment represents a complete vindication for standard-form boilerplate clauses so long as these are sufficiently tightly worded so as to constitute "basis provisions" rather than (controlled) exclusion clauses. In effect, so it might appear, any advice given by a bank, however negligent and misleading, so long as this does not cross the line to become fraud, will not be actionable. Fraud, at least one's own, cannot for the time being be excluded, as a matter of public policy. But public policy, it is submitted, is here of vital importance, and merits further consideration.

Three criticisms may be made of reliance upon "contractual estoppel" as the ground for finding no liability on the part of the banks, despite the finding that negligent advice was given to the company.

CONTRACTUAL ESTOPPEL: DOUBTFUL JURISPRUDENTIAL BASIS

While short of the Supreme Court, the doctrine of "contractual estoppel", resting as it does upon the twin Court of Appeal decisions in *Peekay v Australia and New*

Zealand Banking Group Ltd[39] and *Springwell Navigation Corporation v JP Morgan Chase Bank*[40] (both decisions being widely removed on their facts from the transaction between the banks and Crestsign), is not open to challenge. It is nevertheless necessary to note that the depth and soundness of its jurisprudential basis is open to serious doubt. As Wilken and Ghaly have pointed out,[41] *all other species of estoppel* depend upon detriment of some kind. Indeed the Senior Law Lord, Lord Neuberger, writing extra-judicially, has suggested:

> "[m]ay not estoppel now be seen as a generic term for a claim by a plaintiff who has changed his position in the reasonable and foreseeable belief that a defendant's act, statement, silence or inaction has a particular consequence, so that it would now be unconscionable for the defendant to repudiate that consequence …, at least without giving the plaintiff some compensation."[42]

So-called contractual estoppel requires neither reliance (which would be required for estoppel by representation) nor detriment, still less unconscionability[43] – merely signature. In what sense is it therefore an estoppel? There is no obvious answer. That contractual estoppel sails under a name of a doctrine with which it has no jurisprudential connection, or, to vary the metaphor, purports to belong to a family of concepts with which it shares no legal DNA, adds weight and force to doubt. It is a kind of synchysis. Further, as Gerard McMeel has observed,[44] the concept of contractual estoppel cannot be reconciled with well-established estoppel by deed, as in *Greer v Kettle*.[45] Estoppel by deed operates where the parties have agreed a certain statement of fact or facts for the basis of the transaction which they are about to enter.[46] It is not necessary that the person raising the estoppel should show that the statements were in fact believed to be true, only that these were *regarded as true*.[47] Lord Maugham[48] pointed out that, nonetheless:

> "[i]t is at least equally clear that in equity a party to a deed could not set up an estoppel in reliance on a deed in relation to which there is an equitable right to rescission or in reliance on *an untrue statement*[49] or an untrue recital induced by his own representation,[50] whether innocent or otherwise, to the other party. Authority is scarcely needed for so clear a consequence of a rectification order or an admitted or proved right to such an order."

Thus estoppel by deed is rendered otiose by "estoppel by contract", which effortlessly leaps such equitable niceties – the reason being it is not an estoppel at all. It seems unlikely and unprincipled that an established doctrine (articulated at the highest level) should, in silence, be rendered a mere historical curiosity by *Peekay Intermark Ltd v ANZ*.[51]

If contractual estoppel is not an estoppel, it is necessary to inquire as to what principle of law applies. If it is no more than parties are able to agree what they like, that is of course true, so far as executory obligations and warranties are concerned. Otherwise, it is suggested that there remains force in Diplock J's elegant rejection of the non-reliance clause in *Lowe v Lombank*:[52]

> "To call it an agreement as well as an acknowledgement by the plaintiff cannot convert a statement as to past facts, known by both parties to be untrue, into a contractual obligation, which is essentially a promise by the promisor to the promisee that acts will be done in the future or that facts exist at the time of the promise or will exist in the future. To say that the hirer "agrees" that he has not done something in the past means no more than that the hirer, at the request of the owner, represents that he has not done that thing in the past. If intended by the hirer to be acted upon by the person to whom the representation is made, believed to be true by such person and acted upon by such person to his detriment, it can give rise to an estoppel: it cannot give rise to any positive contractual obligation."[53]

Much judicial ingenuity[54] has been addressed to explaining that Diplock J (sitting as a judge of the Court of Appeal), possibly the most distinguished English contract lawyer of the 20th century, was speaking of something else altogether.[55] What can be said is that the "doctrine", having notably shallow roots, represents a deliberate policy choice by the courts that preferences legal certainty, supplied by the express terms of a contract, over wider extrinsic contextual considerations.[56] Combined with a concurrent apparent distaste exhibited by the English courts for the application of equitable principles in a commercial context, the tendency advantages institutional corporate bargaining strength.[57] But in the financial regulatory context, contractual estoppel is a policy choice dissonant with the regulatory regime as an emanation of public policy (below) that it may seemingly (as here) displace. But it is in this direction, *viz* public policy, importantly, that Aikens LJ nodded at paragraph [144] in *Springwell*.

BARGAINING POWER INEQUALITY

Second, the protections afforded by COBS correlate with the sophistication and experience of the client, relative to that of the firm providing the relevant product or service. In this context it is worth remembering that MiFID and the FCA's COBS draw no distinction between natural and legal persons as clients. Those classified by firms as *retail clients* are provided with the highest level of protection being the least sophisticated. The COBS rules, made as they are pursuant to the requirements of MiFID and the FCA's operational objectives under FSMA,[58] give recognition to, and are intended to address and *re-balance*, disparity of expertise in the relevant product or service and to provide *protection*, specifically, under COBS 9, in relation to advised transactions and recommendations as in *Crestsign*. All information given to a client is required by MiFID to be fair, clear and not misleading.[59] After the general duty of a firm to act honestly, fairly and in accordance with the best interests of its clients, it is one of the most wide-ranging and important conduct of business rules under MiFID. It should be obvious, but can be lost sight of, that the architecture of the rules as to *suitability* and *appropriateness* under COBS are regulatory

requirements that give effect to the public interest to which recognition is given by statute. In this respect, the doctrine of contractual estoppel might be thought to be singularly inapposite, appearing to cut across public policy. As Christopher Clarke J, discussing non-representation clauses in the context of s 2 of the Unfair Contract Terms Act 1977 in *Raiffeissen Zentralbank v RBS* observed:[60] "[e]verything must depend on the facts." He added: "It is obviously advantageous that *commercial parties of equal bargaining power*[61] should be able to agree what responsibility they are taking (or not taking) towards each other without having to satisfy some reasonableness test…" He continued: "If *sophisticated commercial parties*[62] agree, in terms of which they are both aware, to regulate their future relationship by prescribing the basis on which they will be dealing with each other and what representations they are or are not making, a suitably drafted clause may properly be regarded as establishing that no representations (or none other than honest belief) are being made or are intended to be relied on. *Such parties* are capable of distinguishing between statements which are to be treated as representations on which the recipient is entitled to rely, and statements which do not have that character, and should be allowed to agree among themselves into which category any given statement may fall". Similarly in *Watford Electronics v Sanders*,[63] Chadwick LJ referred to *a deal struck between professionally advised experienced parties of equal bargaining power.*[64]

It is easy to lose sight of what purports to be happening, on the judge's analysis in *Crestsign*. In saying that "I find myself unable to resist the conclusion that the banks have successfully disclaimed responsibility for any advice that Mr Gillard might give and (as I have found) did give" the judge found, by necessary implication, that the bank had contracted out of the regulatory protections prescribed by the FCA's COBS pursuant to FSMA. Such a conclusion enables the regulated entity in a strong bargaining position to defy the very regulatory regime to which it subscribes by virtue of being a regulated person. Scarman LJ rejected the analogous argument in relation to liability for misrepresentation in *Cremdean Properties Ltd v Nash*[65] that he nevertheless described as attractive for its simple logic: "*a statement is not a representation unless it is also a statement that what is stated is true. If in context a statement contains no assertion, express or implied, that its content is accurate, there is no representation. Ergo, there can be no misrepresentation; ergo, the Misrepresentation Act 1967 cannot apply to it.*" He commented: "*Humpty Dumpty would have fallen for this argument. If we were to fall for it, the Misrepresentation Act would be dashed to pieces which not all the King's lawyers could put together again.*" If, as the judge found in Crestsign, a regulated person is able to slough-off its regulatory obligations by the simple expedient of "no-advice" and "no recommendation" clauses, Parliament's intention, as delegated by it under FSMA 2000 to the FCA, and the requirements of MiFID, are readily frustrated and displaced.

EXCLUSION OF LIABILITY BY CONTRACTUAL ESTOPPEL FRUSTRATES PUBLIC POLICY

Third, missing from the discussion of many of the decisions concerning the mis-selling of financial derivatives to SMEs, including *Crestsign*, is any explicit recognition of the FCA and the COBS rules as the emanation and articulation, respectively, of public policy, or put another way, an expression of the will of Parliament.[66] As noted, the COBS also implement European regulatory legislation.

"A well-established restriction on the ability of the parties to a convention to create a parallel factual or legal universe governing their relationship by assenting to and acting upon the convention, is that one party may not deprive the other, by reliance on such a convention, of protection afforded to the latter by law as a matter of public policy": *Spencer Bower, the Law Relating to Estoppel by Representation.*[67] Not only are the COBS rules rules which articulate the public policy under FSMA and MiFID, but embedded in the rules themselves are anti-exclusion/avoidance provisions under COBS 2 inserted pursuant to MiFID on 1 November 2007 (seven months before the sale of the swap to Crestsign):

> "A firm must not, in any communication relating to designated investment business seek to: (1) exclude or restrict; or (2) rely on any exclusion or restriction of, any duty or liability it may have to a client under the regulatory system."

Thus the "suitability regime" under COBS 9, once the banks had assumed an advisory role, could not be excluded as a matter of regulatory law. Further, the FCA guidance at COBS 2.1.3 states that a firm should not seek to exclude or restrict, or seek to rely on any exclusion or restriction, of any duty or liability it may have owed to its retail client other than under the regulatory system unless it is honest, *fair* and professional for it to do so. *Ex facie* doing so is incompatible with the overarching regulatory principle/duty under COBS 2.1.1 (MiFID art 19(1)) *to act honestly and fairly (etc) in the client's best interests*. Scant recognition is given by the courts to these requirements. Strikingly, the judge said[68] that if he felt able to apply the test of "reasonableness" under the Unfair Contract Terms Act 1977 (which he found not to apply because the *duty* was excluded), he would not have found this to be satisfied, and would differ in that respect from the view expressed by David Steel J in *Titan Steel Wheels*. If not "reasonable" it is difficult to see that the exclusion was "fair".

The judge concluded that negligent advice was provided but the bank "successfully excluded any duty not to do so" as a result of the standard form documents supplied by it to Crestsign. The word "excluded", even if a slip, is telling. It is the very thing that is prohibited as a matter of public policy represented by COBS. Accordingly, it is suggested, it is within the limitation on contractual estoppel mentioned by Aikens LJ in *Springwell*[69] and referred to more explicitly in *Spencer Bower*. Inexplicably the judge in *Crestsign* makes no reference to the provisions of COBS 2. If it is so easy for the banks to achieve the result the judge found, in circumstances of plainly unequal bargaining power and sophistication, Humpty Dumpty is indeed broken – the common law facilitates infringement of the COBS.

It may be, however, that the learned judge was simply in error in finding the banks to

have successfully excluded liability. The judge may have misdirected himself at the beginning of his judgment in saying: "[t]he regulatory backdrop is relevant *only*[70] to the extent that it may, or it may not, assist in assessing whether the common law duties of care asserted by Crestsign arose and, if they did, whether they were breached." It is submitted that the regulatory backdrop is, additionally, relevant to the question as to whether, where a duty has been voluntarily assumed (namely to advise), such a duty, and consequent liability for breach, can be excluded, whether fairly or at all. The FCA by COBS 2 provides a negative answer. Curiously, the apparent conflict between "contractual estoppel" and the clear terms of the regulatory rules under COBS 2 remains to be judicially considered.[71] It is understood that the decision is subject to an application for permission to appeal to the Court of Appeal. ■

1 The term adopted by Professor Gerard McMeel in *The Construction of Contracts*, 2nd Ed, Oxford, Preface, p ix. Also see the Hon Paul Finn 'Common Law Divergences' Melbourne University Law Review Vol 37, p 509 remarking in English law: "the privileging of contract law as the all but exclusive source of voluntarily assumed rights and obligations".

2 Finn *loc cit* p 514 and n 29. "… The assumption in this, seemingly, is that commercial parties could and should look after their own interests and should bear the risk of their failure to do so. Little by way of concession is to be made for the possibility that a small or medium business enterprise might be quite vulnerable to exploitation by a large, well-resourced enterprise because of its inexperience, lack of power, urgent need, etc" – contrasting the position in other jurisdictions.

3 See eg Lord Walker in *Yeoman's Row Managemenet Ltd v Cobbe* [2009] AC 453 at [81]. For commentary Finn, 'Common Law Divergences' *loc cit.* Sir Anthony Mason in 1994 suggested that the "hopes that equity may be able to provide some sort of moral compass in the commercial context have been defeated by the judicial imperative for certainty…" *The Place of Equity and Equitable Remedies in the Contemporary Common Law World* (1994) 110 LQR. Also Atiyah *The Rise and Fall of Freedom of Contract* (reprinted) Oxford 1988, commenting that the Judicature Acts marked the virtual disappearance of Equity as a separate source of discretionary justice: pp 671-672.

4 The oft repeated mantra in the case law that the bank-customer relationship is typically a debtor-creditor relationship and not fiduciary in character is, accordingly, nothing to the point.

5 Finn, *Fiduciary Obligations*, Law Book Company 1977 – a view supported by Matthew Conaglen, after comprehensive analysis, in *Fiduciary Loyalty, Protecting the Due Performance of Non-Fiduciary Obligations*, Hart Publishing 2011 p 259.

6 Until 1 April 2013 named the Financial Services Authority (FSA).

7 For the full rules: http://fshandbook.info/FS/html/handbook/COBS.

8 2004/39/EC.

9 Being one of the first pieces of legislation adopted under the *Lamfalussy* process under the Lisbon Agenda – given effect under the rules under the FSA's Conduct of Business Sourcebook from 1 November 2007.

10 That the swaps mis-selling scandal was quickly followed by findings by the FSA and US Commodity Futures Trading Commission of widespread manipulation and attempted manipulation by banks of LIBOR (including for the purpose of advantaging bank derivatives books), and related failures in systems and controls to protect against this, raises broader questions about financial regulation that provide a wider context for the present discussion.

11 RBS, a wholly owned subsidiary, acted as the treasury division in relation to the sale of derivatives.

12 Including negligent misstatement under *Hedley Byrne v Heller & Partners* [1964] AC 465. A doctrine for which the courts have not exhibited particularly great enthusiasm, carefully policing the boundary.

13 Judgment [176].

14 Including, for this purpose, a corporate SME inexperienced in the use of IRHPs.

15 McMeel has expressed the view that the entire 'doctrine' of contractual estoppel is *per incuriam*, *The Construction of Contracts*, 26.74 p 718.

16 *Hongkong Fir Shipping v Kawasaki* [1962] 2 QB 26.

17 Wilken and Ghaly, *The Law of Waiver Variation and Estoppel*, Oxford, 2nd Ed, at 13.22 p 315.

18 Further below.

19 *Peekay v ANZ* [2006] 2 Lloyd's Rep 511, Moore-Bick LJ [57].

20 COBS 2.1.2. This applies to any client.

21 Italics supplied. COBS 2.1.3. This applies to retail clients. It is a component of the over-arching "best interests" rule – a rule of distinctly fiduciary character, impliedly subordinating the firm's interest if other than consonant with the client's.

22 In *Seymour v Christine Ockwell & Co* [2005] PNLR 39 the court found that "the regulations afford strong evidence of what is to be expected of a competent adviser in most situations" [34]. In *Shore v Sedgwick* [2007] EWCH 3054, Mr Justice Beatson said that the starting point for determining the extent of an advisor's duty of care both under statute and at common law is the relevant regulatory regime.

23 COBS 2.1.1.

24 There is a statutory anti-avoidance right of action under the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2011/2256) but this has been given an artificially narrow and acontextual interpretation in *Titan Steel Wheels Ltd v RBS* [2010] EWHC 211 (Comm) [2010] 2 Lloyd's Rep 92 so as to render it of no utility to a corporate claimant.

25 It being common ground that breach of the banks' obligations owed to Crestsign under COBS, despite it being an SME, were not actionable by the company under s 138D of FSMA (judgment [13]) because Crestsign is a limited company (*Titan Steel Wheels loc cit*) carrying on a business: qv reg 3(1)(b) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001.

26 Judgment [176].

27 This raises an interesting issue in connection with breach of fiduciary duty – given the position of vulnerability/dependence and the disparity of knowledge and expertise (as found by the judge) that resulted in reliance upon the banks by Mr Parker.

28 The difficulty of the concept is here revealed,

Biog box
Paul Marshall is a barrister practising in commercial and company law from No 5 Chambers, Salisbury Court, London. Email: pma@no5.com

the parties, in the judge's judgment, were bound by what was both unreal, and also untrue. The bank can be taken to have recognised this.

29 *loc cit*.

30 But see: "I reject the suggestion that the bank here owed to the claimants a common law duty of care which involved taking reasonable care to ensure that they understood the nature of the risks involved in entering into the swap transaction": Lord Justice Tomlinson at [30]. The argument that the bank had in fact assumed an advisory role was not advanced on the appeal.

31 See, in particular, paras [34], [38]-[41].

32 The "suitability" obligation is imposed upon the bank by COBS 9. The judge's findings disclose, *prima facie*, infringement by the bank against the regulatory rules.

33 n 12 above.

34 Judgment paras [130]-[133].

35 A clear *prima facie* infringement against COBS 9. It is to be noted that under COBS an unsuitable product may not be recommended (as compared with an inappropriate product or service, which may, subject to warning).

36 It was similarly effective as negativing the Hedley Byrne duty qv *Lord Goff Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 181E.

37 At [153].

38 As distinct from subject matter. The COBS being concerned with modes of contracting, not the particular product or service.

39 [2006] 2 Lloyd's Rep 511 a decision on this point that was originally thought by many to be *obiter* but considered by Gloster J in *Springwell* to be *ratio*: [557]-[568].

40 [2010] EWCA Civ 1221.

41 In the leading text *The Law of Waiver Variation and Estoppel* (above) in particular, see paras 13.22 ff.

42 D Neuberger 'Thoughts on the law of equitable estoppel' (2010) 84 ALJ 225, 237 cited in *Fault Lines in Equity*, Ed Glister and Ridge, Hart Publishing 2012 p 259 and n 96. Neuberger is not the only judge to have suggested that unconscionability is a unifying feature of estoppels.

43 *Springwell* CA [177] per Aikens LJ.

44 *Documentary Fundamentalism in the Senior Courts; the myth of contractual estoppel* [2011] LMCLQ 185, 206 cited by Wilken and Ghaly p 315 n 52.

45 [1938] AC 156, 171.

46 *Greer v Kettle* per Lord Russell p 156 and see the discussion in Wilken and Ghaly (above) at 12.19 ff.

47 *Grunt v Great Boulder Pty Gold Mines* [1937] 59 CLR 641, 676.

48 Formerly a judge of the Chancery Division, Lord of Appeal, and in 1938 appointed Lord Chancellor by Neville Chamberlain, succeeding Lord Hailsham. A judge, in short, whose views on equity may be accorded weight.

49 Italics supplied.

50 The intellectual gymnastics required for which were considered by Chadwick LJ in *Watford Electronics* (n 65 below) at [40], [41].

51 [2006] EWCA Civ 386; [2006] 2 Lloyd's Rep 511 – only one decision was referred to in support of contractual estoppel *Colchester Borough Council v Smith* [1991] Ch 448 and *Lowe v Lombank* was not (below).

52 [1960] 1 WLR 196.

53 p 204.

54 Christopher Clark J (*Raiffeisen Zentralbank Osterreich AG v RBS* [2010] EWHC 1392) and Aikens LJ *Springwell loc cit* not agreeing the basis upon which *Lowe v Lombank* was decided. Aikens LJ also disagreeing with Gloster J in *Springwell* that Diplock J was concerned with a sham of the kind later analysed by Diplock J in *Snook* [1967] 2 QB 786.

55 Being in Aikens LJ's view [169] no more than *obiter* and inconsistent with *Burrough's Adding Machine*, (1925) 41 TLR 276 – referred to via *Spencer Bower* and relied upon by Ferris J in *Colchester* (above) – the only authority on point referred to by Moore-Bick LJ in *Peekay* – [56], [57].

56 See eg Moore-Bick LJ in *Peekay* at [56] and Aikens LJ in *Springwell* at the end of [144].

57 Reinforced, where possible, by narrow and acontextual statutory interpretation as in *Titan Steel Wheels*.

58 FSMA 2000 s 1B.

59 MiFID Art 19(2) and Art 27 of the Implementing Directive.

60 [313] and [314] in a discussion formulating the concept of "basis clauses".

61 Here and next italics supplied.

62 *Ibid*.

63 [2001] EWCA Civ 317.

64 [2001] BLR 143.

65 [1977] 2 EGLR 80.

66 The function of the FCA as a rule making public body, and its related powers and privileges were emphasised by the Supreme Court in *FSA v Sinaloa Gold plc* [2013] UKSC 11.

67 4th Ed, para 8.10.3, cited by HH Judge Hegarty QC in *Proactive Sports Medicine v Wayne Rooney and Ors* [2010] EWHC 1807, [670]: "I confess that I would regard it as a highly unsatisfactory consequence of this principle if it meant that a party who sought to take advantage of a contract which was plainly in restraint of trade could free himself from the fetters of the doctrine by the transparent device of ensuring that some suitable provision akin to clause 24 was included in the contract. The reason why such a device would not, in my judgment, be effective is because restraint of trade is a matter of public policy out of which the parties cannot contract."

68 Judgment [119].

69 At [144].

70 Italics supplied.

71 Space does not permit discussion of the judge's further conclusion that the information given by the banks in connection with break costs was sufficient warning of risk. It is suggested that this conclusion was also *per incuriam*, as to which, see generally, the FCA's draft written submissions to the Court of Appeal (being given permission to intervene – but not, in the event, being called upon) in *Green v Rowley*. The FCA has expressed the view (correctly, it is submitted) that it is the contingent dimension of the break costs, not their fact, which represents the risk against which warning should be given (cf judgment para 48).

Further reading

- Interest rate swaps and the sale of the unknown: blind alleys, an enfeebled equity and the triumph of certainty over fairness [2014] 1 JIBFL 9
- Compensating customers who have been mis-sold interest rate hedging products [2013] 8 JIBFL 507
- LexisNexis Loan Ranger blog: Swaps, betting and the law

Feature

KEY POINTS

- Any claimant who is unable to sue on a statutory cause of action and can only rely on claims for common law negligence is faced with some difficulty as English courts have shown a reluctance to accept that a bank has entered into an advisory relationship with a customer.
- The operation of contractual estoppel in this area is deeply unsatisfactory because it appears that however strong the argument that an advisory relationship has been entered into, appropriate wording can exclude any duty of care arising at all.
- In principle, estoppel by convention could be used to override contractual estoppel but this will depend upon the facts of the case.

Author Gregory Mitchell QC

To advise or not to advise?

This article considers the question of when a bank is liable to its customer for giving advice in the light of recent cases of alleged mis-selling of swaps.

At common law, where a bank gives advice to its customer, the bank owes contractual and tortious duties to take reasonable care in the advice given, and if it is in breach of those duties, then it is liable in damages for the loss caused to its customer. Those common law duties of care may in some circumstances be restricted, or excluded altogether, by appropriate contractual drafting,[1] on the basis of "contractual estoppel". It is the purpose of this article: (i) to examine the case law where claims have been made against banks for having given negligent advice in the different contexts in which they have arisen, and to show that special facts have been required for a finding of liability against a bank, and (ii) to look at the case law on contractual estoppel, and to consider the limitations of that doctrine. The ultimate conclusion reached is that where the special facts required for a finding of liability are proven, then "contractual estoppel" can be answered, if the evidence shows that applying ordinary principles of contract law, waiver and estoppel by convention, the bank can no longer rely upon those terms, because of the way it has conducted itself.

Under statute,[2] a bank is exposed to claims in damages made by "private persons"[3] for breach of statutory duty. The content of the regulatory rules applying to any financial sector may inform the obligations owed at common law, and give rise to concurrent claims for breach of those rules, and common law negligence, in relation to private persons.[4] Clearly a breach of a rule in any regulated sector is likely to be a *prima facie* basis for alleging lack of reasonable care.[5] However, the Conduct of Business Sourcebook Rules (COBS) which apply, *inter alia*, to banks, do not give rise to a general coextensive duty of care on the part of banks at common law.[6] Parliament has limited the right to claim damages for breach of statutory duty to particular rules and particular persons. The Court of Appeal in *Green v RBS* [7] rejected the argument that claims for damages should be extended beyond "private persons". The court considered the recognition of a general duty at common law in the terms of COBS as "*an invitation to the court to drive a coach and horses through the intention of Parliament to confer a private law cause of action upon a limited class*". Thus except for "private persons"[8] banks are not generally liable in damages to customers for breach of COBS.

Where a "private person" has suffered loss as a result of a possible breach of duty by a bank, the first question to consider is whether or not the duty breached is statutory. If so, then the further question of whether or not the bank is liable at common law in negligence, may not arise at all, because the claim for breach of statutory duty will often provide an adequate remedy. If the customer is not a private person, then the question of the claim at common law will arise as a crucial one. It is not the purpose of this article to consider the question of breach of statutory duty further, nor claims for breach of contract save where the duty breached is one of reasonable care. This article deals with claims in negligence alone. Clearly where fraud can be shown then very different principles apply – the courts would not allow a defendant who has committed fraud to escape liability by reliance on contractual terms.

THE CASES ON BANKER'S LIABILITY FOR ADVICE

The English courts have always been reluctant to find a bank liable at common law for giving negligent advice to a customer. This is perhaps one reason why banks often favour English choice of law and jurisdiction clauses.[9] The facts of those cases where banks have been held liable for giving negligent advice to customers have been unusual and involve an agent of a bank "crossing the Rubicon" and taking on an advisory role over and above the ordinary banker and customer relationship. An analysis of the case law is illustrative of the difficulty claimants have always had in persuading the English court that a bank has taken on an advisory role. This has historic roots since the main function of banks was to hold money on deposit for customers or to lend money – and the primary relationship was that of creditor and debtor.[10] Bank officials may also not have been authorised to give financial advice to a customer.[11] Over the last 30 years or so the role of banks has changed fundamentally as banks have advertised themselves as "advisers" and sought to sell a very wide range of financial products, some with disastrous consequences for their customers.[12] Nevertheless the courts have been slow to find banks liable for bad advice.

A distinction must be made as to the contexts within which particular cases of alleged negligent advice have arisen. There are at least four different areas: (1) lending, (2) credit references, (3) investment, and (4) financial instruments including swaps. The last is of course of recent origin since the derivative first became widely used only in the mid-1980s.[13] In addition there are other disparate cases which do not neatly fall into these categories.

Lending cases

Where banks have lent money to customers, and thereafter the customer has accused the bank of having given negligent advice in connection with the loan, most claims have failed. Some of the cases have been counterclaims by indebted customers trying to raise a triable issue and have lacked merit. There are strong *dicta* explaining why if a bank evaluates a particular request for a loan and decides to lend that the customer should not regard the bank's views as any form of advice. In *Williams & Glyn's Bank v Barnes* [1981] Com LR 205 Peter Gibson J said:

> "no duty in law arises upon the bank either to consider the prudence of the lending from the customer's point of view, or to advise with reference to it. Such a duty could arise only by contract, express or implied, or upon the principles of assumption of responsibility and reliance stated in Hedley Byrne or in cases of fiduciary duty."[14]

In *Lloyds Bank v Cobb* (1981)[15] Scott LJ said:

> "The ordinary business of a High Street bank does not include giving advice to customers on the wisdom of commercial projects for the purposes of which the bank is asked to lend money. In my judgment, the ordinary relationship of bankers and customers does not place on the bank any contractual or tortious duty to advise the customers on the wisdom of commercial projects for the purpose of which the bank is asked to lend money. If the bank is to be placed under such a duty, there must be a request from the customer, accepted by the bank, or some arrangement between the customer and the bank, under which the advice is to be given."

Although this was said in the context of lending the point applies more generally – banks do not usually accept an advisory relationship. An advisory role arises where that role has been expressly or impliedly agreed and not otherwise.

Whatever promotional material may say, banks are not disinterested advisers in transactions. This is one reason why the courts are slow to find the relationship with a customer is an advisory one. This was explained by Nourse LJ in *Goldsworthy v Brickell* [1987] Ch 378:

> "... a banker, being a person having a pre-existing and conflicting interest in any loan transaction with a customer, cannot ordinarily be trusted and confided in so as to come under a duty to take care of the customer and to give him disinterested advice..."

This question of a conflict of interest for banks goes much wider than lending. The courts are also slow to recognise statements made by banks as "advice" given to a customer. In *Morgan v Lloyds Bank plc* [1998] Lloyd's Rep Bank 73 a claim was struck out on the basis that the bank was not advising the customer at all but was merely seeking to protect its interests as mortgagee.

Other lending cases where claims have failed include *National Commercial Bank (Jamaica) Ltd v Hew* [2003] UKPC 51 where Lord Millett said:

> "… a borrower is not entitled to rely on the fact that the lender has chosen to lend him the money as evidence, still less as advice, that the lender thinks that the purpose for which the borrower intends to use it is sound."

In *Murphy v HSBC Plc* [2004] HC 467 the claimants bought a hotel with the assistance of a loan from the bank. They asserted that the bank manager took on the role of a trusted adviser and should have explained various matters to them. Silber J rejected the claim on the facts and found that the bank manager never crossed the line and assumed the duties of care alleged. He declined to construe the manager's comments "stating what the Bank … thought of the proposition of lending to the claimants" as "advice" for the purposes of a claim in negligence. Further there was no basis upon which a fiduciary duty could be held to exist.

Lending cases where negligence claims have succeeded have turned on their own special facts. For example in *Box v Midland Bank Ltd* [1979] 2 LL Rep 390 a bank manager was held liable for negligently misstating that his head office would approve the request made for an overdraft facility. On the basis of the statement made the customer incurred considerable expense in a project which was lost when head office said "No." In *Spindler & Verity v Lloyds Bank* [1995] CLC 1557 it was held that on the special facts the bank had taken upon itself the role of a financial adviser. The plaintiffs relied upon the bank advertising itself in the following words: "We don't help only with money. Our advice is tailor-made, confidential and free." They sought facilities from the bank for a property development. The manager tried with the best of intentions to help them by going to see prospective properties and advising whether they were suitable. As a result it was held that the manager had crossed the line and had taken on the role of a business advisor. The use of such promotional material cannot, however, be taken too far. In *James v Barclays Bank Plc* [1995] 4 Bank LR 131, the bank's literature advertised the availability of a comprehensive range of advisory services to farmers. Striking out the plaintiff's notice of appeal, Millett LJ stated:

> "... although the promotional literature put in front of us shows that the bank would no doubt have given comprehensive financial advice to the appellants if they had sought it, it does not suggest for a moment that the bank was willing to undertake the quite different obligations of general financial adviser so as to become responsible for volunteering advice from time to time even though it was not sought."

Credit references

Hedley Byrne v Heller [1964] AC 465 is the leading case on negligent misstatement, and also on a bank's duty of care in tort outside of a contractual relationship. The defendant bank gave a credit reference, about its customer, to the bankers of the plaintiff

advertising agency. The reference was not given directly to the plaintiff because in accordance with ordinary banking practice it was provided to the plaintiff's bankers. The reference was expressly provided on the basis that it was *"without responsibility"*. It was held by the House of Lords that even though there was no contract between the parties, there was a special relationship and so there was sufficient proximity for a duty of care to arise. Had it not been for the exclusion of liability then the bank would have been liable in the tort of negligence.

In *The Royal Bank Trust Co (Trinidad) Ltd v Pampellonne* [1987] 1 LLR 218 it was alleged that the bank gave negligent advice as to the financial standing of a company to its own customer. The bank's argument was that it merely passed on information to its customer and owed no duty of care to advise in relation to that information. The defence succeeded at trial but was overturned by the Court of Appeal who found the bank liable in respect of one of the two transactions. The decision of the majority (3:2) of the Privy Council was that the issue was one of fact for the judge. However, if the facts of the case came up again then liability might well be established – the outcome turned on how the case had been put at trial.

Investment

Normally a bank has no duty to advise in relation to proposed investments. For example the advice given in *Banbury v Bank of Montreal* [1918] AC 626[16] was described as "gratuitous" and outside the scope of the manager's role. There are cases which have succeeded but the facts have been very strong. In *Woods v Martins Bank Ltd* [1959] 1 QB 55 the bank manager advised the customer to invest money in certain shares in a company advising that it was in a sound financial state. In fact the manager was under pressure from his superiors to cause the company to reduce its overdraft because of its financial difficulties. The advice was self-interested and was held to have been negligent. *Banbury* was distinguished on the basis that the business of banking had changed. Salmon J held that:[17]

> "No one but an extremely foolish man or a knave could have given the plaintiff the advice given him by the defendant Johnson."

The modern leading case on investment advice by banks is *JP Morgan Chase v Springwell Navigation* [2008] EWHC 1186 (Comm). The customer invested in GKO Notes sold by the bank which lost their value in the Russian 1998 financial crisis. Wide ranging claims were made for breach of contract, negligent advice, breach of fiduciary duty, negligent misstatement and under s 2 of the Misrepresentation Act 1967. The entire banker customer relationship was analysed in detail in the judgment. Gloster J concluded that the bank had no duty to advise. The customer was sophisticated, the bank had not accepted an advisory relationship in writing, the customer's main contact was with a salesman and not an advisor. Given the contractual and regulatory context the bank had no general advisory duty of care. A fiduciary duty on the bank was rejected[18] on the basis that the relationship was a commercial one. Gloster J said:

> "But the mere fact that one party to a commercial relationship 'trusts' the other does not predicate a fiduciary relationship. The word 'trust', like the word 'advice' has a variety of meanings. In a broad sense, trust is an important element in many commercial dealings. As Steyn J (as he then was) pointed out in *Barclays Bank plc v Quincecare Ltd* 168: '… trust, not distrust, is also the basis of a bank's dealings with its customers…' Springwell no doubt 'trusted' Chase to conduct itself in a commercially appropriate manner. But I do not consider that Springwell had any legitimate expectation that, in its commercial dealings with Springwell, Chase would subordinate its interests to those of Springwell."

In *Rubenstein v HSBC Bank plc* [2012] EWCA Civ 1184[19] the customer asked the bank for investment advice explaining that he could take no risk of loss of capital, and the bank advised on a particular financial product. As a result of the credit crunch the investment sold by the bank lost value and the customer sued the bank for the loss. It was held by the judge that the bank had advised negligently at common law and in breach of statutory duty but the loss was too remote. The finding on remoteness was overturned by the Court of Appeal. This was a special case because the bank took on the role of investment adviser and did not act as a mere seller.

> "The bank accepted that it had a duty not to misstate the terms of the swaps but that it owed no wider duty…"

Financial instruments

In *Bankers Trust International plc v PT Dharmala Sakti Sejahtera* [1995] 4 Bank LR 382 the customer complained that the bank had negligently failed to explain the terms of a swaps transaction. The bank accepted that it had a duty not to misstate the terms of the swaps but that it owed no wider duty, and in particular it had no duty to explain the operation, meaning, terms, effect, risks and possible financial consequences of the swaps. Mance J held that the extent of the bank's duty of explanation depended upon the particular facts. The defendant had held itself out as experienced in relation to such transactions and the bank did not have the duty to explain as claimed.

In *Titan Steel Wheels Ltd v Royal Bank of Scotland plc* [2010] EWHC 211 the customer was a manufacturer of steel wheels for overseas markets exposed to currency risk and so it entered into currency swaps. It suffered loss and claimed that the swaps had been mis-sold by the bank. It was held by David Steel J that Titan was not a "private person" and so could not pursue a claim for breach of statutory duty under s 150 FSMA

2000.[20] The judge went on to hold that the agreed basis of the relationship excluded any advisory duties, but even if this "contractual estoppel" had not been applicable the bank had not crossed the line.[21]

The Scottish case of *Grant Estates Ltd v RBS* [2012] CSOH 133, although not an English precedent, is consistent with English principles. The analysis given by Lord Hodge draws on cases such as *Titan Steel* and *Springwell* and rejects the existence of an advisory relationship. *Green v RBS* [2013] EWCA Civ 1197 concerned a swap sold to the claimants who were "private persons" and so could sue under s 150 FSMA 2000[22] for breach of COBS. The "private person" statutory cause of action was abandoned at trial on the basis that it was time barred. The judge found that the bank did not assume any advisory duty of care.[23] The judge accepted that the bank owed a *Hedley Byrne* duty but not that the scope of the duty was informed by COBS. However, the *Hedley Byrne* duty was not breached. The judge and the Court of Appeal rejected the argument that at common law the duty under COBS r 5.4.3 (duty to take reasonable steps to ensure a customer understands the risks involved) could be sued upon outside of the statutory cause of action.

In *Bailey v Barclays Bank plc* [2014] EWHC 2882 QB the claimant had made a swap and suffered loss. As a private customer he had a claim for breach of statutory duty. The swap was novated to the claimant's company on the advice of the claimant's accountants, and so at that date the company assumed liability under the swap and thereafter the loss suffered fell on the company. The question on this interlocutory hearing was whether the company could claim those losses from the date of novation against the bank. The company's application to amend the particulars of claim was dismissed, leaving the individual claimant to his personal claims up to the date of novation. The decision illustrates the difficulties that may flow when a claimant avoids future loss by novating a swap to a third party.

Crestsign Ltd v NatWest and RBS [2014] EWHC 3043 (Ch) is the subject of an article in this issue ([2014] 11 JIBFL 679) and so requires no explanation of its facts. It is one of those unusual cases where the Rubicon was crossed because the judge accepted that the bank gave advice, see paras 105-111. However this was only a Pyrrhic victory for the claimant because the terms of the contract excluded liability, see para 114. The judge held at 117:

> "The end result is that by the time the swap contract was entered into, what Mr Gillard was saying in effect was: 'although I recommend one of these products as suitable, the banks do not take responsibility for my recommendation; you cannot rely on it and must make up your own mind.' I do not see anything unrealistic about that, nor does it mean the documents must be exemption clauses not basis clauses."

Attempts to impose upon a bank the strict duty of a fiduciary have also fallen on stony ground. As explained by Gloster J[24] in *Springwell* such a duty does not normally arise in the context of the bank/customer relationship. Different considerations apply to the special case of a bank taking security from a third party in relation to a customer's debts and the question of the equitable doctrine of undue influence. The difficulties which arose from attempts to set aside securities on the ground of undue influence led to a large number of controversial cases culminating in the decision of the House of Lords in *Royal Bank of Scotland plc v Ettridge (No 2)* [2001] UKHL 44, [2002] 2 AC 773. Those cases are different because they turn on questions of undue influence, an old doctrine[25] into which new life was breathed by Lord Denning MR in *Lloyds Bank v Bundy* [1975] 1 QB 326.

> "This survey of the case law shows how rare it is that the English courts recognise that a bank has crossed the Rubicon and assumed an advisory duty"

Conclusion on advisory relationships

This survey of the case law shows how rare it is that the English courts recognise that a bank has crossed the Rubicon and assumed an advisory duty. There have been other cases where the question of such a duty has arisen, such as *Midland Bank Ltd v Seymour* [1955] 2 LL Rep 147, *Schioler v National Westminster Bank* [1970] 2 QB 719, *Commercial Banking Co v Jalsard* [1973] AC 279, *Redmond v Allied Irish Banks* [1987] 2 FTLR 264, *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340, *National Bank of Greece SA v Pinios Shipping Co* [1990] 1 AC 637, *Middle Temple v Lloyds Bank plc* [1999] 1 All ER (Comm) 193, *Frost v James Finlay Bank Ltd* [2002] EWCA Civ 667, *Barclays Bank v Khaira* [1992] 1 WLR 623 but these do not require analysis in this article. Some of those cases succeeded[26] but most failed.

CONTRACTUAL ESTOPPEL

The parties to a contract are free to allocate risk arising under their contractual relationship and may by their agreement preclude a common law duty of care arising, see *Henderson v Merrett* [1995] 2 AC 145. Unless a contractual provision offends against public policy, or against some statutory provision such as the Unfair Contract Terms Act 1977 or s 3 of the Misrepresentation Act 1967, then the English courts will give effect to it on the basis that contractual promises should be enforced.

"Contractual estoppel" was explained as follows by Moore-Bick LJ in *Peekay Intermark Ltd v Australia and New Zealand Banking Group Ltd* [2006] EWCA Civ 386:[27]

> "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. For example, it may be desirable to settle a disagreement as to an existing state of affairs in order to establish a clear basis for the contract itself and its subsequent performance. 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, at least so far as concerns those aspects of their relationship to which the agreement was directed. The contract itself gives rise to an estoppel…"

This principle has been endorsed by Aikens LJ in *Springwell Navigation Corp v JP Morgan Chase Bank* [2010] EWCA Civ 1221[28] and widely applied, for example see Gloster J in *JP Morgan Chase Bank v Springwell Navigation* [2008] EWHC 1186, Aikens J in *Trident Turboprop (Dublin) Ltd v First Flight Couriers Ltd* [2008] EWHC 1686 (Comm), David Steel J in *Titan Steel v RBS* [2010] EWHC 211, and by Clarke J in *Raiffeisen v RBS* [2010] EWHC 1392 (Comm).[29] Contractual estoppel is also consistent with the House of Lords decision in *Hedley Byrne* – although there was a duty of care, the bank were not liable because the reference was given expressly on the basis that it was "without responsibility". It is also consistent with *IFE Fund v Goldman Sachs Int* [2007] EWCA Civ 811, where the defendant successfully excluded responsibility for the contents of an information memorandum.

The principle has been applied very recently by Andrew Smith J in *Creditsuisse International v Stichting Vestia* [2014] EWHC 3103 (Comm) describing Moore-Bick LJ's statement in *Peekay* at 302 as: "widely accepted as an authoritative statement of the principle of law that has in recent years been dubbed "contractual estoppel". Andrew Smith J held in *Credit Suisse*[30] that the estoppel can apply to future conduct, referring to *Titan Steel Wheels v RBS* [2010] EWHC 211 and also to *Bank Leumi (UK) plc v Wachner* [2011] 178 (Comm) where Flaux J applied the doctrine to a term, "You agree that you will rely on your own judgment for all trading decisions."[31] Detriment was not required for "contractual estoppel" because the justification of this doctrine is that a party cannot rely on its own breach of contract or take advantage of its own breach.[32]

In *Prime Sight Ltd v Lavarello* [2013] UKPC 22 the Privy Council applied the doctrine of estoppel by deed in respect both of a recital and a term, which stated that a company had paid a sum of money for a property to an individual. That individual subsequently became bankrupt and his trustee was estopped by the terms of the deed from asserting that in fact the company had never paid the sum of money stipulated in the deed. Lord Toulson approved[33] the following statement from *Spencer Bower*:[34]

"… an estoppel by convention need not involve any misleading of a representee by a representor, nor is it essential that the representee shall be shown to have believed in the assumed state of facts or law. The full facts may be known to both parties; but if, even knowing those facts to the full, they are shown to have assumed a different state of facts or law as between themselves for the purposes of a particular transaction, then a convention will be established. The claim of the party raising the estoppel is, not that he believed the assumed version of facts or law was true, but that he believed (and agreed) that it should be treated as true."

Lord Toulson went on to say:[35]

"[46] This passage refers to estoppel by convention and not expressly to estoppel by deed. However, there is no logical reason to treat declaratory statements in a deed which are intended to be contractually binding as less effective than any other express or implied contractual convention. The law as stated by *Spencer Bower* not only carries the considerable authority of Dixon J, who was a master of the common law, and is supported by earlier authorities to which reference has been made, but more fundamentally it accords with the principle of party autonomy which underlies the common law of contract. [47] Parties are ordinarily free to contract on whatever terms they choose and the court's role is to enforce them. There are exceptions and qualifications, but these too are part of the general law of contract. In *Greer v Kettle* [1937] 4 All ER 396 Lord Maugham referred to fraud, illegality, mistake and misrepresentation. Similarly, just as a court may refuse in some circumstances to enforce a contract on grounds of public policy (a topic closely related to illegality), the same will apply to a contractual convention."

Although "contractual estoppel" has not come before the Supreme Court or the Privy Council, if the doctrine were to do so, then it seems likely to be upheld given the decision in *Prime Sight Ltd* and the line of cases referred to above commencing with *Peekay*.

> "Even where the bank has… entered into an advisory relationship with a customer… the claimant may only enjoy a Pyrrhic victory as in *Crestsign*"

CONCLUSION

Where a "private person" is able to sue for a breach of the regulatory rules under s 138D/150 FSMA 2000 then a bank is exposed to liability for breach of statutory duty. However, any claimant who is unable to sue on a statutory cause of action, who can only rely on claims for common law negligence, is faced with some difficulty in showing that the relationship was advisory. The English courts have shown a considerable reluctance to accept that a bank has entered into an advisory relationship with a customer and successful claims have turned on strong facts. Against that background it is not surprising that many SMEs who purchased interest rate swaps before the collapse in interest rates[36] find it difficult to mount a successful claim for damages. Even where the bank has "crossed the Rubicon" and entered into an advisory relationship with a customer as a matter of fact, the claimant may only enjoy a Pyrrhic victory as in *Crestsign*.

The courts have been right to subject a claim by a customer that a bank entered into an advisory relationship to careful analysis

Biog box
Gregory Mitchell QC practises in commercial law from 3 Verulam Buildings, Gray's Inn (3vb.com). Tel: 020 7831 8441. Email: gm@3vb.com.

and to reject most of the claims on the facts. Banks do not often enter into advisory relationships with their customers. However, the operation of "contractual estoppel" in this area is unsatisfactory because it appears that, however strong the argument on the facts that an advisory relationship has been entered into, appropriate wording can exclude any duty of care arising at all, both in relation to past and also to future conduct.

The editors of *Banking Litigation*[37] comment:

> "such contractual estoppels may be vulnerable to another species of estoppel: namely estoppel by convention. If a party to a contract acts upon a false understanding of its rights and obligations and the other party acquiesces in that performance, the latter may be estopped 'by convention' from relying on their original agreement if this would be unjust or unconscionable.[38] Thus if a bank deals with its customers in a manner which (contrary to the contractual disclaimers) encouraged the customer to rely on the bank's expertise or representations and knew (contrary to the contractual non reliance provisions) that the customer did in fact rely on that advice or those representations, the effect might be that the bank is estopped by convention from asserting that those terms formed part of the true agreement if that would lead to consequences that might be considered unjust or unconscionable."

It remains to be seen whether estoppel by convention can be used to override contractual estoppel in any particular case. In principle this argument should be applicable depending upon the facts of the particular case. Why should an earlier contractual estoppel not be displaced by estoppel by convention arising thereafter? On the facts, would the customer be able to show that the "boilerplate" exclusions had been overridden by subsequent events, either by an estoppel by convention or by a waiver or by a variation of the contract? If the underlying facts showing the existence of the advisory relationship were strong enough and it could be shown that the parties moved on from that originally envisaged in the standard terms then the customer might be able to escape from the shackles of contractual estoppel. It also remains to be seen whether a challenge to a bank's standard terms will succeed under the Unfair Contract Terms Act 1977.[39] ■

1 See *Peekay Intermark Ltd v Australia and New Zealand Banking Group Ltd* [2006] EWCA Civ 386.

2 Financial Services and Markets Act 2000 s 150 but now s 138D as inserted under Financial Services Act 2012 s 24.

3 This definition is usefully discussed in *Bailey v Barclays Bank plc* [2014] EWHC 2882 by Judge Keyser QC at paras 41-44 following the decision of David Steel J in *Titan Steel Wheels Ltd v Royal Bank of Scotland plc* [2010] EWHC 211 (Comm) at paras 68-70.

4 See *Loosemore v Financial Concepts* [2001] Lloyd's Rep PN 235 and *Seymour v Caroline Ockwell & Co* [2005] EWHC 1137 (QB); [2005] PNLR 39.

5 For an interesting discussion on this see Piers Reynolds, 'Selling Financial Products: the interface between regulatory and common law standards', *Journal of Banking Law and Regulation* 2014.

6 *Green v RBS* [2013] EWCA Civ 1197 per Tomlinson LJ at para 23.

7 [2013] EWCA Civ 1197.

8 There is also a limited exception under s 150(3) now s 138D(3) discussed in *Encylopedia of Financial Services Law* Vol 1 at 2A-309.

9 New York is often regarded as a more claimant friendly jurisdiction in relation to claims against banks.

10 See *Foley v Hill* (1848) 2 HL Case 28 QB.

11 Eg in *Banbury v Bank of Montreal* [1918] AC 626 the plaintiff was advised by a branch manager to invest a substantial sum in a company. The investment failed and the plaintiff's claim in negligence succeeded below on very strong facts, but failed in the Lords by 3:2 on the basis that it had been conceded the manager acted outside his authority. This case would not be decided in the same way today because the decision turns on the very limited role which was expected of a bank at that time.

12 Compensation schemes have been set up, for example for PPI and swaps mis-selling.

13 The International Swaps and Derivatives Association was only founded in 1985.

14 However, Peter Gibson J left open the possibility of a claim where the bank knew of the imprudence of the borrowing given the way banks were then advertising their services as including giving advice.

15 *12 Legal Decisions Affecting Bankers* 210.

16 See n 8.

17 Page 73.

18 At para 574.

19 For an analysis of this judgment see Gregory Mitchell QC, 'When is a loss regarded as too remote under English law?', [2012] 10 JIBFL 618.

20 Paragraphs 68-70.

21 See judgment at paras 94-97.

22 Now s 138D, see n 5.

23 Tomlinson LJ at para 16.

24 See above.

25 See *Allcard v Skinner* (1887) 36 Ch D 145.

26 Eg *Midland Bank Ltd v Seymour* [1955] 2 LL Rep 147 and Commercial Banking Co v Jalsard [1973] AC 279.

27 At para 56.

28 At para 144.

29 See paras 234-256.

30 At 308.

31 At paras 183-184.

32 See para 309 and Wilken and Ghaly, *The Law of Waiver, Variation and Estoppel* (3rd Edn, 2012) at para 13.22.

33 See para 45.

34 See p 197.

35 See paras 46-47.

36 Rates collapsed from 5% in April 2008 to 0.5% on 5 March 2009.

37 3rd Edn at 11-081.

38 *Chitty on Contracts* 30th Edn at para 3-107.

39 See [2014] 11 JIBFL 679.

Further reading

- Dealing with the sophisticated private investor [2011] 9 JIBFL 556
- Contractual estoppel: *Springwell Navigation Corporation v JP Morgan Chase Bank* [2011] 4 JIBFL 227
- Lexis PSL: Dispute Resolution: Claims and remedies: Contract interpretation

Feature

KEY POINTS

- In the authors' view, adoption of a contract approach to prohibitions is at odds with the current rules governing assignment.
- The model of assignment is based on property and an approach to prohibitions that reflects that model sufficiently caters for the intention of the parties without creating a need for unique rules.
- Recognition of a declaration of trust or of an equitable assignment in the face of a prohibition results in a legal relationship between the obligor and beneficiary/assignee thus denying the purpose of the prohibition.

Authors GJ Tolhurst and JW Carter

Prohibitions on assignment: contract or property?

This article considers whether prohibitions on assignment should be analysed as mere contractual restraints on alienation that do not in law inhibit assignment in equity or whether they characterise contractual rights as property rights and deprive them of their inherent transferability.[1]

INTRODUCTION

Prohibitions on assignment come in various forms. The main categories are clauses drafted as true prohibitions, clauses drafted as promises not to assign, clauses prohibiting assignment without consent (often adding that consent is not to be unreasonably withheld), clauses restricting assignment to certain people or entities and clauses that make contractual rights personal. Until the decision of the House of Lords in *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd*,[2] the efficacy of prohibitions on assignment – other than the last type mentioned – was not clear. That case upheld such provisions and recognised that they were not contrary to public policy.

The basis upon which the House of Lords upheld the prohibition in that case has been debated. The House of Lords held that the effect of a prohibition on assignment depends on construction,[3] however, in most cases the parties' intention is to invalidate the assignment "so as to prevent the transfer of the chose in action".[4] Usually even a clause drafted as a "promise" not to assign will be interpreted as a prohibition on assignment.[5] The purpose of such prohibitions was said to be to "ensure that the original parties to the contract are not brought into direct contractual relations with third parties". The debate concerns how this purpose is achieved. For some it is by recognising that in bringing into existence a contract, the parties may characterise those rights as they see fit, including to deprive them of their transferability. We adopt this view. Since the right comes into existence by agreement and would not exist without that agreement, it is logical to accept that the parties can characterise the contractual rights (and obligations) under the agreement as they see fit. This is an aspect of freedom of contract. There will be exceptions to this position which are informed by public policy. Examples include regularly traded debts and the use of personal property as security.[6] But it is important to many commercial transactions that a prohibition be given effect to, for example the set-off and close-out netting provisions in ISDA master agreements depend on full effect being given to prohibitions on assignment.[7] Usually a promisor will only be concerned with ensuring it is not liable to account to or perform for a third party, so that the right may remain property and be transferable for other purposes. The concept of property also allows for issues to be carefully nuanced. It is not an all or nothing institution. Where it reflects the intention of the parties, it is possible to distinguish between a true prohibition and a promise not to assign. Consider also a term that prohibits assignment without consent where that consent is not to be unreasonably withheld. An attempted assignment without consent being sought or, if it is asked for, consent being reasonably withheld, would be ineffective.[8] Here the intention of the parties is that the chose has the characteristic of being transferable but that transferability is contingent. However, if consent is requested and is unreasonably withheld then we suggest that not only will that be a breach of contract but the assignment will be effective. The condition of requiring consent is intended to give the obligor some choice as to who it accounts to but it is limited by the criterion of "reasonableness", otherwise the inherent assignability of the chose is operative.

> "... if consent is requested and is unreasonably withheld then we suggest that not only will that be a breach of contract but the assignment will be effective"

On another view, there are thought to be limits to the ability of the parties to characterise contractual rights. They may not modify the inherent property aspects of such rights and one of those aspects is transferability. On this view a prohibition works by characterising the obligation of the obligor, the contractual right itself remains assignable in equity but the obligor need only perform for or account to the assignor. The purpose of the prohibition is achieved on the basis that the assignment, being equitable, only gives the assignee rights against the assignor. In

our view, although it is right to give weight to the purpose of the prohibition, this cannot be done in a commercial manner if it involves drawing fine distinctions and if only lip service is paid to the words of the contract which prohibit assignment. Moreover, as we seek to show below, the approach that has been adopted in some recent cases does not uphold that purpose.

THE CONTRACT ANALYSIS OF PROHIBITIONS

The view that prohibitions on assignment merely operate at the level of contract and do not characterise contractual rights is supported by Professor Goode who argues that that analysis was adopted by the House of Lords in *Linden Gardens*.[9] It is certainly true that Lord Browne-Wilkinson said that a "prohibition on assignment normally only invalidates the assignment as against the other party to the contract".[10] However, he went on to express the legal effect of a prohibition as to prevent "the transfer of the chose in action", stating that an attempted assignment was "ineffective to transfer such contractual rights".[11] It was after this that he referred to the purpose of such provisions stating that, "if the law were otherwise, it would defeat the legitimate commercial reason for inserting the contractual prohibition, viz, to ensure that the original parties to the contract are not brought into direct contractual relations with third parties".[12]

Goode stated his view in the following terms:[13]

> "The first point to make is that an assignment of a contract right in breach of a no-assignment clause takes effect only in equity…
>
> "The second point, though one which became apparent only in light of [*Don King Productions Inc v Warren*,[14] and *Barbados Trust Company Ltd v Bank of Zambia*[15]] is that the absence of legitimate grounds for the debtor to seek to negate a transfer of ownership of the contract right from assignor to assignee applies as much before performance of the contract as it does to the fruits of performance. The debtor is entitled to say that he will not give performance to an assignee, but what legitimate interest can he have in saying that not even equitable ownership can be transferred, with the result that, where an assignor who has been paid for the contract right becomes insolvent, the intended assignee is merely an unsecured creditor? … So, whether we are looking at the fruits of performance or at the right to performance, a no-assignment clause is valid only so far as it operates as a matter of contract, conditioning the duty to perform, not as a restraint on alienation."

In *Barbados Trust Company Ltd v Bank of Zambia*[16] the Court of Appeal affirmed the earlier decision in *Don King Productions Inc v Warren*,[17] that a party to a contract can declare that he or she holds the benefit of a contract on trust for a third party even if the rights under the contract are personal and not assignable and even if the contract contains a prohibition on assignment. The decision in *Barbados* concerned a declaration in the face of a prohibition on assignment. The court held that on construction the prohibition did not capture a declaration of trust. It was thought that a declaration of trust was not at odds with the intended purpose of the prohibition as the beneficiary could only enforce its rights against the trustee, no legal relationship existed between the beneficiary and obligor. Walker and Rix LJJ were prepared to go further and, if necessary, allow the beneficiary access to the procedure that allows it to bring an action in its own name against the obligor if the trustee refuses to act.[18] Walker LJ reasoned that the obligor could have no objection to the promisee/trustee enforcing the contract and so could have no objection to the beneficiary having recourse to a mere procedure to bring about that same result as the procedure merely prevents the beneficiary first having to bring an action against the trustee to enforce the contract; although the action was in the name of the beneficiary it operates as if brought by the trustee.[19] Indeed Walker LJ even expressed the view that a prohibition on all forms of alienation might not inhibit the declaration of such a trust as the purpose of not creating a legal relationship between the obligor and a third party is maintained.[20] Rix LJ thought access to the procedure was "necessary to get the legal claim before the court, through the party who owned it"[21] and expressed a view that public policy might inhibit a clause which attempted to extinguish all forms of alienation.[22] Importantly the envisaged trust was not a trust over the fruits of the contract, it was fully vested and the beneficiary through a procedural device could enforce unperformed accrued rights under the contract so as to "obtain what he is beneficially entitled to".[23]

"Moreover, the primary focus is on the purpose of prohibitions, to prevent the obligor being placed in a legal relationship with a third party"

The decision in *Barbados* seems to support the approach to prohibitions on assignment advocated by Goode. There are views expressed as to policy limitations on prohibitions, one cannot extinguish alienability. Moreover, the primary focus is on the purpose of prohibitions, to prevent the obligor being placed in a legal relationship with a third party. So long as that is maintained the promisee is free to deal with the chose in action.

There appears to us to be two primary issues with the approach taken in this case and a number of more general issues with the contract view as it relates to prohibitions. First, the ability of the beneficiary to enforce unperformed contractual rights seems necessarily to

result in the beneficiary having an interest in the contract; it must therefore have a legal relationship with the obligor. So the alleged purpose of the prohibition is not upheld. Moreover, it seems fictional today to suggest the beneficiary has no substantive right to enforce the contract but merely access to a procedure that brings about the same result. That legal sleight of hand is the type of reasoning that commercial parties despise when it neglects reality: the action will be brought, planned and funded by the beneficiary. In addition, as a bare trust, the beneficiary-assignee has an immediate right to call for the trust property.

Second, the result in the *Barbados* case is based on the view that a beneficiary has no direct rights against the obligor. If that is correct then it must also apply to equitable assignments of legal rights as there is still a strong view that these only operate as between the assignee and assignor. For our part we think this is a dated view of such assignments and that today there is a legal relationship between the assignee and obligor resulting from the assignee's ownership of the chose. That this is so can be seen in the requirement that the joinder of the assignor in any action is today viewed as a matter of procedure.[24] Moreover, under the modern law equity considers choses in action as property for the purposes of transfer, they are not merely property because any attempted transfer will be protected.[25] However, there is still much authority that holds that such assignments are only effective as between the assignor and assignee.[26] If correct it would follow then that the reasoning in *Barbados* should be applied to such assignments and this further suggests that the case supports the view of prohibitions favoured by Goode.

ASSESSING THE CONTRACT ANALYSIS

Putting the issue of declarations of trust to one side, in this section we address some particular concerns of recognising the possibility of assigning the benefit of a contract in equity in the face of a prohibition on assignment. If the contract analysis of prohibitions is accepted as the better explanation of how prohibitions operate, so that the benefit of the contract remains assignable in equity, then it will be necessary to determine how that approach fits into the general rules governing assignments. In our view the principal issues that would need to be addressed in adopting the contract view are as follows.

> "... it seems anomalous to have a position that recognises an equitable assignment in the face of a prohibition on assignment"

First, it seems anomalous to have a position that recognises an equitable assignment in the face of a prohibition on assignment. The assignment is surely a breach of contract and the assignee is asking equity to uphold a transaction the basis of which is a breach of another contract.[27]

Secondly, if the assignment in the face of a prohibition on assignment is effective, how is it that the assignee is bound by the prohibition in the sense of not being able to bring an action directly against the obligor? There is either an assignment or there is not! If the prohibition only operates at the level of contract and the assignee is not a party to the contract then it should not be bound by the provision. It seems to us that at some stage it is necessary to admit that at the level of property the prohibition characterises the benefit the assignee takes, that is, it characterises the chose in action.

Thirdly, there is an apparent incongruity between the contract view of prohibitions and the rule that dictates that a personal contractual right cannot be assigned. Whether or not a contractual right is personal is an issue of construction[28] and it has never been the law that an attempted assignment of a personal contractual right is effective in equity; rather equity has respected the personal rights rule.[29] It would therefore appear that unless the personal rights rule is varied it is easy to draft around any policy consideration that underpins the contractual approach to prohibitions: simply make the rights personal.

Fourthly, the rule that upon receipt of notice of an assignment the obligor cannot obtain a discharge from the assignor has always applied to equitable assignments of contractual rights. Yet its operation in the case of this valid equitable assignment in the face of a prohibition seems misplaced, it would not appear unconscionable for the obligor to ignore such a notice, but to ignore it would call into question the efficacy of assignment which vests equitable title in the assignee. This results from having the model of assignment being based on property and then confusing that model with one aspect of assignment – assignments in the face of prohibitions on assignment – being based around principles of contract. It seems nonsensical to create this discrete exception to a long established rule when there is no need to do so by adopting a property approach to prohibitions.

Fifthly, and related to point four, it is a rule of assignment that upon receipt of notice of the assignment the obligor cannot agree a variation of the contract or a discharge of the contract with the assignor without obtaining the consent of the assignee.[30] The reason for this rule is not that the assignee owns the assigned right as the assignment is effective prior to notice, but rather, upon receipt of such notice the conscience of the obligor is bound. However, since the obligor bargained for the prohibition on assignment it cannot be unconscionable for the obligor to agree to discharge or vary the contract without the consent of the assignee. But if that is correct it follows that any assignee taking an assignment in the face of a prohibition on assignment must accept that their rights can by undercut at any time by agreement

between the assignor and obligor and it should take appropriate indemnities from the assignor. It would follow from this that any policy that underpins the upholding of such assignments is fairly weak.

It is possible to make a few more remarks about this contract approach to prohibitions that focus on the commercial basis for such provisions. One important point is that the contract approach appears to put the purpose of the provision above the words of the provision which expressly state that it seeks to prevent assignment. This is not to suggest that the purpose is not important but for the reasons given above, in our view the recognition of a declaration of trust of the type envisaged in *Barbados* in the face of a prohibition or the recognition of an equitable assignment in the face of a prohibition results in a legal relationship between the obligor and beneficiary or assignee thus denying the purpose. Moreover, the enforcement mechanism for such a trust or assignment effectively forces the obligor into a relationship with the beneficiary or assignee. In addition, although in *Barbados* recourse was said to be had to the purpose of the prohibition the court did not appear to appreciate the commercial approach to construction that resort to the purpose of a contract forms part of. Commercial construction leans against drawing fine distinctions in drafting. Yet we have a result that a prohibition on assignment has been held to not capture a declaration of trust when the declared purpose of the prohibition is to prevent legal relations with third parties. However, if commercial construction is to be applied and if that is the purpose of a prohibition then it is difficult to see how a declaration of trust or an equitable assignment can be made in the face of the prohibition. In our view there seems little to differentiate a prohibition on assignment and a clause that makes rights personal when a commercial approach to construction is adopted. Yet that distinction seems inherent in the contractual approach to prohibitions as evidenced by the Court of Appeal in *Barbados*. The results seem inconsistent with the objectives of commercial construction.[31] In our view a commitment to commercial construction would mean that all forms of prohibition on assignment are an attempt by the parties to exercise their power to define their contractual rights as property rights so that in each case the right to receive performance is personal to the assignor. Similarly, any transaction that would create such a relationship between the assignor and obligor would be caught by such a provision whether it be an assignment, trust or charge.

> "… there seems little to differentiate a prohibition on assignment and a clause that makes rights personal when a commercial approach to construction is adopted"

In his defence of the contract approach Goode took the view that it is important to recognise the assignment in the face of a prohibition so as to protect the assignee – who has provided executed consideration for the assignment – from the assignor's insolvency. If that were not the case then Goode argues the assignor's estate would be unjustly enriched.[32] There is, however, a counter argument. Why should the creditors of the assignor be subject to an assignment of which they have no notice? Modern approaches, not only to assignments by way of security, but outright assignments of debts, insist on some perfection requirement, usually registration, in order to have such priority. Although at present, in England, such legislation only exists for securities and book debts, the fact such requirements exist in other jurisdictions shows that as a matter of policy it is not necessarily the case that the assignee should be protected.[33] Moreover, it is possible to imagine a case where the obligor performs first and then the assignor becomes insolvent. The assignee will have the benefit of the obligor's performance, which is not an asset of the assignor or its estate, available to the obligor (as the assignor's creditor) in the insolvency.

CONCLUSION

In our view the House of Lords in *Linden Gardens* took the view that a prohibition on assignment affects the transferability of the chose in action in a manner that reflects the intention of the parties. Usually that intention will be to deny the transferability of the chose so that the promisee cannot assign the benefit of the contract to a third party. Generally there will be no intention to prohibit an assignment of the fruits of a contract and the promisor cannot control the promisee's ability to deal with the fruits of the contract when they are in the hands of the promisee. Property is a sophisticated institution and can deal with differing intentions and can therefore result in a prohibition operating as no more than a promise not to assign if that is the intention of the parties. This approach has the great benefit of working within the current property model of assignment, there is no need to create any distinct rules of assignment if this approach is maintained. For the reasons given above, adoption of a purely contractual approach to prohibitions is at odds with the current rules governing assignment and adds complexity to an already complex area of law.

Finally, if the law takes the position that an assignment in the face of a prohibition should be effective as an equitable assignment then it appears to us that it necessarily follows that the personal rights rule must also be amended with the result that all rights become assignable unless there are good objective reasons for refusing the assignment. It must also follow that an obligation that is found to be personal on construction should be capable of being delegated if there exists no good objective reasons for making it personal. There is some support for adopting that approach.[34] However, it would radically alter our law of

Biog box

GJ Tolhurst is Professor of Commercial Law at the Faculty of Law, University of Sydney, and a consultant at Herbert Smith Freehills. Email: gregory.tolhurst@sydney.edu.au
JW Carter is Professor Emeritus at the University of Sydney, a consultant at Herbert Smith Freehills and general editor of the Journal of Contract Law.
Email: john.carter@hsf.com

assignment as it has developed and should be a step taken only when all the ramifications have been thought through. We do not suggest that the supporters of the contract approach to prohibitions are necessarily advocating such a move but the implications for legal principle of any change to the law of property or contract must always be considered and in our view such an approach to prohibitions opens the door to this larger approach as a matter of legal doctrine. ■

1 This article is based on a longer article published by the writers in the Cambridge Law Journal, see GJ Tolhurst and JW Carter, 'Prohibitions on Assignment: A Choice to be Made', [2014] CLJ 405.

2 [1994] 1 AC 85.

3 [1994] 1 AC 85 at 105.

4 [1994] 1 AC 85 at 108.

5 Eg *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85, 104 per Lord Browne-Wilkinson; *Devefi Pty Ltd v Mateffy Pearl Nagy Pty Ltd* (1993) 113 ALR 225.

6 Eg Unidroit Principles of International Commercial Contracts, 2010, Art 9.1.9. See also Unidroit Convention on International Factoring, Art 6; United Nations Convention on Assignment of Receivables in International Finance, Art 9; Personal Property Securities Act, 2009, (Cth), s 81; UNCITRAL Legislative Guide on Secured Transactions (UN, New York, 2010), paras, [106]-[110].

7 International Swaps and Derivatives Association, Inc.

8 *Hendry v Chartsearch Ltd*, *The Times*, 16 September 1998; *Fulham Partners LLC v National Australia Bank* [2013] NSWCA 296.

9 Roy Goode, "Contractual Prohibitions Against Assignment", [2009] LMCLQ 300 esp at 306-6. Goode relies in part on a decision of Untermyer J in *Sacks v Neptune Meter Co* (1932) 258 NYS 254 at 261-2, who states that the "limitation is not so much imposed on the obligee's right of alienation as on the obligor's duty to perform". However, the clause there was drafted as a promise not to assign and Untermyer made a distinction between true prohibitions and promises not to assign. He was also dealing with the question whether a prohibition operates as an improper restraint on alienation. See also *Devefi Pty Ltd v Mateffy Pearl Nagy Pty Ltd* (1993) 113 225 at 234-7, where the Full Federal Court of Australia suggest that this analysis could flow from a proper construction of the contract but did not adopt it as one dictated by doctrine.

10 [1994] 1 AC 85 at 108.

11 [1994] 1 AC 85 at 108.

12 [1994] 1 AC 85 at 108.

13 [2000] Ch 291 (affirmed [2000] Ch 291).

14 [2000] Ch 291 (affirmed [2000] Ch. 291).

15 [2007] EWCA Civ 148, [2007] 1 Lloyd's Rep 495.

16 [2007] EWCA Civ 148, [2007] 1 Lloyd's Rep 495.

17 [2000] Ch 291 (affirmed [2000] Ch 291).

18 The procedure is referred to as the "Vandepitte" procedure after *Vandepitte v Preferred Accident Insurance Corp of New York* [1933] AC 70. Hooper LJ agreed with Walker and Rix LJJ on the construction point but would not have allowed the beneficiary to use a procedure to bring an action in its own name if the trustee refused to act as that would be at odds with the purpose of the prohibition, [2007] EWCA Civ 148 at [139], [2007] 1 Lloyd's Rep 495 at 520-21.

19 [2007] EWCA Civ 148 at [45], [47], [2007] 1 Lloyd's Rep 495 at 506-507 per Walker LJ.

20 [2007] EWCA Civ 148 at [43], [2007] 1 Lloyd's Rep 495 at 506 per Walker LJ.

21 [2007] EWCA Civ 148 at [102], [2007] 1 Lloyd's Rep 495 at 515.

22 [2007] EWCA Civ 148 at [112], [2007] 1 Lloyd's Rep 495 at 516.

23 [2007] EWCA Civ 148 at [29], [2007] 1 Lloyd's Rep 495, at 503.

24 *Roberts v Gill & Co* [2010] UKSC 22, [2011] 1 AC 240, 263 per Lord Collins.

25 *Fitzroy v Cave* [1905] 2 KB 364, 372-3 per Cozens-Hardy LJ.

26 Eg *Re General Horticultural Company* (1886) 32 Ch D 512 at 515 per Chitty J; *Gorringe v Irwell India Rubber and Gutta Percha Works* (1886) 34 Ch D 128 at 132 per Cotton LJ; *Anning v Anning* (1907) 4 CLR 1049 at 1064 per Isaacs J; *Re Westerton* [1919] 2 Ch 104 at 111 per Sargant J; *Re City Life Assurance Co Ltd* [1926] Ch 191 at 215 per Pollock MR, at 220 per Warrington LJ; *Comptroller of Stamps (Vic) v Howard-Smith* (1936) 54 CLR 614 at 622 per Dixon J; *Holt v Heatherfield Trust Ltd* [1942] 2 KB 1 at 4 per Atkinson J; *Corin v Patton* (1990) 169 CLR 540 at 577 per Deane J; *Showi Shoji Australia Pty Ltd v Oceanic Life Ltd* (1994) 34 NSWLR 548 at 561; *Mid-City Skin Cancer & Laser Centre v Zahedi-Anarak* (2006) 67 NSWLR 569 at 607-8.

27 *R v Chester and North Wales Legal Aid Area Office (No 12)* [1998] 1 WLR 1496 at 1501 per Millett LJ.

28 *Tolhurst v The Associated Portland Cement Manufacturers* (1900) Ltd [1903] AC 414.

29 RP Meagher, JD Heydon and MJ Leeming, *Meagher, Gummow and Lehane's Equity, Doctrines and Remedies*, (4th Edn, Butterworths, Sydney, 2002), para 6.445. See also, WS Holdsworth, "The History of the Treatment of Choses in Action by the Common Law" (1920) 33 Harv L Rev 997, 1022-3. Cf *Mid-City Skin Cancer & Laser Centre v Zahedi-Anarak* (2006) 67 NSWLR 569 at 606-8 per Campbell J.

30 *Brice v Bannister* (1888) 3 QBD 569.

31 See eg *Fiona Trust and Holding Corp v Privalov* [2007] UKHL 40, [2007] Bus LR 1719.

32 Roy Goode, "Contractual Prohibitions Against Assignment" [2009] LMCLQ 300 at 306.

33 Eg Personal Property Securities Act 2009 (Cth), s 12(3).

34 See LA DiMatteo, "Depersonalization of Personal Service Contracts: The Search for a Modern Approach to Assignability" (1994) 27 Akron L Rev 407. Cf, GJ Tolhurst, "Assignment of Contractual Rights: The Apparent Reformulation of the Personal Rights Rule" (2007) 29(1) Australian Bar Review 4.

Further reading

- Restrictions on the transfer of rights in loan contracts [2013] 9 JIBFL 543
- Assignment: problems and pitfalls [2013] 8 JIBFL 489
- Lexis PSL: Banking & Finance: Syndication and transfer of loans

KEY POINTS

- A new model law on secured transactions, prepared by UNCITRAL Working Group VI, aims to provide a global template for modernisation and harmonisation of law in this area.
- The Draft Model Law's unique and ambitious aspirations are simplicity, brevity and conciseness.
- If the Draft Model Law's aspirations are achieved, it is likely to lead to a global trend in modernisation in this area.
- English law may fall behind if it does not reform – the nearest and small opportunity is making bans on assignment ineffective but a much wider reform may be needed.

Feature

Author Dr Magda Raczynska

A new model law of secured transactions: worldwide modernisation in the making?

A new model law on secured transactions is currently being prepared by the UNCITRAL Working Group VI, based on its previous work – the Legislative Guide on Secured Transactions with its Supplement on security in intellectual property. The article explains the context in which the Draft Model Law arises, and shows that its rationale is to provide a simple, concise and shorter model law that would facilitate worldwide modernisation in this area. Although hard to achieve, the success of the Draft Model Law could change the attitudes to law reform in countries where reform is opposed such as England.

INTRODUCTION

A new model law on secured transactions law is currently being drafted by Working Group VI of the UN Commission on International Trade Law (UNCITRAL). The purpose of this note is threefold: first, to explain the need for this new instrument by setting out the context in which it arises and its aims, secondly to suggest ways in which the model law can develop to advance these goals, and finally to identify areas of particular relevance to English law.

DO WE NEED A GLOBAL MODEL LAW ON SECURED TRANSACTIONS?

Importance of a sound legal framework and its development

Secured credit is hugely important to market participants and growth of the economy. With the increasing reliance on secured credit and the growing market interdependency, there is a pressing need to have a sound legal regime for security interests in personal property in both domestic and cross-border transactions. There is evidence to suggest that effective laws, supported by efficient judicial system and enforcement mechanisms, can help attract credit and in so doing promote economic growth.[1]

A number of countries across the world are modernising their laws on secured credit. A few recent examples include Australia, Belgium, France, Jersey, Malawi and Qatar.[2] At the international level, modernisation of secured transactions law is promoted mainly but not exclusively through harmonisation efforts. The law of security interests, seen as part of the law of property, has been historically difficult to harmonise. This initial demur has been progressively overcome over the last three decades through the work of various international organisations and entities. The result to date is an array of international instruments, including:

- international conventions to unify aspects of substantive law:
  - Unidroit Convention on International Factoring (Ottawa, 1988);
  - Unidroit Convention on International Financial Leasing (Ottawa, 1988);
  - United Nations Convention on the Assignment of Receivables in International Trade (New York, 2001);
  - Unidroit Convention on International Interests in Mobile Equipment (Cape Town, 2001) and its protocols: Protocol on Matters Specific to Aircraft Equipment (Cape Town, 2001), Protocol on Matters Specific to Railway Rolling Stock (Luxembourg, 2007) and Protocol on Matters Specific to Space Assets (Berlin, 2012);
  - Although not strictly in the area of secured transactions but relevant to it given the similar treatment of trusts on insolvency is the Hague Convention on the Law Applicable to Trusts and on Their Recognition (The Hague, 1985);
  - Unidroit Convention on Substantive Rules for Intermediated Securities (Geneva, 2009).
- conflicts of laws convention:
  - The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (The Hague, 2006).
- model laws:
  - Model Inter-American Law on Secured Transactions, adopted in 2002 by the Organisation of American States;
  - Model Law of the European Bank of Reconstruction and Development (2004);
  - Unidroit Model Law on Leasing (2008).
- legislative and reference guides:
  - UNCITRAL Legislative Guide on Secured Transactions (2007) and Supplement on Security Rights in Intellectual Property (2010);
  - Draft Common Frame of Reference, which includes Book IX devoted to security interests and which could be seen as a reference guide, prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law.
- binding regional instruments:
  - Uniform Act Organizing Securities (1997) adopted by the Organization for the Harmonization of Business Law in Africa;
  - EU Directive 2002/47/EC on financial collateral arrangements, amended by the Directive 2009/44/EC.

Of these instruments, the widest in scope is the 2007 UNCITRAL Legislative Guide on Secured Transactions ("the Guide" or "the Secured Transactions Guide") with its 2010 Supplement on Security Rights in Intellectual Property. Whilst other instruments either deal only with specific issues (eg security interests in aircraft, rolling stock, space assets; leasing; factoring; assignment of receivables) or are intended for use in certain regions (for example, EBRD model law in Central and Eastern Europe and Asia; Draft Common Frame of Reference in Europe), the Guide is both comprehensive and worldwide. The Secured Transactions Guide is addressed to national legislators in states that do not currently have efficient secured transactions laws as well as to states that already have workable laws but seek to modernise and to harmonise their laws with laws of other states. Admittedly, harmonisation of laws appears as a somewhat secondary purpose in the Guide, which is destined to improve domestic regimes in the first place. Granted, if enough countries modernise their laws in a similar way, harmonisation will be achieved.

In 2012 Working Group VI of UNCITRAL undertook to prepare "a simple, short and concise draft model law on secured transactions based on the general recommendations of the Guide and consistent with other texts prepared by UNCITRAL on secured transactions".[3] Similarly to the Guide, the model law (the "Draft Model Law"),[4] which is in the process of being produced, will serve as a blueprint for countries wishing to modernise their laws. Draft regulations on registration of security as well as guidance to the enactment of the model law are also planned. What will this new effort add? In order to answer this question, we need to explain the difference between legislative guides and model laws and elaborate on the reasons behind this initiative.

Legislative guides and model laws: what is the difference?

There is no technical legal definition of legislative guides and model laws, so any discussion of the two is necessarily based on description of similarities and differences between existing instruments. Both legislative guides and model laws contain recommendations to improve law. However, they are drafted with different needs in mind. Guides identify policy issues that states should have in mind when reforming the law, describe possible ways of dealing with them and provide analysis of these options in light of modernisation aims. They also often include recommendations. Model laws lack the analysis and focus on recommendations or, rather, draft provisions, ready to be implemented to domestic laws, although they may include comments and explanations.

Rationale for the Draft Model Law

The Draft Model Law is to complement the Guide and promote its implementation with a view to addressing urgent issues relating to access to credit and financial inclusion, in particular for small and medium-sized enterprises.[5] The Guide is a large document of over 500 pages, of which 80 contain recommendations and terminology. The Supplement on Security Rights in Intellectual Property adds a further six recommendations and 100 pages of commentary. The recommendations contained in the Guide are detailed which may not suit the style of law reform in some countries.

The idea behind the Draft Model Law is not merely to repeat the Guide's recommendations but instead, it seems, to formulate (as if anew) simpler and more concise provisions based on the Guide's recommendations. We could therefore say that the Draft Model Law adopts a "broad brush" approach to a law reform, leaving the nuance of the law to develop in its application and with support of the commentary and detailed recommendations in the Guide. For example, the Guide's key objectives and fundamental policies underlying a modern secured transactions regime[6] are not repeated in the Draft Model Law but they persist as its bedrock. It is suggested that the simplicity, clarity and conciseness are important values, which may translate into achieving a law reform more efficiently. A number of countries may not have the capacity to analyse and implement the detailed recommendations of the Guide but yet seek to modernise. Achieving any law reform always involves costs. If the costs are too high, a reform may not be worthwhile in some states. If costs can be reduced, modernisation of law may become a realistic goal.

Overview of the Draft Model Law

The Draft Model Law applies to a range of transactions which involve a right in movable assets created by agreement and securing performance of an obligation, regardless of whether the parties have denominated it as a security agreement or not. It also applies to outright transfers of receivables without recharacterising them as security rights and to retention of title agreements, although the issue of recharacterisation seems to be left open for states to decide. Under the Draft Model Law security can be created by any person, whether business or consumer, in favour of any person so long they are not a consumer, in almost any type of asset although there are exceptions such as security in intermediated securities or aircraft.

The Draft Model Law provides the necessary elements for creation of security. The two key methods of perfection of security (or, in the language of the Model Law and the Guide, the "third-party effectiveness") are: (i) registration of a notice in the general security registry, and (ii) taking possession of a tangible asset or a negotiable document encumbered by the security right. This has to be actual possession taken personally, by an agent, an employee or an independent person that acknowledges holding it for that person. Control is also a method of achieving third-party effectiveness, albeit not an independent one, in relation to security in rights to payment from a bank account and uncertificated non-intermediated securities.

Central to the achievement of the goal of certainty and transparency of security rights, as noted in the Guide, recommendation 1(f), is a general, notice-based system of registration, whereby a mere notice of security can be filed, whether before or after the conclusion of the security agreement, without the need to file the entire security agreement. An entire chapter is devoted to the design and operational details of a registry. Registration

of notice also determines priority of a security right. The Draft Model Law further includes provisions on enforcement of security rights, acquisition financing, conflict of laws, provisions concerning transition and the impact of insolvency on a security right.

CRITIQUE OF THE DRAFT MODEL LAW AND SUGGESTIONS FOR THE DRAFTERS

The Draft Model Law is merely at the production stage and perhaps one should not criticise work in progress. In the hope of providing useful feedback rather than unwanted comments smacking of "backseat driving", the following general and specific remarks can be made for consideration by the drafters.

General points

First, it could be argued that one model law cannot be developed to suit all countries across the world, each with different legal traditions. Pre-empting this "one-model-does-not-fit-all" argument, UNCITRAL envisaged that the drafting of the Model Law should be sufficiently flexible to adapt to various legal traditions, which can already be seen in the provision of alternative model rules in some areas (eg Draft Model Law, Art 48 on establishing priority between non-acquisition security rights competing with acquisition security rights). Yet, the challenge for the drafters is not to provide various options but rather to distil the existing compromises into a simpler and shorter document. This is not an easy task and some of the detail of the Guide will inevitably need to be omitted or generalised in order to fashion a more concise law. In so doing, choices will have to be made. It is unclear what the basis for this selection process is (in particular, the aspiration to achieve a short and concise law is not such a basis but, rather, it is the goal). This could usefully be clarified in the Draft Model Law or its commentary.

The second criticism concerns the requirement of consistency. It is envisaged that the Draft Model Law should not contain provisions that are inconsistent with the Guide. The approach, whereby one should follow another's lead in a situation where that other does not easily change, assumes that choices, once made, remain optimal. The process of producing the Draft Model Law should allow for some flexibility to depart from the recommendations of the Guide where there are very good reasons for doing so. An example of an area where such a departure could usefully be considered is the automatic continuation of security rights in proceeds, recommended by the Guide and followed in the Model Law. In both instruments the term "proceeds" is very broad and includes not only assets received as a result of sale or other disposition, collection, lease or licence of an encumbered asset but also natural and civil fruits or revenues and dividends. Yet, allowing security to automatically extend to fruits or income (by contrast to substitutes such as sale proceeds) seems economically inefficient. Although detailed explanation must wait for another day, this may be an area where departure from the Guide could be justified. By way of a modern example, in the Security Interests (Jersey) Law 2012 the definition of proceeds excludes dividends or income.

Finally, some critics might undermine the goal of the Draft Model Law to provide a simple and concise law by labelling it as the "law for dummies". This is easily dismissed. There is no inherent advantage to be had in detailed drafting. Many lawyers working in various areas of law can probably tell a story to illustrate this. One example is found in the English criminal law of self-defence, the rules for which are set out in two different acts: Criminal Law Act 1967, s 3, and Criminal Justice and Immigration Act 2008, s 76. What one act seeks to achieve in a sentence the other does in eighteen subsections sprawling across two pages. We are not better off for the presence of the detail and, on this occasion, we are distinctly worse off. The quality of laws should not be measured by the number of words but, instead, by their accuracy, succinctness and lack of unnecessary complexity.

Specific points

A couple of specific remarks come to mind on the substance of the most recent draft of the Model Law. The first concerns the scope of application to consumer creditors. The second concerns imposition of a general duty to act in good faith and in a commercially reasonable manner.

Under the Draft Model Law, security can be created in favour of any person so long they are not a consumer. It is not clear why the Model Law is to be excluded if the secured party is a consumer (or a small business or microbusiness). Such a provision contradicts the Guide, which provides that the law should apply irrespective of the person of the secured creditor without prejudice to consumer legislation. If the current formulation persists, there is a danger that such security taken by consumers and small secured parties, even though rare, will continue to be governed by existing national laws, which may provide them with even less protection than the Draft Model Law. The Guide should be followed in this respect.

Another remark concerns a provision of the Draft Model Law imposing a duty to exercise rights and perform obligations in good faith and in a commercially reasonable manner. Given that this is a mandatory rule from which parties may not derogate, it may be surprising that the controversial concept of good faith is included, especially because it is not limited to contractual rights and obligations as between the parties but appears to apply more widely, as against third parties. This is more likely than not to generate litigation without an obvious benefit. The inclusion of the duty to act in good faith and a commercially reasonable manner represents the widening of the policy in the Guide, which imposes such a standard of conduct in relation to the enforcement of a security right after debtor default. It is not clear why the extension of such duties, especially the duty to act in good faith, is necessary and what the combined reference to "good faith" as well as "commercial reasonableness" adds. The duty to act in good faith would not, for example, deal with the problem of encumbering the asset with security grossly in excess of the secured obligation (over-collaterialisation) because the duty does not extend to the negotiation stage, which is when it would probably be needed to solve this issue. It is suggested that the reference to good faith

Feature

Biog box
Dr Magda Raczynska is Lecturer in Law at the University of Bristol and Deputy Executive Director of the Secured Transactions Law Reform Project.
Email: magda.raczynska@bristol.ac.uk

should either be usefully clarified in the commentary or deleted, leaving the reference to "commercially reasonable manner".

LESSON(S) FOR ENGLISH LAW

It is perhaps too early to identify to what extent English law can be improved based on the Draft Model Law. However, given the urgency of reforms in England of aspects of receivables financing, one comment cannot wait. Receivables financing is an important source of finance, in particular in relation to small businesses. For this reason, any restrictions on this form of finance should be carefully looked at. Financiers take an assignment or a security right over receivables, which arise under contracts for the supply of goods or services. Such contracts may contain a prohibition against assignment of, or the creation of security over, the receivable. In jurisdictions in which such restrictions are effective, when the assignment takes place notwithstanding the restriction, it may be more difficult for the financiers (the assignees) to enforce the security and collect the debts.[7] The Draft Model Law deals with this problem by providing that assignments of receivables, whether outright or by way of a security right, are effective despite the anti-assignment clause. A similar solution has previously been recommended not only by the Guide but also in the UN Convention on the Assignment of Receivables in International Trade 2001 and the 1988 UNIDROIT Convention on International Factoring. English law ought to follow suit. The Small Business, Enterprise and Employment Bill, currently before Parliament, provides in clause 1 that the Secretary of State may make regulations providing that a ban on assignment clause has no effect. It is hoped that the Draft Model Law will provide an additional argument in favour of reform of English law in this area.

But there is a wider lesson to be had for English law. If the Draft Model Law becomes successful, a worldwide modernisation of the secured transactions regime might become a reality. English law is likely to fall behind. Arguably, English law would have little to offer with its antiquated Bills of Sale Acts 1878-1882 governing security provided by individuals (and so, unduly denying to unincorporated businesses opportunities that are open to companies), its lack of certainty and transparency seen in the lack of registration of title-retention devices, its comparatively more costly transaction-filing registration (instead of notice-filing system), its complex priority rules and the problematic floating charges.[8] Global modernisation of secured transaction regimes is not an unreal vision. If the UNCITRAL Secured Transactions Guide could lead to modernisation of law, for example in July 2013 in Malawi, a simple, short and concise draft model law is likely to be even more successful.

CONCLUSION

The Draft Model Law prepared by UNCITRAL is an ambitious and important effort in facilitating comprehensive modernisation of secured credit worldwide. It is produced with a view to implementing the recommendations of the UNICTRAL Secured Transactions Guide in a shorter, more concise and simpler form. This is a tall order for the drafters and we are yet to see to what extent the expectations will be met. This article has suggested that the model law might benefit from a stronger policy framework within which the translation into this simpler law is to take place and that the principle of consistency with the Guide should not be absolute to accommodate the changing views or practices where there are strong reasons for doing so. Even though the Draft Model Law is a work in progress, it is hoped that some of its model provisions will provide fuel for reforms of secured transactions law in English law, most imminently in relation to making prohibitions on assignment of receivables ineffective. If the Draft Model Law succeeds in reaching its aspirations it is likely to lead to modernisation of secured transactions regimes in a number of countries across the world, leaving those irresponsive to this trend behind. ■

1 See eg R Levine, *Finance and Growth: Theory and Evidence* (National Bureau of Economic Research, Working Paper 10766, 2004) published in P Aghion and S Durlauf (eds), *Handbook of Economic Growth* (2005 1st Edn Elsevier) Vol 1, Ch 12, 865. See also *Asset encumbrance, financial reform and the demand for collateral assets* (Report to the Committee on the Global Financial System, Paper No 49, May 2013) available at http://www.bis.org/publ/cgfs49.pdf. But see S Stacy, 'Follow the Leader?: The Utility of UNCITRAL's Legislative Guide on Secured Transactions for Developing Countries (and Its Call for Harmonization)' (2014) 49 Tex Int LJ 35.

2 For a more comprehensive list and a brief description of the reforms see http://securedtransactionslawreformproject.org/reform-in-other-jurisdictions.

3 Report of UNCITRAL 45th Session (New York, 25 June-6 July 2012) Official Records of the General Assembly, Sixty-seventh Session, Supplement No 17 (A/67/17), para 105 (granting Working Group VI the mandate).

4 See UNCITRAL Working Group VI documents A/CN.9/WG.VI/WP.61, A/CN.9/WG.VI/WP.61/Add.1 as well as A/CN.9/WG.VI/WP.57/Add.2-Add.4.

5 45th Session (New York, 25 June-6 July 2012) Official Records of the General Assembly, Sixty-seventh Session, Supplement No 17 (A/67/17), para 103.

6 Guide, recommendation 1 (11 key objectives) and pp 22-26 (listing 12 fundamental policies) and p 4, para 12 (explaining their source and previous work).

7 For the arguments for and against bans on assignment in the context of English law see the materials from the Seminar on Receivables Financing organised by the Secured Transactions Law Reform Project (8 May 2014) http://securedtransactionslawreformproject.org/what-we-do/ban-on-assignment-clauses/.

8 For further detail see http://securedtransactionslawreformproject.org/the-case-for-reform/.

Further Reading

- Secured Transactions Reform [2013] 1 JIBFL 6
- Personal Property Security Law: where next? Parts 1 and 2 [2012] 8 JIBFL 465; [2012] 9 JIBFL 541
- LexisNexis Loan Ranger blog: Real impetus for reform and research into English law on secured transactions

KEY POINTS

- The extent to which international banks can be held liable for financing terrorist activity is in a state of flux due to a number of ongoing cases in the US courts against foreign-domiciled financial institutions under the Anti-Terrorism Act 1990.
- The cases represent a watershed in citizens' ability to enforce corporate accountability across international boundaries, but raise a number of significant questions for banks about jurisdiction, knowledge of terrorist activity, and the concept of material support to terrorism.
- Investigation and determination of liability in other domestic jurisdictions will not necessarily influence US courts, and domestic laws on the regulation of banks may be disregarded.
- The standard for liability is knowledge regarding the provision of *any* material support to a terrorist organisation, not the aiding of specific terrorist activities.
- In terms of risk management, limitations on liability remain hazy. It seems that international banks must not only protect their liability under domestic law but also take steps to comply with the US counter-terrorism regime.

Authors John RWD Jones QC and Katie O'Byrne

Liability of international banks for financing terror: current cases and risk management

This article examines two recent US cases as a means of exploring issues of liability for international banks and three key concerns arising from these and other recent cases: jurisdiction, knowledge of terrorist activity, and the concept of material support to terrorism. The article then analyses the risk management ramifications of those factors.[1]

INTRODUCTION

To what extent can an international bank be held liable for financing terrorist activity? How can international banks manage the risks of such liability and uphold the aims of counter-terrorist regulation?

The answers to those questions are in a state of flux, primarily due to a number of ongoing cases in US courts under the Anti-Terrorism Act 1990 (18 USC §113B). This article examines two of those cases, *Linde et al v Arab Bank*, 04-CV-2799 (EDNY Sept 22, 2014) and *Weiss et al v National Westminster Bank Plc*, 13-CV-1618, 2014 WL 4667348 (2d Cir Sept 22, 2014). The cases can be used as a platform from which to explore issues of liability for international banks under US and UK law, and the interplay between counter-terrorist financing regimes in different jurisdictions.

This article examines three central concerns arising from these and other recent cases – jurisdiction, the requirement of knowledge of terrorist activity, and the concept of material support to terrorism – before analysing the risk management ramifications of those factors.

CURRENT CASES

This article takes as case studies two ongoing civil claims against international banks in the US courts, as follows:

- *Linde v Arab Bank* was the first civil trial against a bank under the Anti-Terrorism Act. Arab Bank was sued, for knowingly providing financial services to militants, by 297 plaintiffs who were victims of 24 attacks (including bombings, shootings and a mortar attack) launched in Israel by Hamas between 2001 and 2004. On 22 September 2014, Arab Bank was found liable by the jury for the injuries resulting from those attacks. A separate trial will be held to determine quantum of damages. Arab Bank has appealed the finding to the US Court of Appeals for the Second Circuit.
- On the same day as the verdict in *Linde*, the US Court of Appeals for the Second Circuit handed down judgment in *Weiss v Natwest*, reversing a dismissal on summary judgment by the District Court. *Weiss* is a similar suit, filed by approximately 200 Hamas victims against the UK-domiciled National Westminster Bank, a subsidiary of the Royal Bank of Scotland Group plc, for providing material support and resources to a foreign terrorist organisation. Natwest is said to have maintained bank accounts and transferred funds for the Palestine Relief & Development Fund, known as "Interpal", which allegedly provided support for Hamas.

Similar lawsuits are pending in New York against Bank of China Ltd, accused of providing services to Palestine Islamic Jihad, and Credit Lyonnais SA, accused of aiding Hamas.

In addition to the Anti-Terrorism Act, counter-terrorism financing is regulated in the US by the Bank Secrecy Act (31 USC §5311) and the USA PATRIOT Act (115 Stat 272 (2001)), overseen by the Financial Crimes Enforcement Network and other agencies. Under the Bank Secrecy Act, banks are subject to strict requirements to report suspicious activity. The USA PATRIOT Act imposes numerous measures to enhance national financial security, including special due diligence or prohibitions on particular accounts, cooperative efforts with law enforcement, and identification of customers.

Heavy fines and prison sentences apply for violations. While these provisions may have some extraterritorial effects, they apply to financial institutions in the US rather than those domiciled elsewhere.

For the plaintiffs in the recent cases, and in terms of international policy on counter-terrorism financing, the decisions in *Linde* and *Weiss* represent a watershed in citizens' ability to enforce corporate accountability across international boundaries. But for international banks, they raise a number of significant questions, including:

- Under what jurisdiction might banks be liable for financing terror?
- What constitutes knowledge of terrorist activity?
- What constitutes material support to terrorism?

Those questions are addressed in turn, with particular reference to US and UK law.

> "… domestic laws of other nations on the regulation of banks may be disregarded by US courts"

JURISDICTION

Section 2333(a) of the US Code provides civil remedies for US nationals injured by "acts of international terrorism":

> "Any national of the United States injured in his or her person, property, or business by reason of an act of international terrorism, or his or her estate, survivors, or heirs, may sue therefor in any appropriate district court of the United States and shall recover threefold the damages he or she sustains and the cost of the suit, including attorney's fees."

The term "international terrorism" is defined by § 2331(1) to mean:

> "[A]ctivities that (A) involve violent acts or acts dangerous to human life that are a violation of the criminal laws of the United States or of any State, or that would be a criminal violation if committed within the jurisdiction of the United States or of any State; (B) appear to be intended (i) to intimidate or coerce a civilian population; (ii) to influence the policy of a government by intimidation or coercion; or (iii) to affect the conduct of a government by mass destruction, assassination, or kidnapping; and (C) occur primarily outside the territorial jurisdiction of the United States…"

The court in *Weiss* held that while there is a presumption against the extraterritorial application of US laws, "it is overcome by clearly expressed Congressional intent for a statute to apply extraterritorially". The wording of § 2331(1) was "sufficient indication that Congress intended extra-territorial application". Importantly, this was so "regardless of whether there is a risk of conflict with foreign law" and "regardless of the views and laws of other nations".

This statement has at least three major consequences:

- First, designation of a particular organisation as a terrorist organisation by the Office of Foreign Assets Control (OFAC) in the US will be determinative of the status of that organisation under the US laws. The designation of particular organisations as terrorist organisations is, of course, controversial in itself. The recent cases indicate that it will be of no consequence that an organisation is not so designated in the UK or any other jurisdiction. In *Weiss*, Interpal was designated in the US but not the UK.
- Secondly, investigation and determination of liability in other domestic jurisdictions will not tend to influence US courts. The UK has a comprehensive scheme of counter-terrorism legislation, including mandatory reporting of suspicious activity under the Terrorism Act 2000 and the Proceeds of Crime Act 2002, overseen by the National Crime Agency. Regulation, and not litigation, has been the predominant means of enforcement in the UK. Pursuant to that scheme, Interpal was investigated twice by two UK government agencies, the Charity Commission and the Metropolitan Police Special Branch. Both cleared Interpal of terrorist financing and links to terrorism, but the Second Circuit in *Weiss* did not consider this to limit liability under US law.
- Thirdly, domestic laws of other nations on the regulation of banks may be disregarded by US courts. In *Linde*, Arab Bank was ordered to make certain disclosures contrary to Jordanian laws protecting the financial privacy of banking customers. A federal judge ruled that the jury was permitted to infer from the bank's failure to provide the information that it did business with terrorists. The ruling was unsuccessfully appealed (*Linde v Arab Bank*, 706 F.3d 92 (2013)), with the Supreme Court eventually declining to hear the matter.

An interesting contrast may be drawn in this respect with the issue of corporate liability for human rights violations against foreign citizens under the Alien Tort Claims Act (28 USC §1350). The statute provides: "The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States."

Courts of Appeals were divided concerning whether corporations as opposed to natural persons could be held liable under the statute. In April 2013, in *Kiobel v Royal Dutch Petroleum Co* 133 SCt1659 (2013), the US Supreme Court rejected extraterritorial application of the statute, holding that the Alien Tort Claims Act did not create corporate liability nor establish jurisdiction for a claim concerning conduct occurring outside the US. This curtailed the ability of foreign citizens to sue US or foreign corporations for extraterritorial human rights violations in US courts. The decision in *Kiobel* contrasts with the courts' more expansionist attitude to the right of

US citizens to sue foreign corporations for extraterritorial terrorist conduct under the Anti-Terrorism Act.

WHAT CONSTITUTES KNOWLEDGE OF TERRORIST ACTIVITY?

Section 2339B(a)(1) imposes criminal penalties on:

> "[w]hoever knowingly provides material support or resources to a foreign terrorist organization. … To violate this paragraph, a person must have knowledge … that the organization has engaged or engages in terrorist activity (as defined in section 212(a)(3)(B) of the Immigration and Nationality Act)".

The definition of "engage in terrorist activity" in the Immigration and Nationality Act (8 USC §1101) includes "to commit an act that the actor knows, or reasonably should know, affords material support" to terrorism, including "communications, funds, transfer of funds or other material financial benefit".

This creates a double layer of potential liability. As Hamas is an organisation designated as a Foreign Terrorist Organization by the United States Secretary of State, it was sufficient for Arab Bank to transact with a Saudi charity, the Saudi Committee, and for Natwest to transact with Interpal – both organisations which provided support to Hamas – as long as each bank had actual knowledge or reasonably should have known of that support.

As the matter currently stands, it seems that banks are expected to know their customers and to understand and monitor client transactions so as to be able to report any activity contravening the Anti-Terrorism Act, or at least shut down the accounts of clients involved with terrorism. But this gives rise to another question: Can banks always be expected to identify terrorists or terrorist activities? A further, more unsettling, question was raised in the closing speech of Shand Stephens, the lawyer for the Arab Bank in *Linde*: Are banks in a position to determine *who is a terrorist?*

WHAT CONSTITUTES MATERIAL SUPPORT TO TERRORISM?

What kind of knowledge is required to establish liability? Must the bank know that the material support given to the terrorist organisation has been directed towards terrorist activities, or will it be sufficient to know that *any* support has been provided, regardless of the activities supported? The second of these options imposes a much lower bar for liability, and a much higher burden of responsibility (and therefore cost).

In *Holder v Humanitarian Law Project* 561 US 1 (2010), the Supreme Court held that:

> "Congress plainly spoke to the necessary mental state for a violation of § 2339B, and it chose knowledge about the organization's connection to terrorism, not specific intent to further the organization's terrorist activities" (pp 16-17).

> "In *Weiss*, the court confirmed that the standard for liability was 'material support to a terrorist organisation'…"

This was based on an assumption that "foreign terrorist organizations do not maintain legitimate financial firewalls between those funds raised for civil, nonviolent activities, and those ultimately used to support violent, terrorist operations" (p 31). The debate over whether knowledge or specific intent should be required for offences of aiding and abetting echoes the recent debate at the international criminal tribunals in relation to "specific direction" as an element in aiding and abetting under international criminal law.

In *Linde*, Arab Bank argued that there must be a direct causal ("but-for") relationship between the bank's service and a terrorist act for liability to follow. The court rejected this analysis, directing the jury that what was required was substantial assistance with foreseeable consequences.

In *Weiss*, the court confirmed that the standard for liability was "material support to a terrorist organisation", not the aiding of specific terrorist activities. One of the reasons that the UK Charity Commission and Special Branch investigations did not affect liability in the eyes of the US court was that they were directed to answering the latter and not the former question.

RISK MANAGEMENT

What risks arise from the expansion of liability? How might banks be expected to manage those risks while upholding the aims of counter-terrorism financing regimes?

Risks arising from the current case law include:

- litigation risk, as cases are being brought in relation to events that happened some time in the past;
- the potential for unlimited claimants, given the international reach of terrorist activity, for example victims of 9/11 and their families;
- quantum risk, based on number of claimants or level of compensation or both;
- insurance risk, in respect of availability, coverage and cost of insurance;
- lack of certainty based on jury decisions with no appellate authority or regulatory oversight at present;
- "chilling effect" on high-risk business;
- shareholder anxiety and risk to share price and market value;
- retrenchment risk;
- wider ramifications including political instability and reduction in investment in the Middle East and other affected regions.

Some of these risks may of course have benefits in particular quarters, but limitations on liability remain hazy. There is presently a lack of clarity as to what banks can do, or could have done, in order to guard against civil claims. In particular, the verdict and numerous decisions on the evidence in *Linde* and in *Weiss* appear to have regarded

Biog box

John RWD Jones QC is a barrister at Doughty Street Chambers specialising in extradition, war crimes, removing Interpol red notices and sanctions. He is head of Doughty Street International in The Hague, and head of Doughty Street's international criminal law team. Email: j.jones@doughtystreet.co.uk. Katie O'Byrne is a barrister at Doughty Street Chambers and former commercial solicitor, specialising in extradition, international law, public law and human rights. Email: k.obyrne@doughtystreet.co.uk

as inadequate a number of common-sense defences to terrorist financing, including:

- compliance with domestic law;
- compliance with domestic government investigations;
- compliance with banking rules;
- compliance with company policy;
- screening names against UN and OFAC blacklists of named terrorists and terrorist organisations;
- mistake (the name of Ahmad Yassin, the leader of Hamas, was spelt differently on Arab Bank's records and on the blacklists).

The upshot for international banks domiciled in jurisdictions other than the US is that in addition to protecting against liability under domestic law, they must update their internal regulatory procedures to ensure that they comply with the provisions of US counter-terrorism legislation.

At present, it is unclear what standard of enquiry and due diligence is required by banks in relation to the use of their funds. Without additional guidance from the courts or legislature, it is possible that varying standards of investigation and compliance will be adopted within the banking industry. Given the potentially significant legal ramifications of any breach of the laws, prudent banks are likely to dedicate considerable resources to improve the likelihood of compliance, as in the case of obligations imposed by US sanctions on foreign entities.

In practical terms, internal changes across banks may include the development of additional controls and reporting mechanisms, new policies and procedures and staff training – all of which will increase transaction costs, either directly or indirectly. As a consequence, banks will be forced to consider how to absorb the additional costs of compliance and who will bear the ultimate financial burden – customers or shareholders?

CONCLUSION

The current state of flux arising from extraterritorial litigation is unhelpful to corporate entities and potential claimants alike. The cases of *Linde* and *Weiss*, among others, have had the effect of extending and complicating liability for terror financing to international banks domiciled in other jurisdictions, including the UK. This will influence the internal regulation frameworks of international banks. Given the growing volume of litigation, it is hoped that the development of further appellate jurisprudence in this area will create further legal clarity and certainty, allowing risk mitigation while furthering the important aims of the counter-terrorist cause. ■

1 The authors are indebted to Professor Kevin Jon Heller (Academic Expert, Doughty Street Chambers) and Stuart Bruce (Associate, King & Wood Mallesons) for their comments on a draft of this article.

Further reading

- Cross-compliance for financial institutions: The anti-corruption-AML nexus [2014] 8 JIBFL 522
- Traffickers, terrorists and tax criminals [2013] 10 JIBFL 654
- Lexis PSL: Corporate: Money Laundering and terrorist financing

Lexis®PSL Banking & Finance

Written by experts with insight that comes from first-hand experience, LexisPSL Banking & Finance gives step-by-step guidance on how finance transactions work in practice – ensuring that concepts are easily understood, risk is reduced and negotiations are completed quickly and confidently.

LexisPSL Banking & Finance gives you:

- Concise practice notes covering a wide range of specialisms
- Precedent documents with comprehensive drafting notes
- Checklists and flowcharts for quick reference
- Key forms in a format which is easy to fill in, save and edit
- Legal market news with 'so what' analysis
- Direct links to legislation, cases as well as authoritative commentary from the likes of the Journal of International Banking and Financial Law

To find out more about LexisPSL Banking & Finance, visit www.lexislegalintelligence.co.uk/banking-finance and take a free 24-hour trial.

KEY POINTS

- The CJEU prohibits anti-suit injunctions in respect of proceedings within the scope of the Regulation before another member state, even if those proceedings are brought in breach of an exclusive jurisdiction clause.
- English courts have considered alternative remedies for breach of such clauses, including claims for declarations that there has been a breach and/or damages.
- Although such claims have succeeded before the English courts, there may be questions as to whether such claims are compatible with the Regulation.
- Any claims for declarations and/or damages should be brought at an early stage and before the other member state court can be moved to rule on jurisdiction.

Feature

Author Ishfaq Ahmed

Jurisdiction agreements, declarations, damages and compatibility with Regulation 44/2001

The Court of Justice of the European Union (CJEU, formerly the European Court of Justice) has ruled that a member state must not grant an anti-suit injunction restraining the bringing or continuing of proceedings within the scope of Regulation 44/2001 of the Council of the European Union ("the Regulation") in another member state. However, in *Starlight Shipping Co v Allianz Marine & Aviation Versicherungs AG (The Alexandros T)* it was accepted by the English courts that declarations and damages could be granted for the breach of an exclusive English jurisdiction clause in bringing such proceedings. The question arises whether such claims are compatible with the Regulation.

ANTI-SUIT INJUNCTIONS AND THE REGULATION

Anti-suit injunctions were once routinely granted in respect of proceedings commenced in another member state to the Regulation in breach of an exclusive English jurisdiction clause. However, the Regulation sets out a formalised jurisdictional system where proceedings are pending before different member states. The Regulation does not allocate jurisdiction based on which is the most natural or appropriate forum. Instead:

- Under Art 27, where proceedings involving the same cause of action and between the same parties are brought in the courts of different member states, any court other than the court first seised shall of its own motion stay its proceedings until such time as the jurisdiction of the court first seised is established. Where the jurisdiction of the court first seised is established, any court other than the court first seised shall decline jurisdiction in favour of that court.
- Under Art 28, where related actions are pending in the courts of different member states, any court other than the court first seised may stay its proceedings. Actions are deemed to be related where they are so closely connected that it is expedient to hear and determine them together to avoid the risk of irreconcilable judgments resulting from separate proceedings.

English courts at their highest level rejected the argument that anti-suit injunctions were an unwarranted interference with the authority of another court, the rationale being that they operated *in personam* over the defendant. However, the CJEU in *Erich Gasser GmbH v MISAT* Srl (Case C-116/02, [2003] ECR I-14693), *Turner v Grovit* (Case C-159/02, [2004] ECR I-3565) and *West Tankers Inc v Allianz SpA (formerly RAS Riunione Adriatica di Sicurta)* (Case C-185/07, [2009] 1 AC 1138) effectively ruled that anti-suit injunctions cannot be granted within the Regulation context concerning cases before another member state whether for breach of an arbitration or jurisdiction clause or whether in respect of vexatious conduct. These decisions reduced the protection under English law in respect of arbitration clauses and, considered here, exclusive jurisdiction clauses. The CJEU jurisprudence appeared to legitimise the "Italian Torpedo", which despite its title, could be used in any court, by bringing proceedings before another member state court in order to delay or frustrate proceedings in the chosen forum. As a result, parties have considered alternative ways in which to give effect to jurisdiction clauses.

DAMAGES AND DECLARATORY RELIEF

Although the point was considered in *Ellerman Lines Ltd v Read* [1928] 2 KB 144, claims for damages for breach of jurisdiction clauses were not common because of the availability of the more effective anti-suit injunctions. More recently, in *Union Discount Co Ltd v Zoller* [2002] 1 WLR 1517 the Court of Appeal ("CA") allowed recovery of reasonable costs incurred in foreign proceedings where the foreign courts did not generally award costs and these were not requested when the foreign claim was struck out. In A/*S D/S Svendborg v Akar* [2003] EWHC 797 (Comm) it was stated that recovery was not dependent upon the relevant expenses being irrecoverable in the foreign proceedings and an indemnity was given for future costs and expenses of the foreign proceedings. In addition, parties may seek to recover in respect of enforced liability found in the foreign proceedings. In *Donohue v Armco* [2002] 1 All ER 749 (HL) the defendant's counsel accepted that breach of contract in suing elsewhere than in the contractual forum could found a claim

in damages, including any greater liability or being put to a greater expense such as unrecovered costs in the foreign proceedings. Of course, such actions would raise complex questions such as whether, if the action had proceeded in England the English claimant would have been held liable and if so, for what. However, in principle, recovery is allowed. English law also allows a party to make a claim for declarations, including negative declarations, so long as the relief serves a useful purpose (see eg *Howden North v ACE European* [2012] 2 CLC 969). In *The Alexandros T* damages and declarations were sought in the Regulation context.

THE ALEXANDROS T

The Alexandros T sank in 2006, becoming a total loss. Owners (Starlight) claimed against insurers for the insured value. The insurers denied liability arguing unseaworthiness with privity and that Starlight failed to properly report and repair damage. Starlight issued English proceedings against the insurers pursuant to exclusive English jurisdiction clauses in the policies, subject to English law. Starlight also alleged misconduct by the insurers involving witness tampering and bribery, spreading false and malicious rumours and deliberate failure to pay under the policy. Starlight alleged that this had led to consequential financial loss and damage and subsequently wanted to amend to recover losses beyond the measure of the indemnity. The court refused this amendment as English law did not allow such recovery. Proceedings were eventually settled for the insured value excluding interest and costs, the parties entering into a Tomlin order. This included full and final settlement of claims, an indemnity on Starlight's part for the insurers against claims brought against the insurers by any of Starlight's associates and also exclusive English jurisdiction and law clauses.

Despite this over three years later Starlight and associates began nine Greek proceedings in materially identical terms claiming damages of US$150m for loss of hire and loss of opportunity from the insurers and others, such as the insurers' lawyers ("the Greek claims"). The Greek claims referred to breaches of the Greek Civil and Criminal code and the acts complained of were said to constitute delicts under Greek law akin to the torts of defamation and malicious falsehood under English law. However, notably the factual allegations were entirely similar to those that had been raised in the English proceedings. The insurers therefore sought summary relief by way of declarations and damages against Starlight in England pursuant to the Tomlin orders. In addition, further proceedings were commenced before the English courts by one of the insurers. Starlight and its associates sought to argue that the English proceedings ought to be stayed under Arts 27 or 28.

The English proceedings reached the Supreme Court ("SC"), which dealt with a number of issues ([2014] 1 All ER 590). The focus here is the jurisdictional aspects. Although the insurers did not seek an anti-suit injunction they sought a declaration that the Greek claims fell within the settlement agreement and within the exclusive jurisdiction clauses. The SC unanimously held that the insurers' claims that Starlight had brought the Greek claims in breach of the jurisdiction clauses and their claim for declarations to this effect and damages were not the "mirror image" of the foreign proceedings and therefore Art 27 did not apply. They did not have the same cause of action or object. Regarding Art 28, the SC refused to exercise discretion to stay on the basis that the English jurisdiction clause was a strong factor against a stay. The case was remitted back to the CA.

The CA ([2014] EWCA 1010) held that the Greek claims fell within the settlement and indemnity provisions and within the exclusive jurisdiction clauses in both the settlement agreement and the policies. Before the CA Starlight argued that the claims for damages and declarations interfered with the Greek court's jurisdiction to determine its own jurisdiction and, if appropriate, the merits of Starlight's claims, relying on *Turner v Grovit*. The CA held the reliance on *Turner* to be misplaced since *Turner* related to anti-suit injunctions and no such injunction was claimed in *The Alexandros T*. The CA identified the vice of anti-suit injunctions being that they render ineffective the Art 27 and 28 mechanisms for dealing with *lis alibi pendens* and related actions. However, since the SC had held that these were inapplicable, the CA held that there was therefore no question of any interference with the Greek court's jurisdiction. The Greek court was free to consider the Greek claims and would have to decide whether to recognise any judgment of the English court. This was rather an acknowledgment of the Greek court's jurisdiction. In these circumstances there was no infringement of EU law and nor was there any need for a reference to the CJEU despite Starlight's request. The CA therefore gave summary judgment for damages to be assessed for breach of the jurisdiction provisions.

In the most recent episode of the case ([2014] EWHC 3068 (Comm), 26/09/2014) the Commercial Court has made orders for specific performance of Starlight's continuing promises to accept a sum in full and final settlement of claims against the insurers and not to sue the insurers, or their servants and agents. The specific performance ordered was that Starlight sign a Receipt and Recognition of the Release Agreement or that it be signed on their behalf and which provided that the settlement monies had been received by Starlight as continuing full and final settlement of all claims including the Greek claims. The court held that such specific performance would not interfere with the Greek court's jurisdiction and was a determination of rights and obligations under English law settlement agreements, and of the appropriate remedy in respect of Starlight's breach of its obligations under English law contracts. Rather than usurping the Greek court's jurisdiction this would assist the Greek court in recognising and enforcing the English courts' judgments and understanding precisely what the English courts had decided.

ANALYSIS

The Alexandros T represents a strong victory for upholding party autonomy and protecting exclusive English jurisdiction clauses. If proceedings had been stayed the insurers would have had to rely on the Greek court to uphold the jurisdiction clauses and if that failed, they faced Greek proceedings and a potential Greek judgment which may have been enforced in England or elsewhere.

Challenges to the recognition and enforcement of other member state judgements are limited. In particular, Art 34 does not admit as grounds not to recognise a judgment, the fact that the judgment has been obtained in breach of an exclusive jurisdiction clause. An argument that recognition of such a judgment is "*manifestly contrary to public policy*" (Art 34(1)) is problematic (for arguments rejected in the arbitration context see *The Wadi Sudr* [2010] 2 All ER (Comm) 1243). In *Gothaer v Samskip* (Case C-456/11, [2013] QB 548) the CJEU held that a Belgian "procedural" judgment on jurisdiction (the validity of an agreement in favour of the Icelandic courts) must be recognised and findings as to a jurisdiction agreement's validity and scope were binding regardless of its status as *res judicata* in the originating court or in the court where recognition is sought. The CJEU held that mutual trust required that not only must the decision or result but also the originating court's reasoning underpinning it that the clause was valid, be recognised and given effect. As a result, any prior Greek judgment in *The Alexandros T* would probably have been recognised in England and if it had ruled that the exclusive jurisdiction clause was inapplicable, would probably have barred a claim for breach of that clause. The present outcome, however, means that parties wishing to enforce an English jurisdiction clause need not be placed in this position and can argue that the foreign EU proceedings are a breach of the jurisdiction clause and can claim for related declarations and damages on the basis that this is a separate cause of action from the substantive claims being made abroad and therefore the foreign member state court is not seised of these claims.

Despite its merits, it is worth questioning whether the CJEU would agree with the English court analysis. Some arguments are briefly considered.

Article 27

The SC decision on Art 27 accords with the CJEU jurisprudence requiring the same object, cause and party. The English court held that Art 27 did not apply on the basis that defences were not to be considered when looking at causes of action (see eg *Gantner Electronic GmbH v Basch Exploitatie Maatschappij BV* Case C111/01, [2003] ECR I-4207). Whether ignoring defences is too narrow an approach may be questioned although the rule has the merit of certainty. The CJEU has stated that the *lis pendens* rules should be interpreted as broadly as possible (eg *Overseas Union Insurance Ltd v New Hampshire Insurance Co* Case C-351/89, [1993] ECR I-3317). Interestingly, in *The Tatry* (Case C-406/92, [1994] ECR I-5439) the CJEU, in deciding that two actions, one asserting liability for damages and the other denying it, had the same object, held in relation to the fact that damages were not sought in the latter action, that "*the fact that a party seeks a declaration that he is not liable for loss implies that he disputes any obligation to pay damages*". Similarly, in bringing an action before the foreign member state court it could be argued that impliedly the party there is asserting that that court has jurisdiction, whether the grounds for such an assertion are justified or not. This would of course be met with the argument that no cause of action is asserted in the foreign proceedings and would probably be decisive, if correct.

Article 28

There may be good grounds for saying that the proceedings are related and therefore the second proceedings should be stayed under Art 28 to await the outcome of the first proceedings which would then be given such recognition as appropriate. However, in the SC in *The Alexandros T* the decisive factor was the English jurisdiction and law clause and that the natural court to consider the issues was therefore the English court. It is conceivable the CJEU may not see things in the same way and may prioritise the avoidance of the risk of irreconcilable judgments over the protection of jurisdiction clauses. It is possible for example that an English court may give judgment but the other member state court finds that there has been submission. It is sometimes said that there is a strong presumption in favour of a stay and the CJEU may be persuaded to review the proper exercise of discretion. However, the difficulty for the CJEU would be doing this effectively without somehow setting out mandatory requirements on how the discretion should be exercised.

Incompatibility

The question is whether the reasoning in *Turner* and *West Tankers* may extend beyond anti-suit injunctions. The impact on the specific mechanisms of *lis alibi pendens* and related actions was only an aspect of the CJEU's reasoning in *Turner*. In fact, in *Turner* the CJEU reasoned that the injunction backed by penalty was an interference with the jurisdiction of the foreign court. It did not matter that the interference was indirect and intended to prevent an abuse of process. The judgment made as to the abusive conduct implied an assessment of the appropriateness of bringing proceedings before a court of another member state, which was counter to the mutual trust principle prohibiting a court from reviewing the jurisdiction of another member state court (see *Overseas Union*). The grant of an injunction, even if procedural, impaired the Regulation's effectiveness. In *West Tankers* the ECJ accepted that the English proceedings leading to the making of the anti-suit injunction were not within the scope of the Regulation as they related to arbitration. However, the anti-suit injunction was nevertheless held incompatible with the Regulation on the basis that the proceedings in the other member state were within the Regulation's scope as a civil and commercial matter. Thus, even though the English proceedings there were outside the Regulation scope they could still undermine its effectiveness. The use of an anti-suit injunction preventing a member state court "*... from ruling, in accordance with Art 1(2) (d) of that regulation, on the very applicability of the regulation to the dispute brought before it necessarily amounts to stripping that court of the power to rule on its own jurisdiction under* [the] *Regulation...*" . The CJEU made reference to *Gasser* in holding that the anti-suit injunction was "*contrary to the general principle which emerges from the case-law of the court .... that every court seised itself determines, under the rules applicable to it, whether it has jurisdiction to resolve the dispute before it*". *Gasser* decided that it is for the court first seised to pronounce as to its jurisdiction in the light of a jurisdiction clause. In *West Tankers*, the CJEU did not refer to the *Gasser* principle as limited to cases concerning matters falling

Biog box
Ishfaq Ahmed is a barrister practising from Stone Chambers, Gray's Inn, London.
Email: ishfaq.ahmed@stonechambers.com

within Art 27 and which were a mirror image, looking instead at the effect of an anti-suit injunction.

The effect of the declarations and damages in *The Alexandros T* is that the English court decides jurisdictional matters before the other court. It has scope to pre-empt not only jurisdictional issues but also the merits, since if damages can be claimed as discussed above, then it strongly dissuades the party proceeding before the other court. Although the SC referred to the advantage that the court with exclusive jurisdiction decides what is the true meaning of the agreements, the CJEU was clear in *Overseas Union* that the second seised court was not in a better position than the first seised court to decide this. The jurisdiction clause is an independent concept to be judged solely in the light of Art 23 of the Regulation. In addition, where no doubt jurisdiction has been raised in the non-contractual forum, it is difficult to argue that there isn't some effect on that court's consideration of its jurisdiction. In fact, following *Gothaer* not only must the English decision on the jurisdiction clause be recognised but also the underlying reasoning. In *Gothaer* the CJEU emphasised the limited grounds for challenging recognition available under the Regulation, stating that "*the exclusion of review of the jurisdiction of the court of the member state of origin implies, as a correlation, a restriction of the power of the court of the member state in which recognition is sought to ascertain its own jurisdiction because the latter is bound by what was decided by the court of the member state of origin*". It may be argued that the merit of *The Alexandros T* is that it appears to work within the Regulation system of recognition and enforcement. However, together with the latest orders for specific performance the CJEU may have questioned what exactly has been left for the Greek court to decide on jurisdiction in *The Alexandros T.*

Thus, applying these authorities by analogy could lead to the CJEU holding that *The Alexandros T* obstructs or pre-empts another member state court in the exercise of its powers and is therefore incompatible with the Regulation regardless of whether the claims for declarations and damages are categorised as a separate cause of action from the underlying proceedings.

THE EFFECTS OF INCOMPATIBILITY

The effect is likely to depend on what subsequently happens in the foreign proceedings. Any ruling of the CJEU would not rule out an action for declaration and/or damages altogether but rather any action that pre-empts the decision of the member state court first seised. If that member state court upholds the jurisdiction clause then this should not prevent a claim for declaration and/or damages from proceeding, subject to credit for any recovery of costs before that court. However, if the foreign court holds the clause inapplicable for whatever reason there must be doubts about how a claim for declaration and/or damages could succeed in England, bearing in mind the provisions as to recognition (including issue estoppel).

PRACTICAL POINTS

Parties involved in similar litigation should make early claims in England or alternatively, if the foreign proceedings have commenced, early applications for summary judgment, before the other member state court can be moved to consider jurisdiction and give judgment. A claimant before another member state court may refer to jurisdictional issues in its claim documents to pre-empt any subsequent application that may be made in the English courts and to bring Arts 27 and/or 28 into play. The CJEU has accepted the position of negative declarations within the scheme of the Regulation (see eg *The Tatry*) and if a foreign court is willing to entertain a "claim" for a declaration that the English jurisdiction clause is invalid or that the matters are outside its scope or that the foreign court has jurisdiction then this could be used to avoid the effect of *Alexandros T.* Whether the Greek court refers the question whether it is required to recognise the English court judgment in *The Alexandros T* to the CJEU remains to be seen. A future reference from the English courts on whether *The Alexandros T* is compatible with the Regulation is very unlikely.

RECAST REGULATION

On 10 January 2015 the Recast Regulation (Regulation (EU) No 1215/2012) comes into effect, changing the priority rules under the equivalent of Art 27 so that where a member state court on which an agreement confers exclusive jurisdiction is seised, any other member state court shall stay the proceedings until such time as the court seised on the basis of the agreement declares that it has no jurisdiction under the agreement. Where the court designated has established jurisdiction any other member state court shall decline jurisdiction in favour of that court. Although not without its own difficulties, such as where a non-existent agreement is relied upon, it is hoped that where a party can point to a written exclusive jurisdiction agreement, questions as to the appropriateness and extent of declarations and damages for breach of an exclusive jurisdiction clause should not be as relevant.

CONCLUSIONS

The CA refused a reference to the CJEU as there was "*no doubt about the answer to the proposed question*". This was not *The Alexandros T* but the earlier case of *Continental Bank NA v Aeakos Compania Naviera SA* [1994] 1 WLR 588 where the issue of compatibility of anti-suit injunctions with the EU system was not referred. *Continental Bank* also involved Greek proceedings and an English jurisdiction clause. However, the CJEU subsequently and emphatically found that the CA then was wrong. It may be debated whether the same would have followed in *The Alexandros T.* ■

Further reading

- The practical implications of the *West Tankers* decision [2009] 4 JIBFL 182
- The recast Judgments Regulation: imminent reform of the rules of jurisdiction and enforcement of foreign judgments in the European Union [2014] 11 JIBFL 709
- LexisNexis Dispute Resolution blog: Court jurisdiction and the application of Arts 27 and 28 ("The Alexandros T")

KEY POINTS

- The recast Judgments Regulation provides enhanced protection for exclusive jurisdiction clauses for the courts of EU member states.
- A jurisdiction clause will not be binding if it is held to be "null and void" by the law of the designated state.
- A limited power to stay proceedings in favour of the courts of non-member states is introduced, although it might have gone further.
- The recast Regulation represents something of a lost opportunity to clarify the ambit of the arbitration exception.
- Protection for consumers and employees is extended to claims against defendants domiciled in non-member states.
- The abolition of "*exequatur*" allows judgments to be enforced without a declaration of enforceability being required.

Author Professor Jonathan Harris

The recast Judgments Regulation: imminent reform of the rules of jurisdiction and enforcement of foreign judgments in the EU

A revised regime of jurisdiction and enforcement of foreign judgments will apply in the EU to proceedings commenced on or after 15 January 2015. This article considers key changes introduced by the recast Judgments Regulation and comments on their efficacy.

INTRODUCTION

The recast Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("the recast Judgment Regulation") EU 1215/2012 will apply to proceedings commenced on or after 10 January 2015 and will replace the existing Judgment Regulation ((EC) No 44/2001)). The UK opted into the Regulation after the European Commission published its Proposal (COM (2010) 748 final). The recast Judgments Regulation makes very important changes, including in respect of jurisdiction clauses and *lis pendens* in non-member states; although it is a less radical instrument than the Commission Proposal.

EXCLUSIVE JURISDICTION CLAUSES FOR THE COURTS OF MEMBER STATES

The recast Judgments Regulation significantly improves the protection for exclusive jurisdiction clauses in favour of the courts of member states. Hitherto, the inflexible application of the "court first seised" rule meant that once the courts of a member state were seised of proceedings, no other member state's courts could assert jurisdiction, unless and until the court first seised decided that it lacked jurisdiction. This was the effect of the CJEU's decision in *Erich Gasser GmbH v MISAT srl* [2003] ECR I-14693 that "a court second seised whose jurisdiction has been claimed under an agreement conferring jurisdiction must nevertheless stay proceedings until the court first seised has declared that it has no jurisdiction". Although this was designed to prevent parallel proceedings and irreconcilable judgments, it could lead to a race to issue proceedings in a litigant's preferred forum, sometimes for negative declaratory relief. It also led to ineffective protection of the sanctity of jurisdiction agreements.

The recast Judgments Regulation ameliorates matters by creating an exception to the court first seised rule, meaning that the parties must first appear before the courts putatively chosen, which will determine if the clause is valid and effective. Article 31(2) states that: "…where a court of a member state on which an agreement… confers exclusive jurisdiction is seised, any court of another member state shall stay the proceedings until such time as the court seised on the basis of the agreement declares that it has no jurisdiction under the agreement." If that court determines that it has jurisdiction, the courts of other member states must decline it (Art 31(2); see also Recital 22). This provision does not, however, apply where a "weaker" party falling within the ambit of the special protective provisions in the Regulation is the claimant – namely consumers, insurance policy holders and employees – unless the additional criteria for jurisdiction clauses – which are essentially unchanged in the recast Judgments Regulation – are satisfied.

The reform significantly strengthens the protection of jurisdiction clauses. Even so, a party that alleges that it did not agree to a jurisdiction clause will henceforth be forced to make that allegation before the very court that it asserts lacks jurisdiction. If it does not do so, it will not be able to object to recognition of the foreign judgment, since, somewhat disappointingly, no defence has been introduced into the recast Judgments Regulation that the foreign judgment was obtained in breach of a jurisdiction clause. This problem is, however, partially offset by a new provision stating that a jurisdiction clause will not be binding if it is held to be "null and void" by the law of the state whose courts are putatively chosen (Art 25(1)). This means

that the choice of law rules of the designated court should determine the law applicable to the jurisdiction clause and whether it is null and void (Recital 20). This provision, which mirrors Art 6a of the Hague Choice of Court Convention 2005, plugs a welcome lacuna in the existing Regulation, which effectively treated the formality requirements for establishing the validity of a jurisdiction clause as exhaustive, even if it was alleged, for example, that the clause was the product of mistake or duress (see *Benincasa v Dentalkit Srl* [1997] ECR I-3767; *Trasporti Castelletti Spedizioni Internazionali SpA v Hugo Trumpy SpA* [1999] ECR I-1597). However, it gives rise to potential uncertainty, not least since: (a) the law applicable to a jurisdiction clause falls outside the ambit of the Rome I Regulation on Choice of Law in Contract ((EC) No 593/2008, Art 1(2)(e)) and so is a matter for national choice of law rules, which may make the outcome difficult to predict, (b) it is doubtful that the phrase "null and void" will have a clear or consistent meaning or ambit in every legal system, or, indeed, that it is self-evident why a clause that is voidable should be excluded. The Regulation does, however, now explicitly confirm that the jurisdiction clause is separable from the contract to which it relates – so that the invalidity of the latter does not affect the former. Hence, if it were alleged eg that a contract was the product of duress, it would be necessary to show, separately, that the jurisdiction clause was also the result thereof.

A further change is that the Judgments Regulation states that where neither party is domiciled in a member state, the courts of a member state designated by a jurisdiction clause have first refusal but are not bound to accept jurisdiction and can apply national grounds to determine whether to do so. This latitude is removed under the recast Judgments Regulation, with the effect that if the agreement is valid, it must be given effect, regardless of the domicile of the parties.

Elsewhere, the court first seised rule still prevails. The Commission proposed tackling the problem of delay in some legal systems by proposing that the court first seised should normally establish its jurisdiction within six months but this did not find its way into the recast Judgments Regulation.

STAYING PROCEEDINGS IN FAVOUR OF COURTS OF NON-MEMBER STATES

The CJEU held in *Owusu v Jackson* [2005] ECR I-1383 that there is no general power to stay proceedings brought against an EU domiciliary in favour of the courts of a non-member state. The CJEU declined to say whether there are any circumstances in which a stay is possible: and, in particular, whether a stay could be granted in order to give "reflexive" effect to the grounds of exclusive jurisdiction, jurisdiction clauses for the courts of non-member states or where there is *lis pendens* in a non-member state.

The recast Judgment Regulation ameliorates matters by providing a power to stay where the courts of a member state have jurisdiction on the basis of the defendant domicile rule or an alternative ground of "special" jurisdiction and the courts of a non-member state were first seised of identical or related proceedings (Arts 33 and 34, respectively). The power is discretionary and does not operate by strict analogy to the *lis pendens* rules between member states. Where the proceedings in the non-member state involve the same cause of action and the same parties, the court of the member state should still consider whether it may be expected that the court in the third state will, within a reasonable time, render a judgment that will be capable of recognition in that member state; and the court of the member state must be satisfied that it is necessary for the proper administration of justice to stay its proceedings. Necessarily, the former requirement means that the availability of a stay depends on national grounds of recognition of non-member state judgments and so cannot be applied uniformly in all member states. The court shall then dismiss proceedings if the foreign proceedings result in a judgment entitled to recognition. The enhanced flexibility is to be welcomed; although phrases such as "reasonable time" and "proper administration of justice" are unlikely to be easy to apply. As to the latter, a court is directed to consider, *inter alia*, the connections between the facts of the case and the parties and the third state concerned, and the stage to which the proceedings in the third state have progressed. It may also consider "whether the court of the third state has exclusive jurisdiction in the particular case in circumstances where a court of a member state would have exclusive jurisdiction" (Recital 24). Inevitably, in exercising this discretion, the temptation in England to reimport aspects of the *forum non conveniens doctrine*, within the confines permitted by the recast Judgments Regulation, will exist.

The extension of the power to stay to related actions (which the Commission had not proposed) is also to be welcomed. It operates in a similar fashion, although, the court should also consider whether "it is expedient to hear and determine the related actions together to avoid the risk of irreconcilable judgments resulting from separate proceedings". This is rather curious, since there is no power to decline jurisdiction in order to permit consolidation of the proceedings abroad. Where the foreign proceedings are concluded, the court may dismiss its proceedings but is not obliged to do so.

Whilst some flexibility to coordinate proceedings between member and non-member states is better than none, these provisions arguably do not go far enough. The third state must be first seised and there is no power to stay proceedings merely because the courts of a non-member state are clearly the more appropriate forum. Hence, the risk of parallel proceedings in a non-member state remains. Indeed, one might expect instances where there is a rush to commence proceedings, perhaps for negative declaratory relief, in the courts of a non-member state to trigger the applicability of these provisions; or, conversely, a rush to start proceedings in the courts of a member state to preclude the possibility of a stay in favour of the courts of a non-member state. Nor is there any express power to stay proceedings to give reflexive effect to the grounds of exclusive jurisdiction. So, for instance, the courts of the member state where a company has its seat have exclusive jurisdiction in proceedings which have as their object the validity of the constitution, the nullity or the dissolution of companies. It is somewhat surprising that the English courts would have no power to stay proceedings if the company instead had its seat in a non-member state. It may be difficult to enforce the resulting

English judgment in the relevant non-member state. English courts have suggested that a power to stay exists in such circumstances (eg in *Ferrexpo AG v Gilson Investments Ltd* [2012] EWHC 721 (Comm); [2012] 1 Lloyd's Rep. 588) but the matter is far from certain.

Furthermore, the treatment of jurisdiction clauses for non-member states is problematic. There remains no express power to stay proceedings in favour of the chosen court. The authorities are unclear on whether a stay can be granted. On one construction of the CJEU's decision in *Coreck Maritime GmbH v Handelsveem BV* [2000] ECR I-9337, it is for national law to determine what to do in this situation. The view that a stay is permissible has been endorsed, *obiter*, in *Konkola Copper Mines plc v Coromin* [2005] 2 Lloyd's Rep 555; but rejected in *Catalyst Investment Group Ltd v Lewinsohn* [2010] Ch. 218, which considered it to be incompatible with the *Owusu* judgment. At the heart of the issue is the Hague Convention on Choice of Court Agreements 2005, which applies only to exclusive jurisdiction clauses in favour of the courts of contracting states and requires courts of other contracting states to decline or stay proceedings. On 30 January 2014, the European Commission published a proposal for a Council Decision on the approval, on behalf of the European Union, of the Hague Convention (COM/2014/46 final), with a proposed exception in respect of insurance matters. Should the Convention enter into force and be ratified by other non-member states, they would benefit from these provisions and so jurisdiction clauses in favour of their courts would be given effect. Even so, it is likely to be a long time before the Hague Convention will provide a widespread mechanism for giving effect, on a reciprocal basis, to jurisdiction clauses for the courts of non-member states, as and when they ratify the Convention; and it may be regretted that the recast Judgments Regulation did not directly address jurisdiction clauses in favour of the courts of non-member states.

Until the CJEU says otherwise, English courts are likely to continue to consider that a power to apply the recast Judgments Regulation reflexively exists. It must, however, be recognised that the silence of the recast Judgments Regulation on the permissibility of a stay where the courts of a non-member state have exclusive jurisdiction and in the case of jurisdiction clauses for the courts of non-member states, especially when seen in contrast to the express legislation providing a power to stay in the case of *lis pendens*, may lead to a stronger inference that the recast Judgments Regulation does not permit stays of proceedings in favour of the courts of non-member states in either scenario – and may ultimately lead to a retreat from the English case law permitting stays in such circumstances.

THE ARBITRATION EXCEPTION

The arbitration exclusion in the existing Regulation has proven problematic. The exclusion was interpreted by the CJEU in *Allianz SpA v West Tankers Inc* [2009] ECR I-663 extremely narrowly. It held that if the substantive proceedings before a foreign court were civil and commercial in nature, its jurisdiction derived from the Regulation, even if it had to decide a preliminary question as to the validity of an English arbitration agreement. This meant that "mutual trust" operated in respect of the foreign court's interpretation of the arbitration clause, so that English courts could not therefore restrain the apparent breach of the agreement by anti-suit injunction; and that, since nothing in the Regulation said otherwise, the resulting court judgment was enforceable in England (*The Wadi Sudr* [2010] 1 Lloyd's Rep 193). This was particularly problematic since the New York Convention 1958 requires contracting states to enforce arbitral awards and the Regulation is silent on problems of incompatibility between court judgments and arbitral awards.

The Commission proposed to coordinate court and arbitral proceedings by a provision stating that where the agreed seat of an arbitration was in a member state, the courts of another member state whose jurisdiction was contested on the basis of an arbitration clause must stay proceedings so that the courts of the seat of the arbitration or the arbitral tribunal could determine the existence and validity of the clause. The Ministry of Justice, however, lobbied for a blanket exclusion of arbitration. In the event, the Commission Proposal has not been adopted. The only amendment in the recast Judgments Regulation is a decidedly enigmatic new Recital (12), which states that "This Regulation should not apply to arbitration" and that "Nothing in this Regulation should prevent the courts of a member state, when seised of an action in a matter in respect of which the parties have entered into an arbitration agreement, from referring the parties to arbitration, from staying or dismissing the proceedings, or from examining whether the arbitration agreement is null and void, inoperative or incapable of being performed, in accordance with their national law." Furthermore, it provides that the New York Convention 1958 takes precedence over the recast Judgments Regulation (a statement reiterated in Art 73(2)). It also states that a ruling given by a court of a member state as to whether or not an arbitration agreement is invalid (whether determined as the main or an incidental issue) should not be subject to the rules of recognition and enforcement laid down in the Regulation. All this might be taken to suggest that there was now a total exclusion of arbitration, even where the validity of an arbitration clause arises in the context of civil and commercial proceedings.

By contrast, and arguably somewhat inconsistently, Recital (12) states that where a court does give judgment on the merits having determined that an arbitration agreement is invalid, this should not preclude that court's judgment on the substance of the matter from being recognised in accordance with the Regulation. The end result is less than clear or satisfactory. It is not apparent whether the scope of the arbitration exception is substantively changed and the extent to which mutual trust operates in relation to a determination by the courts of another member state as to the validity of an arbitration agreement.

It seems probable, however, that nothing has changed at all and that, in particular, *West Tankers* would be decided the same way under the recast Judgments Regulation. There is also no express provision addressing the relationship between inconsistent judgments and arbitral awards. This will be regretted by many and the recast Judgments Regulation represents something of a lost opportunity to clarify the ambit of the arbitration exception.

Biog box
Professor Jonathan Harris is a practising barrister at Serle Court Chambers, London.
Email: JHarris@serlecourt.co.uk

EXTENSION OF "WEAKER PARTY" PROTECTION

The recast Judgments Regulation extends the protection for employees and consumers acting as claimants to cases where the defendant employer or business is a non-EU domiciliary. These provisions allow "weaker parties" to sue in their home courts and restrict the effectiveness of jurisdiction clauses. Whilst this provision will enhance weaker party protection, it may be unattractive for business located outside the EU who might find themselves vulnerable to being sued across the EU and unable to conclude a binding jurisdiction agreement to negate that risk. In the case of consumers, considerable uncertainty still surrounds the question of when a business might be deemed to be directing its activities to consumers in the EU through its website, and so liable to be sued in the consumer's home state.

In the case of insurance, however, the recast Judgments Regulation does not include a similar provision – a position supported by the Ministry of Justice, who considered that this would unduly restrict the validity of choice of court clauses in insurance contracts, many of which are essentially commercial in character.

PROVISIONAL MEASURES

The recast Judgments Regulation continues to permit courts of a member state to grant provisional or protective relief in support of proceedings in another member state in accordance with its national law (Art 35). The effect of the CJEU jurisprudence, however, at least in respect of interim payment orders, has been to confine such relief to assets within the jurisdiction (see *Van Uden Maritime BV v Kommanditgesellschaft In Firma Deco-Line* [1998] ECR I-7091; *Mietz v Intership Yachting Sneek BV* [1999] ECR I-2277).

The recast Judgments Regulation makes it clear that *ex parte* interim orders are excluded from its ambit, whether granted by the court with jurisdiction on the substance or not (as the CJEU had held in *Denilauler v SNC Couchet Frères* [1980] ECR 1553), unless the measure is served on the defendant prior to enforcement (Art 2 and Recital 33). This is somewhat curious, since service on the defendant does not, of course, ensure that the defendant has the opportunity to challenge the order. The recast Judgments Regulation also states that interim measures granted by a court with jurisdiction on the substance shall circulate freely under the Regulation; but that where the court has no jurisdiction on the substance, its orders shall not be enforceable under the Regulation in other member states. This is arguably regrettable, especially since, for example, an English freezing order in support of foreign proceedings will be unenforceable overseas if, in defiance of the injunction, the defendant takes the assets out of the jurisdiction.

ABOLITION OF "EXEQUATUR"

The recast Judgments Regulation abolishes the "*exequatur*" procedure by which a declaration of enforceability is required to enforce a foreign judgment in another member state (Art 39). "As a result, a judgment given by the courts of a member state should be treated as if it had been given in the member state addressed" (Recital 26). Judgments will instead be enforceable without any special procedure being required. A party seeking enforcement must produce an authentic copy of the judgment and a certificate in a stipulated form certifying that the judgment is enforceable (Arts 37 and 53). These documents must be served on the judgment debtor before the first enforcement measure is taken (Art 43).

In all other respects, however, the recast Judgments Regulation is much less radical than the Commission Proposal, which effectively proposed the abolition in most cases (save in the cases of violations of privacy, defamation and collective redress for consumers) of the public policy defence; and proposed that the defence that the defendant had insufficient notice to arrange its defence where a default judgment had been issued should be raised in the state of origin and not in the state of enforcement. In the event, the existing defences have been retained and a party can apply to set aside registration in the state of enforcement (Art 45).

The Regulation previously provided a defence to recognition where the consumer or insurance provisions of the Regulation were infringed by a foreign court, leaving a lacuna in respect of the employment contract provisions. This has now been remedied, whilst at the same time, the defence now only applies in cases where a "weaker party" is the defendant to the foreign proceedings and is the party purporting to rely on the defence (Art 45(1)(e)).

DEFENDANTS DOMICILED IN NON-MEMBER STATES

The most radical aspect of the Commission's Proposal was the proposed extension of the harmonised rules of jurisdiction to non-EU domiciliaries, meaning that national grounds of jurisdiction would be removed for all matters within its ambit. This radical proposal was, in the event, not supported by the member states and has not been adopted in the recast Judgments Regulation, which continues to derogate to national rules of jurisdiction in such circumstances (save where an exception to the defendant domicile rule exists in the Regulation: Art 6(1)). In particular, there was not felt to be sufficient evidence of a need for complete harmonisation. It is reasonable to suppose that the issue is likely to resurface when the Regulation is revised again in future.

CONCLUSION

The introduction of enhanced protection for exclusive jurisdiction clauses for EU member states and the limited power to stay proceedings in favour of the courts of non-member states should be welcomed. Ultimately, however, the recast Judgments Regulation is a less radical instrument than the Commission's Proposal. The uncertainty about the ambit of the arbitration exception has, if anything, been fuelled. The absence of any provisions on jurisdiction clauses for the courts of non-member states is also regrettable. Overall, the recast Judgments Regulation materially improves upon its predecessor, whilst still leaving the feeling that more could and perhaps should have been done to enhance its effectiveness. ■

Further reading

- The Commission's proposal for reform of the Judgments Regulation [2011] 7 JIBFL 389;
- The demise of Forum Non Conveniens? [2014] 8 JIBFL [509]
- Lexis PSL: Dispute Resolution: Jurisdiction

KEY POINTS
- Turkish market developments illustrate how policy tools may be created to support *shari'a* compliant fixed income securities and attract foreign investors from the Gulf region.
- Legal techniques from securitisation and asset-backed finance may help to access *shari'a* compliant capital markets for funding infrastructure projects in developing countries.
- Recent trends may transform *shari'a* compliant fixed income securities into a significant source of funding for asset finance.

Feature

Authors Claudio Medeossi and Debashis Dey

Recent trends and new perspectives in global Islamic fixed income capital markets

This article tracks the evolution of the global *shari'a* compliant fixed income capital markets with a particular focus on Turkish market developments.

INTRODUCTION

As 2014 draws to a close we are now at the time of year when looking to the future for market trends is almost unavoidable. So, as part of our end of year forecast, we would like the reader to join us in considering the year's developments in global cross-border *shari'a* compliant capital markets, trying to draw some lessons from the recent past while casting our eyes to the future. Certainly, in particular for those more directly involved in this part of the global capital markets, 2014 has been a remarkable year, with the inaugural issuances of the first sovereign *sukuk* by the UK and Senegal in June, by the Republic of South Africa and the Hong Kong Special Administrative Region of the People's Republic of China in September, by the Duchy of Luxembourg in October and the return to the markets of the Republic of Turkey in late November. With these sovereign issuers entering into (or confirming their presence in) the market it is difficult to avoid the impression of having witnessed in the recent months a momentous transformation in the landscape of *shari'a* compliant global fixed income capital markets. Not only has the offering of *shari'a* compliant fixed income instruments available to investors in the markets been substantially diversified (both in terms of currency denominations, geographical exposure and credit standing), but the same dynamics that have so far shaped international *shari'a* compliant fixed income instruments in the global capital markets appear to have been transformed.

RECENT TRENDS

Shari'a compliant fixed income securities are part of the modern Islamic finance which has developed in South East Asia and the Middle East in the second half of the 20th century to reflect the local political demands to create financial systems more aligned with the ethical values of countries with a predominantly Muslim population. In the last decade, however, as a result of the globalisation of the financial markets, a global international market for this type of securities has gradually emerged, growing well beyond the domestic confines of those original markets. In the last few years, Islamic finance has spread well beyond South East Asia and the Middle East and the target of making the domestic financial systems more "inclusive" in order to improve the access to funding irrespective of religious or ethical beliefs and to create a level playing field between conventional and Islamic financial institutions has started being pursued also in countries with secular or non-Islamic legal systems such as Turkey and the UK. This has led not only to new opportunities for Islamic financial institutions emerging but also the creation of *shari'a* compliant fixed income instruments as an integral component of the domestic capital markets of an increasing number of countries. Several European countries including the UK, France and Turkey have explored this option and some have already enacted regulatory and tax legislation to equalise the treatment of *shari'a* compliant instruments with conventional fixed income. The presence of sizable Muslim minorities and the current demographic trends are likely to sustain the expansion of these financial products across Western Europe and farther.

"Inclusiveness", however, has not been the only driving factor and, with the increasing volume of international *shari'a* compliant fixed income instruments issued in the market, several financial centres have started jostling for position to claim the title of centre for global *shari'a* compliant fixed income capital markets. The interest in attracting the lucrative service industries supporting and operating around the main financial markets and retaining or increasing their share of these markets has led to active public and political support for promoting the development of the existing

"… several financial centres have started jostling for position to claim the title of centre for global *shari'a* compliant fixed income capital markets"

global or regional conventional financial centres as new Islamic financial centres. The recent sovereign issuances of the UK, Hong Kong and Luxembourg (and on a regional level also South Africa and Turkey) are clearly also aiming to promote the international standing of London, Hong Kong, Luxemburg, as well as Istanbul and Johannesburg in an increasingly competitive environment. However, while pursuing these objectives, the recent issuances are also raising new political aims and concerns. Attracting foreign capital and targeting in particular the liquidity existing in the Middle East is increasingly seen as a fundamental public policy aim by many governments across the globe and the availability of tools and strategies that are suitable to attract such foreign capital is at the forefront of such governments' consideration. The recent sovereign issuances of Senegal, South Africa and Turkey, for example, reflect these political ambitions in different ways.

The concurrence of all of these trends however is also having a broader and deeper impact on global *shari'a* compliant fixed income capital markets and seems to be refashioning this type of debt securities. To fully appreciate this evolution, it may be helpful to consider how the more recent issuances differ from the traditional *shari'a* compliant fixed income securities issued in the Gulf region and, in this respect, the Turkish market developments and the related legislative enactments in the last three years offer a useful insight. The recent Turkish market developments also help to illustrate how policy tools may be developed and what issues need to be addressed as a result.

DEVELOPING SUITABLE POLICY TOOLS: THE TURKISH EXAMPLE

With a long presence in international capital markets as an issuer of conventional debt instruments and a secular constitution, the Republic of Turkey, despite its predominantly Muslim population, did not appear to be the most obvious candidate for issuing *shari'a* compliant sovereign fixed income instruments in 2012; particularly considering that the yields on conventional Turkish bonds were then still pricing inside yields expected from a *sukuk*. Primarily borne out of the political desire to support the opening of the domestic market to participation banks and to promote Istanbul as a regional financial hub, the approach adopted by the Republic since 2011 is, therefore, an interesting case study.

The issuance of *shari'a* compliant instruments was first made possible in Turkey by the introduction in 2010 of a form of asset backed debt instruments (known in the Turkish legislation as lease certificates) through covered bond style legislation which made it possible for participation banks to tap the market via a regulated entity (known as an asset leasing company) which is subject to the supervision of the Capital Markets Board of Turkey (CMB). This was followed by the introduction of appropriate amendments to the tax legislation intended to make it more attractive for foreign investors to invest in these products. To begin to win the confidence of investors in the product, the Republic of Turkey decided to enter the market and issue lease certificates in 2012. Since 2012, the Republic has repeatedly tapped the market issuing its own lease certificates both in the domestic and the international capital markets and in so doing has established a clear benchmark for foreign investors. These sovereign issuances have helped foreign investors to become familiar with this market, have established a yield curve for lease certificates, and have contributed to make it possible for the participation banks to directly access the international capital markets themselves.

The success of this policy – clearly reflected in the ability of all the Turkish participation banks to access the international (as well as the Turkish domestic) capital markets in recent years – has led the CMB to attempt to open these sources of funding well beyond the still narrow participation banks sector. In 2013 the CMB enacted a bold amendment of the regulatory framework intended to make the lease certificates also available to other institutions, including corporate groups and project financing for local infrastructural projects. These developments in the Turkish legislation on *shari'a* compliant fixed income securities was considered in more detail in the article "The emergence of the Turkish *sukuk* market" recently published in [2014] 10 JIBFL 578. Though it is too early to assess the impact of the new legal framework, which, notwithstanding the interest by several Turkish corporates, has not yet been tested in the market, it is interesting to note how the new legislation is reshaping the nature of the lease certificates.

ASSET BASED VERSUS ASSET BACK INSTRUMENTS

Though a typical international *shari'a* compliant fixed income instrument issued in the Gulf region is usually structured as a beneficial interest in an English law governed off-shore trust, the income generating asset forming part of the trust property (typically located on-shore) is not segregated from other assets (as the transfer of the asset is typically not required to be perfected under the law of the relevant jurisdiction). The profit return on the certificates is only linked to the performance by the obligor of its contractual arrangements entered into with the trustee, which also forms part of the trust property. The return on the investment is "based" on the asset – rather than being "backed" (or in other words secured) by it – and the value of the asset is only intended to provide the parameters for determining the size of the capital issue and the financial performance of the instrument and is not calculated on the basis of its real market value. As a result an investor investing in such an instrument practically invests in the credit risk of the obligor rather than in the value of the income generating asset.

Though generally compared in the market to a similar asset based *sukuk al ijara* as issued in the Gulf region, the Turkish lease certificates present quite distinct legal features. The Turkish

lease certificates benefit from statutory segregation and (after the reforms enacted in 2013) are subject to a statutory debt to asset ratio based on the real market value of the underlying assets. As such, the Turkish lease certificates are much closer to an asset backed instrument than a typical *sukuk* originated in the Gulf region.

These characteristic legal features do not seem to have played a significant role in the market assessment and pricing of these instruments which seem to still be primarily perceived by the market as asset based instruments. However, it is difficult to imagine that this will remain the case if the aim of the CMB to promote lease certificates as a source of funding for project finance is to succeed. The segregation of the assets for the benefit of the investor is such an important credit enhancement factor that it can hardly be ignored in structuring any such future project finance bond.

ASSET FINANCE IN SUB-SAHARAN AFRICA: REPLICATING THE TURKISH MODEL?

Whether the approach pursued by the Republic of Turkey may provide a roadmap suitable for other countries is difficult to say. However, it is already possible to note certain similarities between the Turkish lease certificates and the inaugural issuances of international *shari'a* compliant fixed income instruments recently completed by the Republic of Senegal and the Republic of South Africa.

The Senegalese issuance has been structured using securitisation legal principles, with a transfer of assets – including a *usufruct* over governmental building complexes – to a securitisation fund which then leased back the buildings to the Senegalese government and funded the purchase of the assets by issuing to investors units in the securitisation fund. As the securitisation fund is a form of co-ownership of the underlying assets under Senegalese law, the units are equivalent to a beneficial interest in a trust and the structure is consistent with *shari'a*. However, the use of securitisation techniques results in an instrument which structurally is an asset backed (rather than an asset based) debt security.

Similarly, in the inaugural South African issuance, the certificates represent beneficial interests in an onshore trust created over certain assets located in South Africa, including a personal *usufruct* right over government owned infrastructure assets. As the trust has been perfected in accordance with South African law, notwithstanding the apparent similarities with an asset based *sukuk al ijara* as issued in the Gulf region, the underlying assets are segregated through the trust. The South African issuance was considered in more detail in the article "Breaking new ground in Africa: South Africa joins the global *sukuk* race", recently published in [2014] 11 JIBFL 649.

In both the Senegalese and South African issuances, due to the sovereign nature of the debt securities, these structural legal features may appear rather academic and pale into commercial insignificance. Notwithstanding the legal segregation of the assets, any return for the investors depends purely on the timely performance of the sovereign rather than on the real performance of the assets (the local government, in each case, is the only debtor of the securitised receivable or is the only entity entitled to own the relevant assets). Therefore, in the context of these sovereign issuances, any distinction between asset backed and asset based securities is of little practical consequence. However, should these legal structures be replicated in the context of non-sovereign *shari'a* compliant fixed income securities, these aspects would have a much greater relevance, as the financial product would appear closer to the Turkish lease certificates than to standard issuances originated in the Gulf region. This conclusion is very significant given the declared intention of each of these countries to use Islamic finance to attract foreign investment in their respective economies, either to fund public owned businesses or private companies or to fund infrastructure projects.

This of course does not spell the imminent end of the *shari'a* compliant asset based fixed income securities which have so successfully been issued in the Middle East and South East Asia. Sovereign issuers and corporate entities in these regions having a financial standing sufficiently strong to approach the international capital markets are likely to be able to tap the markets with traditional instruments. In many emerging markets, however, the use of asset backed structures may be necessary.

> "When used within secular legal systems with a predominantly non-Muslim population, form over substance is inevitably likely to be less attractive and a gradual shift towards more typical asset finance is likely to occur"

The utilisation of legal models based on domestic legal frameworks for asset backed products like in Senegal is also highly significant as it may allow potential avenues for structuring fixed income instruments to be identified in line with the requirements of *shari'a* law using well understood legal concepts in the local jurisdiction. Many civil law countries exploring how to allow domestic issuers to tap the international *shari'a* compliant capital markets may prefer using or adapting such existing legal frameworks instead of using off-shore trust structures like those used in the Gulf region. In particular, when recognition of foreign trusts may be an issue, such an approach would have the benefit of retaining the legal certainty

Feature

Biog box

Claudio Medeossi is director for capital markets, corporate trust and Islamic finance in the London office of Clifford Chance LLP and Debashis Dey is a partner in the Dubai office of Clifford Chance LLP and a leading expert on structuring and advising on sukuk issuances. Both have extensive experience in structuring international sukuk as well as advising on a variety of other capital market transactions and have worked on the recent first sovereign sukuk issuances of the UK, Republic of South Africa and Turkey.

Email: claudio.medeossi@cliffordchance.com; debashis.dey@cliffordchance.com

of well-known domestic legal principles. Such an outcome would seem to be more likely if these countries were to try to access the international *shari'a* compliant capital markets for funding infrastructure projects.

When used within secular legal systems with a predominantly non-Muslim population, form over substance is inevitably likely to be less attractive and a gradual shift towards more typical asset finance is likely to occur.

Introducing a legal framework suitable for issuing *shari'a* compliant fixed income instruments is not going to be the panacea for all the funding problems of every country. Unrealistic expectations should be discouraged. The market developments in Turkey may help to understand the potential obstacles limiting the growth of *shari'a* compliant finance. Notwithstanding the recent legislative development, lease certificates remain a form of asset finance and the

> "... the significance of the sovereign issuances in winning the confidence of the markets cannot be underestimated, as the support of the government is vital to create an environment, which may attract foreign capital"

A NEW ROAD MAP

The recent experience of the Turkish market confirms that, in order to attract foreign capital by targeting the liquidity existing in the Middle East, the role played by the state is likely to be critical. A clear legal framework is necessary and it must be capable of reconciling the requirements of *shari'a* law, as required by Islamic scholars, with the demand of legal certainty from investors. This may be achieved using legal principles borrowed from securitisation and asset backed finance without the need to enact specific legislation for Islamic finance. This may allow potential avenues for structuring the investment to be identified so as to fit both the expectations of traditional investors familiar with asset based *sukuk* and the more demanding requirements of full asset segregation, and therefore reducing the potential risk of legal uncertainty inevitably associated with the adoption of new legal principles. Introducing a favourable tax regime is also important. However, the significance of the sovereign issuances in winning the confidence of the markets cannot be underestimated, as the support of the government is vital to create an environment which may attract foreign capital.

availability of *shari'a* compliant assets is a prerequisite for issuing any such lease certificates. Outside those countries where all the economic activities have to comply with *shari'a*, drawing a neat line between *shari'a* compliant and *shari'a* non-compliant assets within any business organisation may be problematic. In many countries, therefore, the availability of suitable assets is likely to be a major constraint and it may be difficult to see how Islamic finance may become a general source of funding for all types of businesses. However, most infrastructure assets are likely to create no such problems and the use of *shari'a* compliant capital markets to fund (or refund) projects is more promising. International investment is unlikely to be attracted unless sufficiently strong credit ratings can be achieved. Investor appetite is likely to remain focused on investment grade securities and by itself a *shari'a* compliant structure would not be sufficient to mitigate concerns on the low credit rating of the obligor. The availability of Islamic finance may therefore be limited as a result of the low sovereign rating of the relevant jurisdictions. Conversely, in order to achieve a more attractive rating, structuring the securities as asset backed (rather than asset based) *shari'a* compliant fixed income instruments – along the lines of the Turkish lease certificates or using securitisation techniques like in Senegal – may become a prerequisite for accessing these markets.

In any case, the active role played by local governments in issuing *shari'a* compliant fixed income instruments is manifest.

CONCLUSION

In the years to come it is not unlikely that 2014 will be seen as a turning point in the development of the global international market for *shari'a* compliant fixed income securities. With the issuance of *sukuk* by the UK, Luxembourg and Hong Kong, some of the main global financial centres have entered the race to position themselves as the key markets for these products. These sovereign issuances are likely to provide useful benchmarks for investors interested to invest outside of the core Islamic markets in the Middle East and South East Asia. Developed economies are increasingly keen to find ways to attract foreign investment. At the same time, there is an increasing focus on how to attract investment in infrastructure projects, particularly in emerging markets where there is a higher demand for such investments and potentially higher long-term returns. The time seems ripe for an increased sophistication of this financial product to accomplish the several roles it can play. These trends are likely to transform *shari'a* compliant fixed income securities into one of the main types of asset finance. ■

Further reading

- The emergence of the Turkish sukuk market [2014] 9 JIBFL 578
- Breaking new ground in Africa: South Africa joins the global sukuk race [2014] 10 JIBFL 649
- LexisNexis Loan Ranger blog: Islamic finance – developments in 2014 and a look ahead to 2015

KEY POINTS

- The Supreme Court judgment resolves earlier conflicting case law on the limits of the rule that where an agent acquires a benefit as a result of his fiduciary position, he is treated as having acquired it for the benefit of his principal, so that it is beneficially owned by the principal.
- In finding that a bribe or secret commission received by an agent is held on trust for his principal, the Supreme Court has delivered a highly significant judgment, giving principals greater powers of recovery.
- The judgment serves as a reminder to lenders of the potentially onerous duties assumed by agents, arrangers and security trustees under secured syndicated loan arrangements and of the importance of clearly defining such duties contractually.

Feature

Authors Emily Tearle and Simon Buckingham

FHR European Ventures v Cedar Capital: a decision with wider implications for the loan market?

In this article, the authors consider the impact of *FHR European Ventures LLP and others v Cedar Capital Partners LLC* [2014] UKSC 45 in the context of syndicated loan arrangements.

THE AGREED PRINCIPLES

It is well understood that the relationship between an agent and his principal is one that is based on trust and confidence and may, therefore, give rise to fiduciary duties owed by the agent to his principal. Two further established principles are derived from a fiduciary relationship: (i) an agent must not profit from his trust, nor indeed must he place himself in a position in which his duty and his interest conflict, and (ii) an agent who acts for two principals with potentially conflicting interests without the informed consent of both is in breach of his obligation of undivided loyalty and may be subject to a conflict between his duty to one principal and his duty to the other. These core principles were clearly summarised in the decision of Millett LJ in *Bristol and West Building Society v Mothew* [1998] Ch 1, 18.

A further important and undisputed principle is that where an agent receives a benefit in breach of his fiduciary duty, the agent is obliged to account to the principal for that benefit and must pay, in effect, a sum equal to the benefit by way of equitable compensation. However, case law has demonstrated that there are occasions where an agent who acquires a benefit by virtue of his fiduciary position, (or pursuant to an opportunity which results from his fiduciary position), is to be treated as having acquired that benefit on behalf of his principal so that it is beneficially owned by the principal ("the Rule").

The central question which had yet to be resolved was whether this Rule applied to a bribe or secret commission, received by an agent in breach of his fiduciary duty. If it did, then it would be held by the agent on trust for his principal, entitling the principal to a proprietary remedy; if not, the principal would merely have a personal claim for equitable compensation in a sum equal to the bribe or commission's value. The distinction between a personal claim and a proprietary right derived from the Rule is an important one, both because a principal's proprietary claim would have priority over the unsecured creditors of the agent on an insolvency and because the principal will be able to trace the benefit represented by the proprietary claim into the hands of third parties if necessary.

Judicial decisions going back to the 19th century have answered this question in different ways with dramatically different results. Enter stage right the unanimous decision of the Supreme Court in *FHR European Ventures LLP and others v Cedar Capital Partners LLC* [2014] UKSC 45 to cut through the previous conflicting judgments and years of academic debate and resolve this issue once and for all.

A RESUME OF THE FACTS

In 2004, the claimants together purchased the Monte Carlo Grand Hotel through a vehicle called FHR European Ventures LLP (FHR). Cedar Capital Partners LLC (Cedar) acted as FHR's agent in negotiating the purchase. The fact that Cedar therefore owed fiduciary duties to FHR was never in dispute. However, unbeknown to FHR, Cedar had entered into an exclusive brokerage agreement with the vendor of the hotel, entitling Cedar to receive a brokerage fee of €10m on the conclusion of the sale and purchase.

In 2009, FHR brought proceedings against Cedar for the €10m brokerage fee. Simon J at first instance found that Cedar had failed to make proper disclosure of the exclusive brokerage agreement to FHR and was therefore in breach of its fiduciary duty for failing to obtain properly informed consent. However, whilst Simon J ordered Cedar to pay the €10m to FHR, he refused to grant a proprietary remedy in respect of the monies.

FHR appealed, solely on the question of whether it was entitled to a proprietary remedy. The Court of Appeal unanimously overturned the decision on the point ([2013] EWCA Civ 17) and held that FHR did have a proprietary claim for the brokerage fee. In doing so, Sir Terence Etherton, Chancellor, highlighted the difficulty their Lordships had encountered in reconciling the prior

conflicting Court of Appeal judgments which had made *"the law more complex and uncertain and dependent on very fine factual distinctions"* and invited the Supreme Court to overhaul *"this entire area of the law… in order to provide a coherent and logical framework"*. Cedar appealed to the Supreme Court.

THE DEBATE

In order to cut through the arguments before them, the Supreme Court resolved first to attempt to marry up the cases which have addressed the issue and then go on to consider policy and practical arguments before reaching its conclusion.

Their Lordships identified a number of cases over the past 150 years or so where it did not seem to be in dispute that, if the recipient of the benefit had received it in breach of his fiduciary duty to the plaintiff, then he held it on trust for the plaintiff. Indeed, many of those cases contained observations to suggest that the Rule applied to all benefits received by an agent in breach of its fiduciary duty. So far so good. However, their Lordships then faced having to reconcile that line of cases with a House of Lords decision which seemed to go the other way, namely *Tyrell v Bank of London* (1862) 10 HL Cas 26, together with subsequent Court of Appeal authorities in *Metropolitan Bank v Heiron* (1880) 5 Ex D 319, *Lister & Co v Stubbs* (1890) 45 Ch D 1 and more recently, *Sinclair Investments Ltd v Versailles Trade Finance Ltd* [2012] Ch 453 where arguments based on a proprietary claim were, for one reason or another, rejected.

In order to assist them, their Lordships turned to the wealth of academic debate surrounding this issue which Pill LJ, in the Court of Appeal in this case, described as having given rise to *"passions of a force uncommon in the legal world"* – [2014] Ch 1, para 61. Deliberation over the arguments on both sides got them no closer to deciding which was to be preferred. Lord Neuberger concluded that it was not possible *"to identify any plainly right or plainly wrong answer to the issue of the extent of the Rule, as a matter of pure legal authority."* Instead, it was consideration of points of principle and practicality which broke the deadlock.

THE DECISION

It is clear that their Lordships were striving for a simple and neat solution which did not run contrary to general principles. Lord Neuberger stated:

> "Clarity and simplicity are highly desirable qualities in the law. Subtle distinctions are sometimes inevitable, but in the present case… there is plainly no right answer, and, accordingly, in the absence of any other good reason, it would seem right to opt for the simple answer."

Their Lordships were clearly attracted to the neatness of a finding that all unauthorised benefits received by an agent fell within the Rule and that the agent holds the bribe or secret commission on trust for his principal, to which the principal has a proprietary claim.

> "Their Lordships acknowledged the existence of a significant body of conflicting case law but concluded that it lacked clarity and consistency…"

Essentially, their Lordships made four key points:

(1) The Rule was consistent with the principles of the law of agency in that an agent owes a duty of undivided loyalty to his principal and is obliged to deliver up to his principal the entire benefit of his acts, whether or not those acts were authorised, not simply pay him compensation.
(2) It was an unattractive argument to differentiate between benefits derived from secret profits received whilst acting for a principal and a bribe or secret commission received from a third party which the principal could never himself have obtained, nor was such an approach consistent with earlier judgments.
(3) To apply the Rule so that it includes bribes and secret commissions has the advantage of matching up the circumstances when an agent has to account for any benefit received in breach of his fiduciary duty with those in which the principal can claim the beneficial ownership of the benefit. It also avoids a paradoxical situation where a principal whose agent receives a bribe is worse off than one whose agent profits in a less inappropriate manner.
(4) As a matter of public policy, the law should be particularly stringent towards parties who are paid bribes or secret commissions and this is not outweighed by concerns that unsecured creditors may be prejudiced by this outcome.

Therefore, as a matter of principle and practicality, the simplicity of a broad application of the Rule such that any benefit acquired by an agent as a result of his agency and in breach of his fiduciary duty is held on trust for his principal outweighed the potential for uncertainty caused by seeking to separate out specified circumstances where it did not apply. Their Lordships acknowledged the existence of a significant body of conflicting case law but concluded that it lacked clarity and consistency and that they were not obliged to follow it. Further, they concluded that the law had taken a *"wrong turn"* in the Court of Appeal decisions in *Heiron* and *Lister* and therefore, they should be overturned, together with any subsequent decisions such as *Sinclair*, at least to the extent that they relied on or followed them. What, then, of the House of Lords decision in *Tyrrell*? That, too, was deemed to be inconsistent and was accordingly disapproved.

THE CONSEQUENCES

The resolution of this issue has important implications for those seeking recompense for the double dealing of their agent. The

Biog box

Emily Tearle is a professional support lawyer for the Dispute Resolution department at Travers Smith LLP. Email: emily.tearle@traverssmith.com

Simon Buckingham is a professional support lawyer for the Finance department at Travers Smith LLP. Email: simon.buckingham@traverssmith.com

claimant principal is in a much stronger position when seeking to recover the bribe or secret commission. First, he can bring a proprietary claim against the agent, which enables him to trace into the agent's assets, and if necessary, into the assets of third party knowing recipients. He may also apply for a proprietary injunction to freeze the bribe/secret commission and its traceable proceeds.

Secondly, if the agent becomes insolvent, then the principal will have priority over unsecured creditors. In their judgment, their Lordships were briefly troubled by the possibility of potential prejudice to an agent's unsecured creditors, but concluded that this was outweighed by the justice of a principal being allowed to trace the proceeds of the bribe or commission more effectively than the limited entitlement to trace at common law. That said, this decision does not prevent the principal from bringing a personal claim if the outcome is likely to be more lucrative, if, say, the agent has invested the bribe and its value has dramatically decreased.

For a lender acting as arranger, agent and/or security trustee in the context of syndicated loan arrangements, this decision gives pause for thought. In assuming duties in any of those capacities, the lender will certainly owe a duty of care and any agency or trustee function may be expected to give rise to a fiduciary relationship with all the duties and obligations that it entails. However, it is perfectly possible, and indeed market practice, for lenders in such roles to ensure that appropriate contractual wording is in place at the outset to put strict limits on their duties. In particular, lenders in those roles generally require express terms to be included in their finance documents which state that they owe no fiduciary duties and will frequently require an indemnity from the other lenders for any loss suffered or liability incurred in discharging such functions.

Such provisions in fact tend to go even further, purporting to restrict the extent to which the arranger, agent or security trustee might owe a duty of care to other lenders or the borrower at all. Whilst the courts will scrutinise the relevant terms of the loan agreement to ascertain the extent to which such duties have been expressly excluded when breaches of duty are alleged, they are prepared to uphold such provisions. For example, in *Torre Asset Funding Ltd & Another v The Royal Bank of Scotland Plc* [2013] EWHC 2670 (Ch) concerning a lender acting as agent of the syndicate, the High Court readily concluded that provisions within the transaction documents gave rise to functions which were solely mechanical and administrative and that the agent's responsibility to its syndicate was to be narrowly construed. Likewise, in the context of a lender acting as arranger, in *IFE Fund SA v Goldman Sachs International* [2007] EWCA Civ 811, the Court of Appeal endorsed a decision of the High Court which gave effect to contractual provisions relieving the arranger from any duty to disclose information from the auditors which was provided after distribution of the information memorandum.

The role of security trustee might give rise to greater issues. Notwithstanding any contractual exclusions, as a trustee for the lenders, the existence of a fiduciary relationship might be assumed and be of special significance where, as is frequently the case, the security trustee has potentially conflicting duties as a trustee towards both senior lenders and subordinated, junior lenders. In *Saltri III Ltd v MD Mezzanine SA SICAR & Ors* [2012] EWHC 3025 (Comm) the junior, mezzanine lenders in the syndicate argued just this point. The High Court concluded that a person in the position of a security trustee could be in a fiduciary position insofar as some of its functions were concerned, and not others. The court paid close attention to the contractual provisions delineating the duties of the security trustee set out in the intercreditor agreement and found that the contractual terms were inconsistent with any assumption of fiduciary duties. Therefore, even in these circumstances, the express contractual terms will prevail over any implied assumption of a fiduciary relationship.

Finally, the fee arrangements which typically apply in the context of a secured syndicated loan agreement warrant particular consideration following the *FHR* decision. Such arrangements do include an element of secrecy, since the quantum of fees payable by the borrower to the agent, arranger and/or the security trustee is frequently set out in a fees letter which is seldom disclosed to the syndicate of lenders. However, it would be wrong to characterise such payments (the existence of which are normally disclosed to the lenders and which are made in consideration for the assumption of real responsibilities and functions) as either secret commissions or profit, or as a benefit received in breach of a fiduciary duty, provided that it is clear from the contractual matrix that the lenders are aware that a fee is to be paid by the borrower. The normal, market approach (and one which it would be wise to follow in the light of principles expounded in *FHR*) is to expressly impose the obligation to pay fees in the loan agreement (avoiding any suggestion that the fee constitutes a secret profit) even if the quantum and timing of payment is addressed elsewhere.

The *FHR* decision therefore serves to remind lenders fulfilling the function of agents, arrangers and security trustees of the onerous duties assumed by agents and trustees generally, of their duties to account to their principals and beneficiaries for profits received in breach of fiduciary duties and of the need for carefully-considered wording in the contractual documents governing such relationships, in order to dilute the duties which would otherwise apply. ■

Further reading

- FHR European Ventures LLP: the demise of *Sinclair v Versailles* and a welcome return to orthodoxy [2014] 5 CRI 175
- The role of the security trustee: lessons from the *Stabilus* restructuring [2013] 4 JIBFL 201
- Lexis PSL: Restructuring and Insolvency: Recovery of property

Feature

KEY POINTS

- The Sausalitos transaction illustrates the use of a bond structure for an acquisition financing or refinancing, including a flexible capex line, by way of a unitranche style financing provided solely by debt funds – which may have greater application or appetite in small- and mid-market transactions.
- In addition, a bond structure may assist in alleviating regulatory concerns in some jurisdictions – such as Germany – as well as other general legal issues including call protection clauses. Generally speaking, it is a flexible/adaptable structuring alternative when compared to standard loan structures.
- On the one hand, a bond can be a highly liquid and transferable instrument making it attractive for various types of investors. On the other, the bond format could also be structured rather restrictively.
- A bond structure can also include a flexible capex facility without the requirement to involve an additional bank loan lender.

Authors Marc Trinkaus and Steffen Schellschmidt

Acquisition financing for the Sausalitos group: the creation of a cleared unitranche acquisition and capex bond

The bond-style secured unitranche financing of the acquisition of the Sausalitos restaurant chain was a bond/loan hybrid transaction. The transaction demonstrates the flexibility of this kind of financing instrument provided by "non-bank lenders"/ debt funds only, including how it can be tailored to include customary (and for some, more comfortable) LMA-style loan financing features and a capex facility within a bond format. Unitranche financings provided by debt funds have already been common products over the last few years in eg the US and French markets. They are also regularly seen in other European countries, in particular in relation to the financing of small- and mid-cap businesses with extended capex needs where the bullet structure of the unitranche is seen as an advantage to the common term loan A structures. However, the financing of additional capex or liquidity needs usually requires the involvement of an additional bank lender which gives rise to various structural issues such as super senior ranking, shared security or voting rights between the lending groups.

ACQUISITION FINANCING BY USE OF BOND ISSUANCES ONLY

The Sausalitos transaction comprised the acquisition of the Sausalitos group, a German based chain of restaurant bars, by the Belgian based private equity group Ergon Capital Partners from EQT Expansion Capital, financed by debt funds related to Kartesia Advisor LLP and European Capital Ltd.

For several reasons the financing was structured as a German law bearer bond (*Inhaberschuldverschreibung*) cleared by Clearstream. It consists of a unitranche bond issuance for acquisition purposes and supplemental capex bond issuances, both benefiting from a customary security and guarantee package.

One challenging aspect of the bond structure was to implement a flexible instrument to finance capex measures in the overall financing package without having to provide a separate Revolving Credit Facility (RCF)/Capex loan facility which, to date, has been the more common approach in other unitranche financings.

LEGAL DOCUMENTATION

The legal documentation package was different from a loan transaction both as far as the mechanical documentation required to implement the bond specific aspects was concerned (for example the calculation and paying agency roles) as well as in the way the provisions reflecting a customary secured loan financing were split and spread across the central documents due to the fact that the bond terms themselves only contained rights not obligations of the bondholders and other finance parties.

The key financing documents were the Purchase Agreements (one for each of the unitranche and capex bonds), the Global Bond to which the relevant bond terms and conditions were scheduled, as well as the Trust Agreement, the Subordination Agreement and the Agency Agreement.

The framework documents applicable to the bonds in general were the Trust Agreement, the Subordination Agreement and the Agency Agreement, as well as the Purchase Agreements, each relating specifically to the unitranche or capex bonds. The actual financing terms (interest, repayment, transfer etc) were set out in the Global Bond to which the terms and conditions were attached.

The financing documents dealt with the following issues:

- *Agency Agreement*: This agreement contained the mechanical bond-specific provisions in relation to the principal paying agent and the calculation agent, including delivery and authentication of the physical bond as well as payments to bondholders. It was entered into between the issuer/s, the principal paying agent and the calculation agent, given the difference in nature between issued bonds and borrowed loans. These

agents were appointed by the issuer, and the bond and agency relationship in this respect therefore lay between the issuer and the relevant agent. The agents not only calculate, for example, the relevant interest payable under the bonds, but also make the relevant on-payment to the clearing system for value for the respective bondholders.

- *Trust Agreement*: This agreement set out certain of the provisions usually included in a LMA-style intercreditor agreement, for example the appointment of the security trustee and parallel debt (due to the accessory nature of a German law pledge security), as well as the guarantee and indemnity usually included in an LMA-style leveraged facilities agreement. For these reasons this agreement also contained the parameters and prerequisites for additional guarantors or issuers to accede to the financing documents, also in the same style as an LMA-style leveraged facilities agreement. The bondholders did not need to sign this document (as they are usually not known to the issuer), but the trustee acts on the bondholders' behalf. Although the trustee is technically appointed by the issuer, it is solely acting for the benefit of the bondholders following its appointment.
- *Subordination Agreement*: This agreement contained the remainder of the key provisions usually included in an LMA-style intercreditor agreement, namely the ranking and priority, permitted payments and subordination, enforcement provisions (including distressed disposals) and the payments waterfall. Additional guarantors and issuers are also required to accede to this agreement to preserve the framework of the financing.
- *Purchase Agreements* (in relation to the unitranche bond and the capex bond): The Purchase Agreements themselves are fairly short documents between the issuer and each initial bondholder. These agreements deal with the requirements and mechanics around the purchase and issue of the relevant bond, drawing from both a bond-style and loan-style financing, including purpose (loan-style), payment/issue (bond-style), transfer requirements (loan-style) and conditions precedent (loan-style). The Purchase Agreement was the only document which allowed for specific arrangements between the issuer and each bondholder which are otherwise uncommon in bond documentation, eg transfer restrictions, white lists, future drawings. To facilitate the required capex line, the Purchase Agreement for the capex bond also permitted the issuance of several supplemental bond issuances during a pre-defined issuance period upon the satisfaction of certain conditions precedent. It thus matches the utilisation provisions of an LMA-style loan financing.

> "... allowance for further issuances will effect mechanically and procedurally how the bond is issued... and how ongoing payments are maintained"

- *Terms and Conditions* ("T&Cs"): These were scheduled to the relevant Global Bond providing for the actual financing terms. The Global Bond was included in the relevant Purchase Agreement. The body of the T&Cs were generally bond-style, including providing for interest, payments (including early redemption), resolutions of bondholders/amendments. The schedules to the T&Cs included some of the key aspects of a loan-style financing, and set out mandatory redemption, representations, covenants/undertakings, financial covenants and events of default each based on LMA-loan provisions and adjusted to reflect usual unitranche financing features.

TERMS OF BOND STRUCTURED ACQUISITION FINANCING

Points of difference to a loan financing

Although generally a flexible and "customisable" product, some key points to note in using a bond structured financing in transactions such as Sausalitos are as follows.

- *Regulatory*: There are often jurisdiction-specific requirements for credit providers to be able to advance loans to borrowers incorporated or established in that jurisdiction. For example, subject to various exceptions and carve outs, any person wishing to carry on banking business (including "lending business") in Germany commercially or on a scale that requires a commercially organised business requires a banking licence. Structuring the financing as a bond rather than a loan can assist with this type of regulatory issue, provided that the transaction is structured as a customary bond transaction.
- *Prepayment penalties/non-call periods*: Likewise, restrictions under mandatory law such as limitations under German law on the inclusion of prepayment penalties in relation to loans bearing a variable interest rate (eg based on EURIBOR/LIBOR fixing rates) do not necessarily apply in a bond financing, meaning the need for complex structuring may be avoided or minimised.
- *Technical and mechanical*: Although the scope for the bond set up is flexible, considerations such as usage of a clearing system, a paying agent and the allowance for further issuances will effect mechanically and procedurally how the bond is issued (ie how the financing is "drawn", in particular when multiple drawings are anticipated) and how ongoing payments are maintained. It is common for bonds to be issued in physical global form, which gives rise to particular considerations around funding in the context of an acquisition financing (eg clearing

Biog box
Marc Trinkaus is a partner at Linklaters LLP in Frankfurt; and Steffen Schellschmidt is a managing associate at Linklaters LLP in Frankfurt. Email: marc.trinkaus@linklaters.com; steffen.schellschmidt@linklaters.com

and settlement). Notably, the agency roles and responsibility under a bond structure vary from that of a facility agent under a loan style financing, in particular the onus tends to be on the issuer for maintenance and calculation of payments rather than on the bondholders.

- *Transferability*: While syndication and transferability of a bond are possible and these parameters can be contractually agreed, restrictions can also be implemented in order to achieve a non-transferable or very narrowly-transferable bond. However, any limitations to the transfer of a bond are non-standard and are typically against the nature of a cleared bond which is designed for quick and easy transferability.
- *Voting*: In a typical bond financing, the bondholders are an anonymous group, with the trustee acting on their behalf. The German Bond Act allows for majority decisions of bondholders and provides protection for minority bondholders by requiring a 75% majority to pass bondholder resolutions in respect of material amendments to the terms and conditions which are binding on all bondholders. In addition, an early termination of all bonds in case of an event of default requires only a minimum of 25% of the bondholders voting to exercise their termination rights. This threshold cannot be increased in order to protect the early termination right of minority bondholders. For any other decisions, the relevant required majority may be individually agreed in the finance documents and can reflect the usual majority lender concept under a loan financing.

Similarities with loan financings

There were also several similarities to a loan financing in the Sausalitos transaction. Given the flexibility of the bond instrument, it was possible to customise the Sausalitos financing to include several LMA-loan style features as follows:

- *Undertakings, representations, financial covenants*: As mentioned above, provisions such as financial covenants, general undertakings, information undertakings and reporting, representations, events of default, mandatory repayment (ie redemption), margin and ratchet were included, each based heavily on customary LMA leveraged-style loan agreements. In addition, the bondholders benefitted from a leverage-style security and guarantee package.
- *Intercreditor provisions*: Also as mentioned above, several LMA-style Intercreditor Agreement provisions were included, split between the Trust Agreement (equalisation, proceeds waterfall, parallel debt and most enforcement provisions) and the Subordination Agreement (subordination, ranking and restrictions in relation to shareholder and intra-group payments).

Characteristics of the unitranche and capex bonds

The "term loan" bond for the Sausalitos transaction was economically structured as a unitranche debt. In most respects the capex bond reflected a typical capex loan facility financing. In relation to the unitranche features and the capex bond:

- *Unitranche bond*: As per most unitranche deals, the loan style aspects of the documentation were generally LMA leveraged style.
- *No RCF*: The Sausalitos financing did not include a RCF. The usual unitranche intercreditor features in this respect were therefore not relevant, for example material events of default, creditor group enforcement rights, rights to purchase debt and similar enforcement/value protection features.
- *Unitranche features*: However, customary unitranche features were compatible with the bond financing structure and were included in, for example, the bullet repayment (or in this instance, redemption), the non-call protection and a EURIBOR floor set above zero.
- *Capex bond*: The capex bond was structured in a similar way to a capex facility in a leveraged style facility, for instance in relation to "drawing" (issuance) and the requirements in relation to the use of proceeds, as well as the availability period and commitment fees. Additional target group members were also able to accede to become issuers of capex bonds. Essentially, the T&Cs applicable to the capex bond were the same as for the unitranche bond however these capex features, and the other key documents set out above, formed the framework for both the capex and unitranche bonds. In order to allow the drawing under the capex bond, initial bondholders underwrote the entire volume. The capex bond was structured as an "up to amount" issuance allowing a write up and write down of the nominal amount of the capex bond from time to time. By including the capex line into the bond structure instead of a separate loan facility, the usual unitranche intercreditor features dealing with a super senior bank lender and thus complexity with regard to eg voting and enforcement rights could be avoided.

SUMMARY

In summary, the unitranche bond financing provided, for the issuer and investor alike, an attractive financing package with flexible terms and reasonable returns. It remains to be seen to what extent other borrowers and unitranche providers will pursue similar structures in the future. In any event, the unitranche capex bond adds another element to the toolkit of "non-bank lenders" in their competition with traditional banks. ■

Further reading

- Borrowing from a fund: 10 points to watch out for in LMA documentation [2013] 8 JIBFL 516
- The rise of unitranche financing in Europe [2013] 10 JIBFL 659
- A lifeline for struggling miners? Fund managers enter the fray [2014] 4 JIBFL 247

HERBERT SMITH FREEHILLS

With more than 2,800 lawyers, operating from over 20 offices across Asia Pacific, EMEA and North America, Herbert Smith Freehills provides premium quality, full-service legal advice from its market-leading dispute resolution, projects and transactional practices, combined with expertise in a number of global industry sectors, including energy, natural resources, infrastructure and financial services.

In Practice

Author Eric Fiszelson

Cross-collateralisation arrangements in French portfolio deals

Acquisitions of portfolios of project assets (either in development or already in operation) have been driving the French market for the past few years. Commercial banks and institutional investors alike are interested in financing these portfolios for a number of reasons (diversification, natural hedging of operational risks, economies of scales, etc). These lenders will (quite naturally) seek to rely on upstream and cross-stream guarantees from each project company within the portfolio. French corporate law is, however, not particularly well suited to achieve this objective. A number of strong constraints will prevent lenders from obtaining a full, unfettered cross-collateralisation over the whole French portfolio. It does not mean that all forms of cross-collateralisation are prohibited, but expectations should be managed.

FINANCIAL ASSISTANCE PROHIBITIONS

Financial assistance refers to a situation where a company uses its own assets to purchase its own shares or to guarantee/secure any such purchase. Under French law, the rule of thumb is that financial assistance is prohibited. The purpose of this prohibition is to preserve the capital base of a company from its shareholders and the company's creditors. This prohibition is applicable to limited liability companies (which are the most commonly used corporate vehicles for projects carried out in France) and French law does not provide for any "whitewash" procedures that could neutralise this prohibition. Although there are no similar provisions applicable to other forms of French companies, corporate benefit restrictions are such (see below) that the end result is the same for every form of French corporation: the shares of French project companies acquired by the acquisition company may be pledged to secure the acquisition facility, but the French project company may not grant security under, or guarantee, this facility.

CORPORATE BENEFIT

As a general rule, French companies should refrain from granting any upstream or cross-stream guarantees and security. As a result, great care should be taken when dealing with any deviation from this principle. This is because, if guarantees or security interests granted by a French company fall foul of its corporate interest, executives and/or shareholders of that company may be exposed to criminal liability for misappropriation of corporate funds and to civil liability for mismanagement. Any bank or financial institution that benefits from fraudulent guarantees or security directly may also be held liable, as an accessory.

French law does not provide for any definition of what constitutes the corporate interest or benefit of a company, although French case law has ruled that downstream guarantees and security are deemed to be in the corporate interest of the relevant guarantor. The security or guarantee would then be deemed null and void as well. That said, based on French case law, the common view is that upstream or cross-stream guarantees may be in the interest of the guarantor (or security provider) if the following criteria are met:

(i) the guarantor and its parent or sister company share a common economic, social (ie labour related) or financial interest which forms part of a group-wide strategy;

(ii) the guarantor must demonstrate that a quid pro quo existed for granting that guarantee;

(iii) the guarantee should not affect the overall balance of the respective commitments of the relevant members of the group; and

(iv) the guarantee shall not exceed the financial capacities of the guarantor.

The above criteria are factual and financial, not legal. It is therefore somewhat difficult to assess how they should be met in practice. Practitioners consider that the only way to argue that the French company has an interest in giving upstream or cross-stream guarantees or security is to demonstrate that the guarantor gains direct financial benefit as a result. Therefore, where an upstream or cross-stream guarantee or security is capped to the amount of a facility which is (or may be) made available to the guarantor indirectly (ie by way of an intra-group loan made to it by its parent or sister company with the proceeds of the relevant facility), the risk of liability for misappropriation should be avoided. Going beyond this "tipping point" would raise issues.

USE OF EXCESS CASH, RESERVES AND INTRA-GROUP LOANS

The above constraints are obviously stringent and could lead one to believe that cross-collateralisation is, in a French context, nothing but cosmetic. There are, fortunately, ways to achieve some form of cross-collateralisation. For instance, the excess cash flow generated by the operations of each project company may be used to fund cross-collateralised debt service reserves at the level of the acquisition company. Alternatively, or additionally, the finance documentation may provide for the provision of loans from project companies which generate excess cash to other members of the portfolio faced with operational difficulties. In order not to raise corporate benefit issues, these loans will need to be provided at a rate which reflects market rates, should preferably be subject to certain limitations (either in terms of amount or frequency, so as to avoid the artificial assistance of a project company which is under-performing structurally) and should be repayable whenever the lending company is, in turn, faced with operational issues.

In short, portfolio financing should not ignore the rigours of French corporate laws. The number of recent transactions carried out in France demonstrates however that in spite of them, deals get done in France. ■

Biog box

Eric Fiszelson is a partner in finance at Herbert Smith Freehills, Paris. Email: eric.fiszelson@hsf.com

OLSWANG

Olswang LLP is a law firm with a pre-eminent reputation in the TMT and real-estate industries. The firm has more than 100 partners across eight international offices.

In Practice

Author Charles Kerrigan

The interpretation of contracts relating to financial transactions: postscript

This is a postscript to a series of articles which have considered rules on interpretation of contracts and their specific applicability to financial transactions. This article will look forward to longer term changes which technology may make in this area. Some of these will mean that documentation, and therefore interpretation, will change.

Let us look at this in context. Banks are technology businesses. They exist for two reasons. First, to provide payment services. Secondly, as distribution channels for capital. Both of these are problems which can be solved by technology. Technology is expensive, however. When banks were the biggest companies in the world, they had the balance sheets to provide the best technology solutions to these problems. It is no coincidence that just as pure technology companies become the largest businesses in the world (Apple, Facebook, Google *et al*) they are providing competition to the banks. (In fact, banks are sophisticated in finding technology solutions, for example, to reduce marginal transaction costs and increase efficiencies in the operations of their businesses. Their difficulty in retail banking is that in a battle for the customer their brands do not compare favourably to Apple, Facebook, Google.)

If we see banks as technology businesses will it continue to be the case that operational matters in banks are addressed through technology but banks' contracts are not changed or improved by technology?

In Part 4 of this series of articles (under the heading "Practical assistance") we raised the issue of computers in banks dynamically interacting with contracts. There is currently a disconnect between the practical operation of a contract written in code in a bank computer (ie for a loan, to produce statements etc; for a securitisation or invoice discounting transaction, to reflect more of the economic operation of the contract terms) and the parties' agreement being written in the paper contract. Clearly, there is a risk of mistranslation. In addition, the bank computer is rarely programmed with a complete set of contract terms so that, for example, while producing a statement it may not identify a particular prepayment or exit fee payable on a contingency.

Matters are developing in this area. A German artificial intelligence application called Elterngeld ("parents' money") (reported in the *New Scientist* but not, as far as I can see, the UK legal press) is designed to make decisions on child benefit claims made to Germany's Federal Employment Agency. Currently the text of the relevant law is broken down into machine-readable format (a time-consuming process) before being processed by the application. It has been proposed that new laws in this area should be drafted in a format which takes account of the application. The legislation would be built as a structured database containing the relevant rules and information on how they relate to each other, avoiding the need for the intermediate translation into machine-readable format.

Bitcoin is pertinent in this context. Bitcoin is a (and certainly the most famous) crypto-currency ie a digital currency based on cryptography. What is its relevance here? First, Bitcoin operates as an asset register of digital assets (known as the blockchain). In other words, it can be used to effect and register the transfer of any asset which is registered digitally (eg ownership of value in an account, of entries in a land register). Secondly, it is a protocol (a system of digital rules for data exchange between computers). What this means is that Bitcoin is, in effect, programmable money (as are other crypto-currencies). It can register a transfer of value and, in addition, terms and conditions can be written into the protocol and therefore into the value transfer. Taking a simple example Bitcoins can be placed into, and released from, escrow by terms which are inherent in the Bitcoins (for example, authorisation conditions to release from the escrow). In effect the money can have contract terms comprised in it. (In addition, Bitcoin is not anonymous. In fact, it makes transactions traceable.)

Beyond crypto-currencies, smart contracts will be a significant development in legal practice in the next few years. Computerisation of legal drafting is not a new subject. The seminal text in this area was published by the American Bar Foundation in 1982 (*Computer-Aided Drafting of Legal Documents* by Charles S Saxon). What is changing is that the technology is developing quickly and machines are now sophisticated enough to learn from human editorial control, both in the development of smart contracts and the use of predictive coding technology in US litigation discovery.

There is always scepticism about these matters in the legal profession. Financial institutions are more open-minded and the technology companies which will be the new entrants in financial services will be playing on their home ground. Money is a form of social technology which is interesting to the tech industry for obvious reasons. Financial transactions will be changed as a result, including for lawyers. ■

Biog box

Charles Kerrigan is a partner in the banking group at the London office of Olswang. Email: Charles.kerrigan@olswang.com

DLA PIPER

DLA Piper is a global law firm with 4,200 lawyers located in more than 30 countries throughout the Americas, Asia Pacific, Europe and the Middle East. With one of the largest specialist banking and finance litigation teams in the world, we are well positioned to help companies with their legal needs, wherever, and whenever they need it. The UK team, which is made up of "dedicated and experienced banking and finance litigation practitioners" (Chambers & Partners UK 2013), acts for hundreds of financial institutions, including all the major UK clearing banks and provides advice and representation to banks, mortgage banks, building societies, finance houses, factors and invoice discounters and merchant acquirers as well as regulatory authorities.

In Practice

Authors Jamie Curle, Linos Choo, James Carter and Sophie Payton

Fraud and illegality exceptions to banks' obligations to pay under letters of credit

Fraud is a well-established exception to the autonomy principle, whereby a letter of credit (L/C) is treated as independent from the underlying contract to which it relates, and thereby to banks' obligations to make payment under the L/C. A more recent development is the recognition of an exception where there is illegality in the underlying transaction.

This article looks at the recent case of *Alternative Power Solution v Central Electricity Board* [2014] UKPC 31 in which the Privy Council clarified the test to be applied in establishing the fraud exception and, in so doing, reinforced the distinction between banks' obligations under L/Cs and the obligations of the parties to the underlying transaction. It also looks at the illegality exception as developed in *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152 and *Mahonia Ltd v JP Morgan Chase Bank and West LB* [2003] 2 Lloyds Rep 911 and [2004] EWHC 1938 (Comm).

THE ALTERNATIVE POWER CASE AND FRAUD EXCEPTION

The starting position with regard to a bank's obligation to pay under a L/C is set out in Art 4 of UCP 600 (Uniform Customs and Practice for Documentary Credits): "…the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary. A beneficiary can in no case avail itself of the contractual relationships existing between banks or between the applicant and the issuing bank."

However, English law provides for an exception to that autonomous payment obligation where, at the time of presentation of the documentation against which the bank is to make payment, fraud on the part of the presenting party or its agents has been drawn to the bank's attention. In those circumstances the bank should refuse to make payment and the court will intervene to prevent payment.

In the *Alternative Power* case the appellant, Alternative Power Solution (APS), appealed to the Privy Council against an injunction granted by the Supreme Court of Mauritius (and upheld by the Mauritius Court of Appeal) restraining the bank from paying APS under a L/C issued pursuant to a contract for the sale of lamps between APS and the respondent, Central Electricity Board (CEB).

CEB alleged that APS' demand for payment under the L/C was fraudulent because APS had not supplied the lamps in accordance with the contract which, among other things, required the lamps to be manufactured in China and entitled CEB to inspect the lamps before shipment. On CEB's case, the bank must have been aware of these breaches because the contract was required to be produced to the bank by APS in demanding payment.

The Privy Council rejected the test applied by the first instance judge in granting an injunction restraining payment under the L/C – "a serious *prima facie* arguable case that there might be an attempt to defraud" – and, having reviewed the English law authorities, clarified that, on the correct test, it needed to be established (or shown to be "seriously arguable" at the interlocutory stage) that the only realistic inference is that:

- the beneficiary could not honestly have believed in the validity of its demands under the L/C; and
- the bank was aware of the fraud.

The Privy Council emphasised the distinction between CEB's allegations of breach of contract by APS, which were matters for arbitration between those parties, and the bank's liability under the L/C, which did not require it to delve into the terms of the underlying contract.

THE ILLEGALITY EXCEPTION

English courts are also willing to recognise illegality as a further exception to the autonomy principle. The exception was first considered in *Group Josi Re* where it was argued that reinsurance contracts, in relation to which documentary credits were opened, were illegal. The Court of Appeal held the contracts were enforceable. However, it also held that if they had been found to be illegal, the L/Cs would have been rendered illegal, or at least unenforceable, either directly or because they were tainted by illegality.

In *Mahonia* it was argued that transactions had been entered into to enable a party to prepare its accounts in breach of US securities law. While the transactions were enforceable, the High Court held that if an unlawful purpose had been established, to which both parties to the transactions were privy, the L/C issued in respect of the transactions would have been tied to that unlawful purpose and therefore unenforceable.

CONCLUSION

These cases confirm, as the High Court in *Mahonia* put it, the "impregnable financial integrity of a letter of credit as the life-blood of international commerce". Banks must meet their obligations under L/Cs in the absence of fraud or illegality and the scope of the exceptions to a bank's obligation to make payment remains tightly circumscribed. ■

Biog box

Jamie Curle (partner), Linos Choo (partner), James Carter (legal director) and Sophie Payton (associate) are members of DLA Piper's Litigation & Regulatory team in London which specialises in the banking and financial services sector.

Email: jamie.curle@dlapiper.com; linos.choo@dlapiper.com; james.carter@dlapiper.com; sophie.payton@dlapiper.com

FSLA
financial services lawyers association

The Financial Services Lawyers Association provides a forum for the open exchange of views and the dissemination of knowledge and ideas in financial services law and regulation. Members include solicitors, barristers, academics, judges, students and non-lawyers working in the industry. FSLA hosts a variety of events throughout the year. To find out more about individual and corporate membership go to www.fsla.org.uk.

FSLA Update

Authors **Tim Aron** and **Tim Frazer** of **Arnold and Porter (UK) LLP**[1]

The FCA's competition power

The Financial Services Act 2012 gives the Financial Conduct Authority (FCA) a statutory objective and duty to promote effective competition in the interest of consumers in the market for regulated financial services or services carried out by regulated investment exchanges. The FCA has also been given competition law powers as contained in Part 1 of the Competition Act 1998 and Part 4 of the Enterprise Act 2002. This collection of powers will be implemented in April 2015 to allow the FCA time to build the necessary competition skills and expertise.

The Financial Services and Markets Act 2000 (FSMA 2000) gives the FCA a single strategic objective, which is supported by three operational objectives to ensure that the financial services markets work well. To that end, these operational objectives consist of securing an appropriate degree of protection for consumers (consumer protection), protecting and enhancing the integrity of the UK financial system (market integrity) and promoting effective competition in the interests of consumers.

Matters to which the FCA may have regard in considering the effectiveness of competition in a particular market include:

- the needs of different consumers who may use those services, including their need for information that enables them to make informed choices;
- the ease with which consumers can access those services, including consumers in areas affected by social or economic deprivation;
- the ease with which consumers who obtain those services can switch supplier;
- the ease with which new entrants can enter the market; and
- how far competition is encouraging innovation.

In addition to its strategic and operational objectives, the FCA has a further responsibility known as the competition duty. This duty requires the FCA to promote effective competition in the interests of consumers when carrying out its general function, to the extent that doing so is compatible with acting in a way which advances the FCA's consumer protection or integrity objectives.

THE FCA'S CURRENT COMPETITION POWERS

Under the existing legislation, the FCA does not have the same explicit competition powers as other sectoral regulators such as Ofcom, Ofgem or Ofwat. Although it has competition and consumer protection duties, the FCA is not classed by HM Government as an economic regulator. Currently the FCA does not have the power to investigate breaches of the competition law prohibitions under the Competition Act 1998 or make market investigation references under the Enterprise Act 2002 to the Competition and Markets Authority (CMA) for detailed review. However, the FCA has the power to request the CMA to consider a financial services market and whether this has features which prevent, restrict or distort competition in connection with the supply or acquisition of any financial services market in the UK. The CMA must publish a reasoned response to such a request within 90 days, specifying whether it has decided to take any action, and if so what action.

In order to pursue its competition mandate, the FCA can take regulatory action against the firms it regulates. For example, the FCA could vary the permission that a firm operates under or impose requirements on how the firm operates, for example through requesting a firm to maintain prudential limits on large exposures. The FCA can also conduct market studies, which can potentially result in a reference to the CMA, or in the FCA taking regulatory action under its general remedial powers.

MARKET STUDIES

The FCA considers market studies to be its main tool for examining competition issues in the markets. The processes and principles are broadly similar to the CMA's approach of market studies. How long each market study will take will depend on many factors such as the scale and complexity of the market but generally the FCA expects to complete a market study between six months and a year after launch. Since its inception in April 2013, the FCA has launched market studies into products such as cash savings, general insurance add-ons and retirement income. The FCA also considers competition issues through its thematic reviews to assess a current or emerging risk relating to an issue or product across a number of firms within a sector or market. The FCA's most recent thematic review on mobile banking and payments, was published in September 2014.

In July 2014, the FCA launched its fourth investigation into the wholesale banking sector. The investigation focused primarily on competition in wholesale securities and investment markets and related activities such as corporate banking. But the wholesale sector covers services between banks and financial institutions, some of which are not actually regulated by the FCA. The study therefore includes elements outside the FCA's current scope of regulation and shows the FCA's increasing involvement in competition issues.

MOU

In April 2014 the CMA replaced the Office of Fair Trading and the Competition Commission. The CMA and FCA have different but complementary powers in relation to competition issues. On 12 June 2014, the FCA and the CMA agreed a new Memorandum of Understanding (MoU) to set out a framework for co-operation and working arrangements between the two regulators in relation to competition issues, consumer protection, access to payment systems and the sharing of information for the performance of their functions. This MoU replaces an earlier one of April 2013 between the FCA and CMA's predecessor, the OFT.

The MoU is technically non-binding, it aims to draw together the two organisations' *"mutual understanding and co-operation"* in their complementary role but it is also positioned as a statement of intent entered into less than a year before the FCA gains concurrent competition enforcement powers in relation to financial sector activities. The MoU also contains more general provisions such as the sharing of information and the interchange of staff between the two authorities to facilitate the development of personnel with expertise in both competition and financial regulation. This MoU and the effectiveness of its practices are to be reviewed from time to time by the CMA and the FCA as required or at the request of the CMA, the FCA, or other members of the UK Competition Network.[2]

FROM APRIL 2015

With effect from April 2015, the Financial Services (Banking Reform) Act 2013 will amend FSMA 2000 to give the FCA powers to enforce the European and UK competition prohibition of agreements restricting or distorting competition and the abuse of a dominant position. These powers will be exercisable concurrently by the EU Commission and the CMA. The FCA's power to enforce the competition prohibitions under Part 1 of the Competition Act, will cover the provision of financial services generally, and so will extend beyond the existing regulatory perimeter, for example, to the foreign exchange markets.

As with other sectoral regulators, the FCA will be required to consider whether it would be more appropriate to proceed under the Competition Act in a given case before using certain sector specific regulatory powers.[3] The FCA will also have the responsibility of keeping under review those markets in which it may exercise concurrent competition law functions.

The CMA and the FCA will have to consult each other before either exercises its concurrent functions and neither can exercise any concurrent function if it has already been exercised by the other. The CMA will also retain a leadership and co-ordination role with the power to decide which body is in the best place to deal with a case or in specific circumstances to take over a case from a regulator, even if that regulator is already investigating the case. The Secretary of State has discretionary power to remove the concurrent competition functions from a regulator.

CONCLUSION

The concurrent powers the FCA will exercise in 2015, along with the CMA and other sectoral regulators will change the UK competition map and the balance of powers amongst competition regulators. However, the extent to which the FCA's close ongoing supervisory relationship with regulated firms will be altered by the new competition powers remains to be seen. An issue that is likely to be closely observed over the coming months is the interaction between Principle 11 and the CMA's leniency regime.[4] Firms may, for example, be obligated to disclose information to the FCA under

"The CMA and the FCA will have to consult each other before either exercises its concurrent functions..."

Principle 11 which can then be shared with the CMA or more widely. This will not bring the firm that discloses under Principle 11 leniency but should it prevent leniency being granted to another cartel member who subsequently blows the whistle and seeks leniency from the CMA? Similarly, will information that is passed by a whistleblower to the CMA in exchange for leniency expose the whistleblower to regulatory action in the event that the CMA shares the information with the FCA or more widely? New regimes such as this inevitably give rise to new questions and challenges. ■

1 The authors would like to thank Luc Gyselen, a partner at Arnold and Porter LLP in Brussels, for his comments.

2 The Civil Aviation Authority, Ofcom, Ofgem, Ofwat, Office of Rail Regulation and the Utility Regulator for Northern Ireland.

3 The statutory primacy obligation does not apply to the exercise of all FSMA 2000 powers but as a matter of public law the FCA is likely to need to give consideration to which powers are more appropriate in any event.

4 Principle 11 provides that a firm must deal with its regulators in an open and co-operative way, and must disclose to the appropriate regulator appropriately anything relating to the firm of which that regulator would reasonably expect notice.

Biog box

Tim Aron and Tim Frazer are partners at Arnold and Porter (UK) LLP in London. Email: tim.aron@aporter.com; tim.frazer@aporter.com

Book Review

Mark Walsh and **David Howe** of Sidley Austin LLP review a recent financial title

Title: ***Disclosure and Due Diligence in the International Capital Markets***
Author: Roger Wedderburn-Day, Allen & Overy
ISBN: 978 1 84661 959 5
Price: Paperback (£100); eBook (£90); also available online
Publisher: Jordan Publishing (2014)

Although of much wider appeal, Roger Wedderburn-Day's recently published *Disclosure and Due Diligence in the International Capital Markets* is essential reading for junior capital markets practitioners (particularly lawyers) working in the Euromarkets. It will also be of considerable interest to more senior practitioners, including US lawyers working on transactions where there is a need to reconcile overlapping US, EU-wide and member-state specific requirements.

It is unusual to see an English lawyer take on the topic of disclosure and due diligence in quite this way. Although the Prospectus Directive and Prospectus Directive Regulation have been with us now for many years, the guidance they and the European Securities and Markets Authority (ESMA) provide about disclosure is still limited relative to the more extensive guidance and requirements available to US securities lawyers through the rules under the Securities Act of 1933, the various forms under the Securities Exchange Act of 1934, and related Securities and Exhange Commission (SEC) guidance and commentary. In addition to which, as Roger notes, although there has been a very long history of US lawyers working with and preparing issuer disclosure, there has been less time for a post-Prospectus Directive disclosure "culture" to develop in Europe. Indeed, as he also notes, the tradition in Europe for a long time was for issuer disclosure to be more within the remit of the bankers working on the transaction in question. So, as we work towards a more Europe-centred disclosure consensus, it was high time for a book that presents the issues from a primarily UK and European perspective.

Roger's background and experience make him an ideal candidate for such a book. Without exactly saying so, it reflects many years of experience, with the suggestion of late nights, dimly-lit windowless conference rooms, possibly poor take-away food, exotic locations, tight deadlines and other challenges in the company of first time issuers in the capital markets, perhaps with what might for him have been, in the early days at least, the added frustration of US lawyers "imposing" their MD&A (Management's Discussion and Analysis of Financial Condition and Results of Operations), Guide 3 and other US-specific requirements on a predominantly non-US securities offering. It would have been a good vantage point from which to assess the advantages and disadvantages of the US approach and to form a view as to how best to apply that longer tradition of disclosure and due diligence in a European context. On balance, it seems Roger has found much of potential use in US custom and practice. He refers favourably and with some frequency to US law, custom and practice as described in Johnson and McLaughlin's *Corporate Finance and the Securities Laws*.

Understanding and reflecting the requirements of the statutory disclosure regime under the Prospectus Directive and the various related implementing regulations can often prove to be a challenge, even for the most seasoned of practitioners. A combination of inadequate drafting and various fundamental flaws in approach that fail to reflect the way in which the international capital markets actually operate often make the legislation difficult to navigate. This is, perhaps, not unsurprising given the way EU legislation is originated, drafted and approved, with the result frequently being an uneasy and flawed collection of often competing compromise positions. Roger usefully flags some of the more unhelpful discrepancies and challenges, including the illogical distinctions in the disclosure regimes for high denomination and low denomination securities, the unnecessarily complicated and proscriptive summary regime under Art 24 and Annex XXII and the difficulties in applying the requirements relating to supplemental prospectuses under Art 16. We concur with many of Roger's observations. His succinct and focused commentary on these points will no doubt provide a modicum of comfort to those who find themselves, head in hands, puzzling over how to satisfy the particular requirements of an Annex which self-evidently does not apply to the relevant issuer in question.

One significant difference between the US and European approaches relates to disclosure concerning the securities being

offered. Although the SEC has provided some guidance as to what information may be "material" to an offering (and has included the nature of the security in a list of related considerations), the US Securities Act and related SEC rules do not generally distinguish in detail between debt and equity when it comes to the amount of issuer and guarantor disclosure to be included in a prospectus or other offering document. Conversely, the Prospectus Directive and Prospectus Directive Regulation clearly distinguish between debt and equity securities and between retail and wholesale offerings of debt. These distinctions determine the years to be covered by the audited financial statements, whether or not an OFR (Operating and Financial Review) or other financial review needs to be included, and perhaps the nature of the risks that need to be emphasised. In the case of a US offering, the requirements are broadly the same for both debt and equity.

Subject to this overriding difference, there is much in the approach Roger suggests which will be familiar to an experienced US securities lawyer: the range of materials to be requested of the issuer and examined, the need for prudence when dealing with the "message" an issuer wishes to convey and the need for plain English and concise, well thought through and consistent drafting. Indeed, there is very little in what Roger says that one could disagree with. The drafting of an OFR, MD&A or other financial review might be a less familiar process for some English lawyers, requiring a real understanding of the issuer's financial statements and a need to "flesh out" the related analysis in consultation with the issuer and auditors. This lack of familiarity for English qualified practitioners is likely exacerbated by the tendency of predominantly English law firms to separate their equity and debt capital markets lawyers into different practice groups, with equity deals being handled by corporate teams and debt deals being handled by capital markets or finance teams. US lawyers, on the other hand, are typically expected to work on both equity and debt deals and are nowadays less typically expected to also, and at the same time, be M&A or other non-capital markets practitioners.

One slight difference of emphasis might perhaps be the best approach to the first draft of the prospectus. Roger (correctly in our view) laments the still widespread practice of lawyers circulating inadequate and incomplete first drafts in the supposed interests of time and "getting something out". Our own view is that a real effort should be made up-front to ensure the first draft is highly developed, including, in the case of a deal which requires one, a "decent" financial review. It is sometimes a matter of surprise and interest that poor first drafts often appear to pass unnoticed by clients. Related to this, our view is that the first draft should have benefitted from significant partner input before it is distributed to the working group. Although associates are very often extremely capable, there are few occasions when their efforts cannot benefit from the review and input of the supervising partner with a view to saving everyone time and effort later on. Roger correctly identifies the need for decent up-front work product, but places less emphasis in his text on the need for active partner involvement at this early stage. Having said that, whether or not expressly stated, he may very well share our view of its importance.

Another point not made specifically by Roger, but which we feel is worth making within the context of a discussion of the conduct of any due diligence process relates to the nature of the role to be performed by lawyers working on the transactions in question. As our late partner Charles J Johnson, Jr noted in his preface to the first edition of *Corporate Finance and the Securities Laws*, "[m]ost financial transactions should be viewed as cooperative endeavours, not adversary proceedings... Counsel for the underwriters in a public offering should always remember that the issuer is his client's client and that the managing underwriter has worked hard to secure this relationship. The issuer's officers and lawyers should be treated accordingly." In our experience, lawyers who come from an M&A or other more confrontational legal background (but also, on occasion, full-time securities lawyers who should know better) sometimes overlook this important point. In the ideal scenario, both issuer's and underwriters' counsel are working together constructively in the pursuit of their respective clients' common goal, which is a smooth and successful transaction. There are certainly points where the interests of the issuer and the underwriters differ, but they are relatively few and can generally be handled without the need for acrimony. Whatever else, the issuer and underwriters most certainly share a common interest in preparing a prospectus that satisfies applicable disclosure requirements and which, through the conduct of up-front work by the issuer and due diligence by the underwriters, is materially accurate and complete.

Disclosure and Due Diligence in the International Capital Markets is a timely, well considered and thoughtful book which covers a wide range of technical and practical issues surrounding the due diligence process and the preparation of disclosure for capital markets transactions, highlighting the key statutory and common law provisions of relevance to practitioners and providing helpful practical examples and discussions of the relevant case law (both US and English) and current approaches of the relevant regulators. In doing so, it also very deftly negotiates the sometimes rocky path between detail and readability. We highly recommend Roger Wedderburn-Day's new book, which we enjoyed reading and discussing. ■

Biog box

Mark Walsh is a New York and English law capital markets partner at Sidley Austin LLP in London. He works primarily on transactions with a US distribution or other element, including Rule 144A, Reg S and SEC-registered offerings. Email: mwalsh@sidley.com

David Howe is an English law capital markets partner at Sidley Austin LLP in London. Whether acting for the issuer, arranger or trustee, he works primarily on transactions for US, Asia-Pacific and European issuers in the Euromarkets. Email: dhowe@sidley.com

ONE ESSEX COURT

One Essex Court is a leading set of barristers' chambers, specialising in commercial litigation. Its members provide specialist advice and advocacy services worldwide, which include all areas of dispute resolution, litigation and arbitration Work embraces all aspects of domestic and international trade, commerce and finance.

Cases Analysis

Sam O'Leary and **Michael Watkins** of One Essex Court report on the latest banking law cases

SUBROGATION AND SET-OFF: AN UNLIQUIDATED CLAIM AGAINST AN INSOLVENT CREDITOR

Day v Tiuta International Ltd

[2014] EWCA Civ 1246

Court of Appeal of England and Wales

SUMMARY

A mortgagee may enforce its security notwithstanding any unliquidated claim which the mortgagor may assert; such a claim may not be used to effectively repay the mortgage debt. In this case, the appointment of receivers was valid either under the creditor's charge or through subrogated rights to the charge of the previous creditor. The doctrine of subrogation did not require that appointment to have been made pursuant to the subrogated security.

FACTS

Mr Day, a businessman and developer, wished to redevelop a property he owned in Surrey. He entered into a loan facility agreement with Tiuta International Ltd (TIL) pursuant to which TIL agreed to lend Mr Day £12.6m of which £6.6m would be used to repay his existing borrowings and the remaining £6m was to be lent in tranches against architects' certificates. Mr Day alleged that TIL had persistently failed to make payments on time which he said had affected the progress of the development.

On 5 July 2012, TIL was placed into administration and no further advances were made by TIL. Mr Day alleged that this had left the property in a half-built state, exposed to the elements and incapable of completion. Pursuant to the loan facility agreement, the loan was repayable on 9 November 2012. However, Mr Day failed to repay the loan. TIL appointed receivers over Mr Day's property who took possession, only for Mr Day to retake possession. Mr Day brought proceedings against TIL and the receivers, asserting an unliquidated claim for damages and contending (*inter alia*) that he could set this claim off against the TIL Loan to release the Property from the TIL Charge and thereby invalidate the appointment of the Receivers. TIL counterclaimed, suing for the balance of the loan (over £10m) and declarations in support of the appointment and activities of the receivers.

TIL applied under CPR 3.4(2)(a) to strike out those paragraphs in the Particulars of Claim which raised the set-off argument. TIL also sought summary judgment in respect of the declaratory relief sought.

Mr Day also claimed to be entitled to rescind the loan agreement on the basis that he had been induced to enter into it on the basis of fraudulent misrepresentations made by TIL relating to the state of its financial affairs. TIL responded that even if the loan and TIL's charge (the "TIL Charge") were rescinded, it would be subrogated to the charge of the previous financier, Standard Chartered (the "SC Charge").

SALES J

At first instance, Sales J found for TIL. Sales J concluded:

(i) that binding Court of Appeal authority (including *Samuel Keller (Holdings) Ltd v Martins Bank Ltd* [1971] 1 WLR 43; *Barclays Bank plc v Tennet* (unreported, 6 June 1984) and *National Westminster Bank plc v Skelton* [1993] 1 All ER 242) rendered Mr Day's claim to equitable set-off incapable of defeating TIL's right to enforce the TIL Charge; and

(ii) even if Mr Day were entitled to rescind the TIL Charge, on the grounds of fraudulent misrepresentation, that nonetheless TIL was entitled to be treated as subrogated to the rights of Standard Chartered under the SC Charge, which would have entitled TIL to appoint the Receivers and to have the Receivers sell the Property and to apply the proceeds of sale in reduction of the monies outstanding under the TIL Loan Agreement,"at least to the extent of the lending from Standard Chartered which was discharged by use of TIL's money".

COURT OF APPEAL (MOSES, GLOSTER AND VOS LJJ)

Mr Day raised three main arguments on appeal:

(i) that relief could not be granted on the basis of subrogation unless and until it had been decided that the party seeking subrogation had not obtained the security for which it had bargained; but in the present case TIL strongly contended that the TIL Charge was valid; if that were correct, then TIL had obtained all the rights for which it had bargained and could not have any rights of subrogation pursuant to the SC Charge;

(ii) that since TIL had not taken the necessary steps to seek to appoint the Receivers pursuant to the terms of the SC Charge, the Receivers had no authority or power to sell the Property until they had been appointed by TIL pursuant to the terms of the SC Charge; that had never taken place;

(iii) that Mr Day had an arguable prospect of establishing at trial that TIL would not have been entitled to any rights of subrogation under the SC Charge, as any claim to exercise such rights

> would have been defeated by the application of equitable principles such as "he who seeks equity must do equity" or because "he who seeks equity must come with clean hands;" those principles would apply in circumstances such as the present, where the sum of £3m (approximately), which TIL had paid to Standard Chartered, had been paid pursuant to a facility agreement that had been procured by TIL's fraudulent misrepresentation, which had caused Mr Day losses greater than the sum of £3m; moreover Mr Day had set offs in respect of TIL's breaches of the TIL Loan Agreement which exceeded the sum paid and would reduce TIL's payment to zero, thereby disentitling it to any subrogation.

The Court of Appeal dismissed Mr Day's appeal.

SUBROGATION AS AN ALTERNATIVE TO RELIANCE ON THE TIL CHARGE

Mr Day's first ground of appeal was dismissed on the basis that a party is entitled to rely on an alternative case, which it maintains only in case it fails on its primary case (ie that the TIL Charge was valid). There was no basis to say that the primary case had to be resolved before the alternative case could be considered. The Court of Appeal also held that if the TIL Charge was voidable *ab initio* then subrogation would be available against an earlier charge; it was not necessary to show that the TIL Charge was void *ab initio* (*UCB Group Ltd v Hedworth* [2003] EWCA Civ 1717 followed).

RECEIVERS APPOINTED PURSUANT TO TIL CHARGE, NOT SC CHARGE

The Court of Appeal also rejected Mr Day's second ground of appeal, holding that a party purporting to exercise subrogated rights is not required to do so pursuant to the powers contained in the subrogated security. It would be sufficient for TIL to have appointed the Receivers by reference to the TIL Charge and then seek to justify such appointment by reference to the SC Charge or (more accurately) by reference to a new equitable charge created by reference to the equitable doctrine of subrogation (*Halifax plc v Omar* [2002] P&CR 26, 377 followed).

EQUITABLE MAXIMS

The Court of Appeal rejected the submission made on behalf of Mr Day that if TIL sought to rely upon its payment of £3m to Standard Chartered as entitling it to be subrogated to the SC Charge, without setting off, or giving credit for Mr Day's unliquidated damages claim (which, according to Mr Day, far exceeded £3m), TIL would not be "doing equity". Gloster LJ held (quoting Meagher, Gummow and Lehane) that the maxim "he who seeks equity must do equity" simply means that "any plaintiff who wishes to avail himself of an equitable remedy can only do so on terms that he fulfils his own legal and equitable obligations arising out of the subject matter of the dispute".

A further argument raised on Mr Day's behalf was that TIL would not be "doing equity" if it appointed receivers over Mr Day's property, applied the proceeds of sale against Mr Day's debt to TIL (at least insofar as TIL's money had been used to pay off Standard Chartered) and left Mr Day to claim against TIL as an unsecured creditor.

The Court of Appeal also rejected this argument. Gloster LJ concluded that the rights of a mortgagee in *Samuel Keller (Holdings) Ltd*, as approved by this court in the subsequent cases, would be wholly undermined if such rights were nonetheless subject to the possibility that a mortgagor could restrain the application by the mortgagee of the proceeds of sale of the mortgaged property in discharge of the secured debt. TIL's insolvency did not provide any basis for saying that TIL would not be "doing equity" by enforcing its charge over Mr Day's property.

Similarly, the Court of Appeal rejected the application of the maxim: "He who seeks equity must come with clean hands." The alleged dishonesty did not have an immediate and necessary connection to TIA's attempt to enforce its charge (or subrogated right). TIL's claim to subrogation arose from the fact that TIL paid £3m to Standard Chartered in discharge of the SC Charge.

COMMENT

The most interesting part of the judgment is Gloster LJ's discussion of Mr Day's second ground of appeal. Gloster LJ confirmed that a person who discharges a creditor's security interest and who is regarded as having acquired that interest by subrogation does not actually acquire the creditor's interest. Rather, he or she obtains a new and independent equitable security interest that replicates the creditor's interest.

The doctrine of subrogation recognises that the subrogated creditor's legal relations with a person who would otherwise be unjustly enriched are regulated as if the benefit of the charge had been assigned to him. This means that the claimant does not necessarily occupy exactly the same position as the discharged creditor in every respect. Whilst these new rights often mirror the characteristics and content of the rights previously held by the creditor (and cannot be greater than those rights) they need not resemble them in every respect. ■

Sam O'Leary

VOID DERIVATIVES AND ISDA MASTER AGREEMENT 2002

Credit Suisse International v Stichting Vestia Group

[2014] EWHC 3103 (Comm) (Andrew Smith J)

SUMMARY

The doctrine of contractual estoppel can apply to warranties relating to a future state of affairs, and can result in a derivative being enforced against an entity notwithstanding that the derivative itself is void for lack of capacity.

FACTS

The claimant ("Credit Suisse") purported to enter into a number

Cases *Analysis*

of derivative transactions with a Dutch social housing association ("Vestia") pursuant to an ISDA Master Agreement (2002) (the "Master Agreement") dated as of 9 November 2010, which included a Credit Support Annex (the "CSA"). Subsequently, on 19 June 2012, Credit Suisse contended that they had validly terminated the Master Agreement by reason of Vestia's failure to provide security due under the CSA. Credit Suisse therefore claimed an Early Termination Amount (as defined) from Vestia, in the amount of €83,196,829.

Vestia's principal defence to the claim was to contend that the transactions were never binding on it because Vestia did not have capacity to make them (the "Capacity Defence"). Vestia also contended that its employees had no authority to enter into the transactions (the "Authority Defence"), and that the termination notice was invalid in any event, such that Vestia was never in default under the Master Agreement (the "Notice Defence").

In the event that Vestia's Capacity and/or Authority Defences were to succeed, Credit Suisse claimed damages for breach of alleged warranties in the Master Agreement and a "Management Certificate" as to Vestia's capacity and/or authority to enter into future transactions, and also claimed damages at common law for alleged misrepresentations.

THE CAPACITY DEFENCE

Andrew Smith J first considered whether the various transactions entered into pursuant to the Master Agreement were not binding on Vestia by reason of a lack of capacity. In light of the Court of Appeal's decision in *Haugesund Kommune v Depfa ACS Bank* [2010] EWCA Civ 579, it was common ground (at first instance at least) that the question whether Vestia had capacity to enter into the derivatives was governed by Dutch law, being the law of the place of incorporation. It was also common ground that the legal consequences of a lack of capacity were governed by English law, being the law of the putative transaction (ie the derivatives).

Andrew Smith J held that Credit Suisse bore the burden of proving that Vestia had capacity to enter into the derivatives (para 186), and that they had failed to discharge this burden in relation to six out of the nine disputed transactions. His reasoning can be summarised as follows:

(i) As a matter of Dutch law, Vestia was a housing association, not a company. Accordingly, it could only enter into transactions that were within its objects. Vestia's principal object was to operate "*exclusively in the field of social housing*", but Dutch law recognised a doctrine of "*secondary acts*" which enabled Vestia to enter into financial transactions provided they were regarded as contributing to Vestia's principal object. In the context of a derivative, Andrew Smith J held that this meant Vestia only had capacity to enter into a derivative if it was properly to be regarded as a "*hedging instrument*" (paras 219 and 220).

(ii) Andrew Smith J therefore considered what constituted "*hedging*" in some depth (paras 217 to 227). He held that: (a) "*hedging*" covered instruments that reduce or eliminate exposure to risks from existing or anticipated borrowing liabilities; (b) it could potentially extend to instruments that reduce or eliminate the risk of illiquidity; (c) in assessing whether an instrument had this effect, it was important to assess the overall risks of the entity's portfolio as a whole; (d) "*hedging*" involved the acquisition of a hedging instrument, and the cancellation or alteration of such an instrument; (e) the characterisation of the instrument should not be approached in isolation from the entity's other investments; (f) the transaction was to be characterised objectively; and (g) the correct legal characterisation of a transaction did not depend on how an accountant would characterise it for the purposes of the entity's accounts.

(iii) Applied to the facts, Andrew Smith J grouped the derivatives into distinct contracts depending on when they were entered into. The first two transactions, entered into at the same time, involved a plain vanilla payer swap and a swaption, which Andrew Smith J held to be hedging instruments, as defined. He reached the same conclusion in respect of the third contract, which involved cancelling a plain vanilla swap. However, the remaining contracts did not effectively hedge Vestia against risks arising from its principal business, and were regarded as outside Vestia's objects.

(iv) Vestia contended that the legal effect of a lack of capacity was straightforward: as a matter of English law, a contract is void if one of the parties lacked capacity to enter into it (*Haugesund*, para 60). Credit Suisse sought to overcome this point by arguing that the common law should be developed by analogy with ss 39 and 40 of the Companies Act 2006 to reflect the protections granted to those contracting with companies. Andrew Smith J rejected this argument, seeing no proper reason to depart from the common law rule (para 259). It followed that six out of the nine derivative transactions were held to be void.

THE AUTHORITY DEFENCE

This issue only arose if Vestia had no capacity to enter into the transactions but, for some reason, they could nonetheless be bound by a contract that they had no capacity to make (para 275). Accordingly, it did not strictly arise. However, Andrew Smith J considered the point and held that the contracts would also be void for want of authority because Vestia's agents did not have actual or apparent authority to enter into contracts that were outside Vestia's objects.

MASTER AGREEMENT AND MANAGEMENT CERTIFICATE

It was common ground that the Master Agreement itself was not outside Vestia's capacity, and, as such, Vestia was bound by its obligations contained therein. In this regard, the Master Agreement, together with a Management Certificate and the Schedule to the Master Agreement contained a number of representations and warranties about Vestia's capacity and the authority of its agents.

Section 3 of the Master Agreement provided as follows:

➨ "Each party makes the representations contained in [*inter alia* ss 3(a), 3(d) and 3(f)] (which representations will be deemed to be repeated by each party on each date when a Transaction is entered into and, in the case of the representations in s 3(f), at all times until the termination of this Agreement). If any "Additional

Representation" is specified in the Schedule or any Confirmation as applying, the party or parties specified for such Additional Representation will make, and if applicable, be deemed to repeat such Additional Representation at the time or times specified for such Additional Representation."

Section 3(a) of the Master Agreement provided:

"(ii) Powers. It has the power to execute this Agreement and any other documentation relating to this Agreement to which it is a party, to deliver this Agreement and any other documentation relating to this Agreement that it is required by this Agreement to deliver and to perform its obligations under this Agreement… and has taken all necessary action to authorise such execution, delivery and performance.

(iii) No Violation or Conflict. Such execution, delivery and performance does not violate or conflict with any law applicable to it, any provision of its constitutional documents, any order or judgment of any court or other agency of government applicable to it or any of its assets or any contractual restriction binding on or affecting it or any of its assets.

(iv) Consents. All governmental and other consents that are required to have been obtained by it with respect to this Agreement… have been obtained and are in full force and effect and all conditions of any such consents have been complied with. And

(v) Obligations Binding. Its obligations under this Agreement… constitute its legal, valid and binding obligations, enforceable in accordance with their respective terms."

Section 3(d) provided that any further information furnished in writing in a Schedule was "*true, accurate and complete in every material respect*". The Schedule included a Management Certificate, certifying, *inter alia*, that Vestia "*has all requisite power and authority to enter into and perform any [derivative transaction]*" and that entering into any derivative transaction would not result in a violation of "*Vestia's articles of association*" or "*any applicable law*".

The Schedule also provided for "Additional Representations" as follows:

"[Vestia] hereby represents and warrants to [Credit Suisse] (which representations will be deemed to be repeated by [Vestia] on each date on which a Transaction (*sic*) is entered into that:

(i) [Vestia's] entry into and performance of its obligations under this Agreement and each Transaction hereunder is and will be in compliance with its articles of association (statute), its financial rules (*financieel statuut*) and any other laws or regulations applicable to [Vestia] from time to time including, but not limited to, the [BBSH] (as the same may be amended supplemented or replaced); and

(ii) [Vestia] is entering into each Transaction purely for the purpose of hedging its exposures and not for the purpose of speculation."

It was common ground that Credit Suisse could not rely upon any representations that were deemed to have been repeated when each of the void transactions was entered into. As Hobhouse J put it in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1994] 4 All ER 890 at 905b: "*the contract… includes the standard warranty of capacity…; it is recognised by the plaintiffs in this action that it was ultra vires the council to give this warranty just as it was ultra vires the council to enter into the contract as a whole.*" However, Credit Suisse contended that the provisions in ss 3(a) and 3(d) of the Master Agreement were to be construed as warranties that any future transactions would be within Vestia's capacity.

Andrew Smith J rejected this argument insofar as it related to ss 3(a), 3(d) and the Management Certificate. In his judgment, these contained statements of fact and were not warranties as to the future. However, Andrew Smith J held that the Additional Representations were warranties as to the future: "*[t]hey unambiguously refer to Vestia warranting to Credit Suisse the matters therein stated, and to my mind the parties clearly intended them to take effect as contractual undertakings as well as representations*". On this basis, Vestia was in breach of the Additional Representations in the Master Agreement and it became necessary to decide what remedy Credit Suisse was entitled to. Credit Suisse argued that this breach gave rise to a contractual estoppel which entitled Credit Suisse to enforce the transactions as though they were valid; alternatively that Vestia was liable for damages in the same amount for breach of warranty.

Andrew Smith J accepted Credit Suisse's estoppel argument, holding: (a) that the basis for a contractual estoppel lay in the doctrine that the courts will not permit a defendant to rely upon its own wrong; (b) that it was capable of applying to contractual warranties as to the future, not just statements of existing fact; and (c) that its application was not precluded by the doctrine that an entity cannot expand its capacity by estoppel (paras 301 to 321). If he had been wrong about this, Andrew Smith J would have upheld the alternative claim for breach of warranty (para 322). On either basis, Vestia was liable to Credit Suisse in an amount equal to the sums that would have been due, had the transactions been valid.

THE NOTICE DEFENCE

Vestia's final line of defence was to deny that Credit Suisse had validly terminated the Master Agreement. This argument turned on the default provisions in the Master Agreement. In particular, Vestia contended that although they had been obliged to provide additional collateral, the market had moved such that by the time Credit Suisse purported to terminate, they were no longer obliged to do so. This, it was said, meant that there was no Event of Default "*continuing*" as at the date of the purported termination.

Andrew Smith J rejected this argument. In his view, there was a default when Vestia became obliged to provide collateral and failed to do so. That default was continuing when Credit Suisse purported to terminate because they had still not provided collateral. It would be commercially undesirable for a collateral call to lose its force simply because of a subsequent market movement. ■

Michael Watkins

NORTON ROSE FULBRIGHT

If you wish to contact Norton Rose Fulbright with regard to any item on this update please contact Simon Lovegrove on +44 20 7444 3110 or email Simon.Lovegrove@nortonrosefulbright.com

Regulation Update

A round-up of regulatory changes by **Norton Rose Fulbright**

CONSULTATION ON UK FICC MARKETS	On 27 October 2014, as part of the Fair and Effective Markets Review (FEMR) the Bank of England (BoE) published a consultation document seeking views on the fairness and effectiveness of the fixed income, currency and commodities markets. The deadline for responding to the consultation document is 30 January 2015. The FEMR will publish its independent recommendations in June 2015.
NEW FATF GUIDANCE	The Financial Action Task Force (FATF) Recommendations 24 and 25 cover transparency and beneficial ownership of legal persons and arrangements. Previously the FATF has noted that the implementation of these particular Recommendations has proved to be challenging. On 27 October 2014, the FATF published a guidance paper to assist countries in their implementation of these Recommendations (and also Recommendation 1 as it relates to understanding the money laundering/financing of terrorism risks of legal persons and legal arrangements). Also on the same day, the FATF published an updated version of its guidance concerning a risk-based approach for the banking sector. The guidance has three sections. Section 1 covers the key elements of the risk-based approach and needs to be read in conjunction with ss 2 and 3, which provide specific guidance on the effective implementation of a risk-based approach to banking supervisors and banks. The FATF will develop a separate paper on the risk-based approach for the securities sector.
ESMA UPDATES EMIR Q&A	On 24 October 2014, the European Securities and Markets Authority (ESMA) published an updated version of its questions and answers paper (the Q&A) on the implementation of the European Markets Infrastructure Regulation (EMIR). The updated Q&A contained further guidance concerning trade reporting to trade repositories.
BOE SETS OUT HOW IT WILL RESOLVE FAILED INSTITUTIONS	On 23 October 2014, the BoE published an approach document which described the framework that is available to it to resolve failing banks, building societies and certain types of investment firm. The first part of the approach document outlined the aims of resolution and described the key features of the UK's resolution regime. The second part set out how the BoE expects to carry out the resolution of a failing firm in practice, using the powers available to it as the UK resolution authority.
LIST OF IDENTIFIED FINANCIAL CONGLOMERATES	On 23 October 2014, the Joint Committee of the European Supervisory Authorities published its 2014 list of identified financial conglomerates.
EBA CONSULTS ON IMPLEMENTATION OF GUIDELINES ON INTERNET PAYMENTS SECURITY	On 31 January 2013, the European Central Bank (ECB) published final recommendations for the security of internet payments. The publication followed a two-month public consultation and represented the first output of SecuRe Pay. SecuRe Pay is a voluntary co-operative initiative between relevant authorities from the EEA, including national supervisors of payment service providers and overseers. Its objective is to facilitate common knowledge and understanding of issues related to the security of electronic retail payment services and instruments. During a review this year SecuRe Pay concluded that the implementation of the ECB's final recommendations would benefit from a more solid legal basis to ensure consistent implementation by financial institutions across the EU. SecuRe Pay brought this to the attention of the European Banking Authority (EBA) which agreed to develop guidelines based on the recommendations. On 20 October 2014, the EBA published a consultation paper containing draft guidelines.The deadline for comments on the consultation paper is 14 November 2014.

FSB CONSULTS ON GUIDANCE ON COOPERATION AND INFORMATION SHARING WITH NON-CMG HOST AUTHORITIES	The Financial Stability Board's (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions (the FSB Key Attributes) require home and key host authorities of FSB-designated global systemically important financial institutions (G-SIFIs) to maintain crisis management groups (CMGs) to prepare for and manage a cross border financial crisis affecting the firm. They also require co-operation and information sharing between CMGs and jurisdictions where the G-SIFI has a systemic presence locally but does not participate in the CMG. On 17 October 2014, the FSB published draft guidance on cooperation and information sharing with host authorities of jurisdictions not represented on CMGs where a G-SIFI has a systemic presence. The deadline for comments on the consultation was 1 December 2014.
FSB PUBLISHES GUIDANCE ON THE RESOLUTION OF NON-BANK FINANCIAL INSTITUTIONS	On 15 October 2014, the FSB adopted additional guidance that elaborated on specific FSB Key Attributes relating to information sharing for resolution purposes. The FSB also published sector-specific guidance that set out how the FSB Key Attributes should be applied for insurers, financial market infrastructures and the protection of client assets in resolution. The newly adopted guidance documents have been incorporated as annexes into the 2014 version of the FSB Key Attributes. No changes have been made to the text of the original FSB Key Attributes. These remain the umbrella standard for resolution regimes covering financial institutions of all types that could be systemic in failure.
EBA DISCLOSES PROBE INTO EU BANKERS' ALLOWANCES	On 15 October 2014, the EBA published a report on the application of the CRD IV Directive and the use of allowances. In the report the EBA stated that it is of the view that role-based allowances which are discretionary, not predetermined, not transparent to staff or not permanent should not be considered as fixed but should be classified as variable remuneration, in line with the letter and purpose of the CRD IV Directive. The EBA also stated that following the publication of the report, institutions which use such discretionary role-based allowances will be expected to treat them as variable remuneration and change their remuneration policies so that they comply with the requirements for variable remuneration in Art 94 CRD IV Directive.
EBA CONSULTS ON SIMPLE, STANDARD AND TRANSPARENT SECURITISATIONS AND THEIR POTENTIAL REGULATORY RECOGNITION	On 14 October 2014, the EBA published a discussion paper on simple, standard and transparent securitisations. Whilst the EBA continues its work to determine the conditions to identify simple, standard and transparent products within the securitisation market, the discussion paper contained preliminary views on defining the three pillars: simplicity, standardisation and transparency. The EBA expects that these, together with criteria on the credit quality of the securitised assets, should shape a new class of securitisation products that are prudentially sound and may become subject to specific regulatory recognition. The deadline for comments on the discussion paper is 14 January 2014.
CPMI AND IOSCO ISSUE REPORT ON THE RECOVERY OF FINANCIAL MARKET INFRASTRUCTURES	On 15 October 2014, the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions (CPMI-IOSCO) published a report entitled Recovery of financial market infrastructures. The purpose of the report is to provide guidance for FMIs and authorities on the development of recovery plans. The report is not intended to create additional standards beyond those set out in the CPSS-IOSCO Principles for financial market infrastructures (the PFMI) but rather are designed to provide supplemental guidance on, and a menu of tools for, observance of the PFMI.
PRA CONSULTS ON RING-FENCING	On 6 October 2014, the PRA published Consultation Paper 19/14: The implementation of ring-fencing: consultation on legal structure, governance and the continuity of services and facilities (CP19/14). In CP19/14 the PRA set out its proposed ring-fencing policy in three areas: - legal structures of groups containing a ring-fenced body (RFB); - the governance of groups containing a RFB; and - continuity of services and facilities. These proposals for RFBs complement a broader set of proposals set out in Discussion Paper 1/14: Ensuring operational continuity in resolution. The PRA intends to undertake a further consultation on other aspects of ring-fencing in due course. The deadline for comments on CP19/14 is 6 January 2015.

Regulation Update

FSB PUBLISHES REGULATORY FRAMEWORK FOR HAIRCUTS ON NON-CENTRALLY CLEARED SECURITIES FINANCING TRANSACTIONS

On 14 October 2014, the FSB published a Regulatory framework for haircuts on non-centrally cleared securities financing transactions (the Framework).

The Framework is an important part of the FSB's policy recommendations to address shadow banking risks in relation to securities financing transactions. The Framework is intended to limit the build-up of excessive leverage outside the banking system, and to help reduce procyclicality of that leverage. The Framework comprises of two complementary elements:

- qualitative standards to be incorporated into existing or new regulatory standards for methodologies used by market participants that provide securities financing to calculate haircuts on the collateral received (including additional guidance for methodologies used by market participants to calculate margins on a portfolio basis); and
- a framework of numerical haircut floors that will apply to non-centrally cleared securities financing transactions in which financing against collateral other than government securities is provided to non-banks. Centrally-cleared securities financing transactions and financing provided to banks and broker-dealers subject to adequate capital and liquidity regulation on a consolidated basis are excluded.

Annex 4 of the Framework contains a consultative proposal. The FSB has decided to raise the levels of numerical haircut floors, existing market and central bank haircuts, and data on historical price volatility of different asset classes. The FSB has also decided to propose applying the numerical haircut floors to non-bank-to-non-bank transactions so as to ensure that shadow banking activities are fully covered, to reduce the risk of regulatory arbitrage, and to maintain a level playing field. The deadline for comments is 15 December 2014.

The FSB has also published a background document entitled Procyclicality of haircuts: Evidence from QIS1. This document examined the procyclicality of haircuts on non-centrally cleared securities financing transactions and their role during the global financial crisis based on the first stage QIS (QIS1) data.

BCBS PUBLISHES REVISED CORPORATE GOVERNANCE PRINCIPLES FOR BANKS

On 10 October 2014, the Basel Committee on Banking Supervision (BCBS) published a consultation paper seeking to update its 2011 Principles for enhancing corporate governance. The deadline for comments on the consultation paper is 9 January 2015.

PRA CONSULTS ON DEPOSITOR PROTECTION

On 6 October 2014, the PRA published Consultation Paper 20/14: Depositor protection (CP20/14). In CP20/14 the PRA set out proposed changes to its rules in order to implement the recast Deposit Guarantee Schemes Directive. It also proposed new rules intended to ensure that depositors protected by the Financial Services Compensation Scheme can have continuity of access to their accounts during resolution, as well as changes to the existing single customer view rules on firms. The deadline for comments on CP20/14 is 6 January 2015.

PRA PUBLISHES DISCUSSION PAPER ON ENSURING OPERATIONAL CONTINUITY IN RESOLUTION

On 6 October 2014, the PRA published Discussion Paper 1/14: Ensuring operational continuity in resolution (DP1/14). In DP1/14 the PRA set out its preliminary views on the principles that firms' operational arrangements must satisfy in order to facilitate recovery actions, resolution and post-resolution restructuring. The deadline for comments on DP1/14 is 6 January 2015.

BCBS CONSULTS ON REVISIONS TO THE STANDARDISED APPROACH FOR MEASURING OPERATIONAL RISK CAPITAL

On 6 October 2014, the BCBS published a consultative document which set out proposed revisions to the standardised approach for measuring operational risk capital. When finalised the revised standardised approach will replace the existing non-model-based approaches which comprise the Basic Indicator Approach, the Standardised Approach, and the Alternative Standardised Approach. In addition to streamlining the framework, the new approach will address weaknesses identified in the existing approaches. The deadline for comments on the consultative document is 6 January 2015.

FAQS ON CSD REGULATION

On 6 October 2014, the European Commission published frequently asked questions (FAQs) concerning the Regulation on improving securities settlement and regulating central securities depositories (the CSD Regulation). The FAQs cover three particular topics concerning the CSD Regulation:

- the timing of implementation;
- the scope of the requirements; and
- the position of third country central securities depositories (CSDs).

REVIEW OF THE PRINCIPLES FOR THE SOUND MANAGEMENT OF OPERATIONAL RISK	Earlier this year the BCBS conducted a review concerning banks' implementation of its Principles for the Sound Management of Operational Risk (the Management Principles). The review covered 60 systemically important banks in 20 jurisdictions. On 6 October 2014, the BCBS published a paper setting out its findings from the review. In summary, implementation of the Management Principles across banks has varied significantly and more work is needed to achieve full implementation. In particular, the following four Principles are the least thoroughly implemented: ➨ operational risk identification and assessment; ➨ change management; ➨ operational risk appetite and tolerance; and ➨ disclosure.
EBA CONSULTS ON GROUP FINANCIAL SUPPORT	On 3 October 2014, the EBA published a consultation paper on draft regulatory technical standards (RTS) and guidelines specifying the conditions for group financial support, and draft implementing technical standards (ITS) on the disclosure of group financial support agreements under the Bank Recovery and Resolution Directive (the BRRD). The deadline for responding to the consultation paper is 4 January 2015.
EBA CONSULTS ON TREATMENT OF LIABILITIES IN BAIL-IN	The BRRD specifies the sequence in which the power to write down or convert liabilities in resolution should be applied. This sequence provides that capital instruments as defined in the Capital Requirements Regulation (CRR) should bear losses first, before other liabilities. The BRRD also makes a similar provision about the power to write down or convert capital instruments at the point of non-viability (the PONV conversion power). To ensure that the absorption of losses by capital instruments is effective, and that resolution authorities and other stakeholders have a clear understanding of how this sequence should be applied, the BRRD mandates the EBA to issue guidelines clarifying the interrelationship between the provisions of the BRRD and the provisions of the CRR and the CRD IV Directive, as far as this affects the write-down sequence. On 1 October 2014, the EBA published a consultation paper on draft guidelines concerning the interrelationship between the BRRD sequence of write-down and conversion and CRR/CRD IV Directive. The deadline for comments on the consultation paper is 3 January 2015.
IMPLEMENTING THE FPC'S RECOMMENDATION ON LOAN TO INCOME RATIOS IN MORTGAGE LENDING	On 1 October 2014, both the PRA and the FCA published their final rules and guidance concerning their approach to implementing the Financial Policy Committee's recommendation that both regulators take steps to ensure that mortgage lenders constrain the proportion of new lending at loan to income ratios (LTI) at or above 4.5 to no more than 15% of the total number of new mortgage loans. This recommendation applies to all lenders which extend residential mortgage lending in excess of £100m per annum. The PRA published Policy Statement 9/14: Implementing the Financial Policy Committee's recommendation on loan to income ratios in mortgage lending. The FCA published Finalised Guidance 14/8: Guidance on the Financial Policy Committee's recommendation on loan to income ratios in mortgage lending.
ESMA DEFINES PRODUCTS, COUNTERPARTIES AND STARTING DATES FOR THE CLEARING OF INTEREST RATE SWAPS	On 1 October 2014, the ESMA published a final report containing draft RTS for the central clearing of interest rate swaps (IRS) which it is required to develop under EMIR. The RTS define the types of IRS contracts which will have to be centrally cleared, the types of counterparties covered by the obligation and the dates by which central clearing of IRS will become mandatory.
ESMA CONSULTS ON DRAFT STANDARDS FOR THE CLEARING OF FOREIGN EXCHANGE NON-DELIVERABLE FORWARDS	On 1 October 2014, the ESMA published a consultation paper on draft RTS for the clearing of foreign exchange non-deliverable forwards. The consultation paper was ESMA's third consultation on the clearing obligation. It was published following the delivery to the European Commission of ESMA's final report on the clearing obligation for IRS classes and shortly after the end of the consultation period for the second clearing obligation paper on credit default swaps. It incorporated the feedback received to the first consultation paper on IRS only and is consistent with the final report on IRS. The deadline for comments on the consultation paper was 6 November 2014.
FCA SPEECHES	The FCA has published the following speeches: ➨ Consumer credit seminar (Linda Woodall on 21 October 2014); ➨ Competition in the interests of consumers (Martin Wheatley on 17 October 2014); and ➨ Surveillance: The FCA's expectations and toolkits (Patrick Spens on 7 October 2014).

DLA Piper is a global law firm with 4,200 lawyers located in more than 30 countries throughout the Americas, Asia Pacific, Europe and the Middle East. With one of the largest specialist banking and finance litigation teams in the world, we are well positioned to help companies with their legal needs, wherever, and whenever they need it. The UK team, which is made up of "dedicated and experienced banking and finance litigation practitioners" (Chambers & Partners UK 2013), acts for hundreds of financial institutions, including all the major UK clearing banks and provides advice and representation to banks, mortgage banks, building societies, finance houses, factors and invoice discounters and merchant acquirers as well as regulatory authorities.

Market Movements

DLA Piper UK LLP reviews key market developments in the banking sector

Domestic banking

Following a series of rate rigging incidents, the **Bank of England** has started a nine-month investigation into London's financial markets in a bid to restore faith in the integrity of the UK as a financial centre. A report summarising the review's conclusions is expected in June 2015 – *Telegraph, 28 October 2014*

The **Bank of England** has promised an independent investigation into the enforced closure of the Clearing House Automated Payment System (CHAPS) on 20 October. The fault appears to have stemmed from a "technical issue related to some routine maintenance" – *Telegraph, 21 October 2014*

The **Bank of England** will publish the findings of its stress tests on the financial stability of UK's banks on 16 December. Banks will find out the results the day before – *Times, 11 October 2014*

The **Co-Operative Bank** has appointed Dennis Holt, former head of Lloyds TSB's retail arm, as its new chairman – Telegraph, 27 October 2014

HSBC has announced profits for the first nine months of 2014 of $17bn – *Guardian.com, 3 November 2014*

Online and telephone-based bank **First Direct**, part of **HSBC**, is to compensate customers for selling complex investment products without having checked first that they were suitable for them, or that the investors understood what they were getting – *Financial Times, 16 October 2014*

An internal investigation conducted by **Lloyds Banking Group** into forex manipulation has found no evidence of wrongdoing. Lloyds does not expect to be fined by the regulators and has passed on the results from the investigation to the Financial Conduct Authority (FCA) – *Sunday Telegraph, 2 November 2014*

The City of London Police will receive free training and advice on financial crime from **The Royal Bank of Scotland** (**RBS**). The police are eager to tap into **RBS** employees' expertise in cyber technology and financial instruments – *Financial Times, 3 November 2014*

RBS has reported third quarter pre-tax profits of £1.27bn, as cash earmarked to cover anticipated losses on bad loans in its Irish operation and "bad bank" has been released back into the lender. **RBS** has confirmed that it will retain its Irish operation Ulster Bank – *Telegraph.co.uk, 31 October 2014*

RBS is set to join the peer-to-peer lending market intending to pilot an online platform in an affiliation with a third party operator before the end of 2014 – *Financial Times, 20 October 2014*

RBS has joined forces with payment solutions company Taulia to provide corporate clients with electronic invoicing as a method of paying their suppliers ahead of time in return for a discount – *FT.com, 12 October 2014*

The second profit warning in five months from **Standard Chartered** has seen shares drop to a five-year low. Profits for the quarter were $1.5bn, lower than the $1.8bn for the same period in 2013, mostly as a result of impairments on commercial loans due to some extent to declines in commodity prices – *Telegraph.co.uk, 28 October 2014*

Domestic general

Northern Rock and **Bradford & Bingley** have paid back £12bn of the £49.9bn that they received from the taxpayer, equating to almost 25% of the debt owed by the banks to the government – *Times, 31 October 2014*

The recent turmoil in global stock markets has claimed its most prominent casualty, with leading challenger bank **Aldermore** forced to cancel plans for a £875m listing. The "deterioration" in equities is being blamed by the bank for its decision to call off the IPO – *Times, 16 October 2014*

The latest figures from the FCA show that banks have paid £1.542bn in compensation over the mis-selling of interest rate swaps to small firms. This figure compares to just £2m that had been paid out by September 2013 – *Telegraph, 15 October 2014*

It is proposed that the new payments watchdog, the Payments Systems Regulator, will be responsible for regulating credit and debit card systems. New powers will mean that, from April, the regulator will

be able to ensure that access to systems such as Mastercard and Visa will be available to small banks on the same terms as to larger ones – *Telegraph, 14 October 2014*

Former Ofcom head, Dame Colette Bowe, has been appointed as the first chairwoman of the UK's new banking standards body. The banking standards review council, which is industry-funded, will look to improve morals in the City – *Times, 10 October 2014*

European banking

BNP Paribas reported an 11% increase in quarterly profits to €1.5bn (£1.2bn) – *Independent, 1 November 2014*

Credit Suisse has returned to profit. The Swiss lender exceeded analysts' forecasts of Swfr808m for the third quarter, reporting pre-tax profits of Swfr1.3bn (£852m) which contrasted with a Swfr700m loss in the previous quarter – *Independent.co.uk, 23 October 2014*

Deutsche Bank has reported third quarter losses of €92m compared to a profit of €51m at this point in 2013, and has said potential costs from future investigations and litigation have "materially impacted" on its profits – *Independent.co.uk, 29 October 2014*

The European Central Bank (**ECB**) has created an Asset-Backed Securities Purchase Programme and has said that it will start buying asset-backed securities in November – *Telegraph, 31 October 2014*

The **ECB** has begun the next stage of its fight to stave off deflation and revive the Eurozone economy, buying covered bonds from banks in a move that could lead to €1tn (£790bn) being pumped into the Eurozone financial system – *Guardian, 21 October 2014*

UBS has announced a rise of over 30% in its net income for the third quarter of 2014. The bank has set aside £1.2bn to safeguard against potential fines and settlements in ongoing investigations relating to currency manipulation and tax evasion – *Telegraph, 29 October 2014*

European general

25 European lenders have failed **ECB** stress tests to determine whether European banks are robust enough to cope in the event of another financial crisis. Britain's four major banks passed the stress tests, whilst Italy's banks fared the worst – *Telegraph, 27 October 2014*

Germany's rejection of both calls for stimulus measures and plans from the **ECB** to purchase bonds and securities, has laid bare the bitter divisions that exist over the best way to respond to stagnation in the Eurozone – *Times, 18 October 2014*

International banking

The **Bank of China** is one of the banks chosen by the Treasury to lead the first sale of bonds denominated in the yuan outside of China as the UK tries to establish itself as the main European centre for Chinese finance – *Times, 10 October 2014*

Citigroup is to end consumer banking services in eleven countries, including Japan, the Czech Republic and Egypt, to enable it to concentrate on the markets where it believes it has the potential for growth – *Times, 15 October 2014*

Investment bank **Goldman Sachs** has reported a 50% increase in third-quarter profits on the back of a pick-up in bond markets, a return to form in its fixed-income division, and fees from its work on a number of mergers and acquisitions. The results were better than had been expected by analysts – *Times, 17 October 2014*

JP Morgan reported strong results for the last financial quarter, with profits up to $5.57bn compared to a $380m loss at the same time in 2013. Revenue was up by almost 5% with particularly strong results recorded in the bank's fixed-income trading business – *Telegraph, 15 October 2014*

National Australia Bank Chief Executive, Andrew Thorburn, has said that exiting the UK market is an "absolute priority". The bank wants to focus on its home market and New Zealand and is exploring options for UK subsidiaries **Clydesdale Bank** and **Yorkshire Bank**, including stock market flotation – *Telegraph, 30 October 2014*

International general

The US Federal Reserve plans to end its quantitative easing scheme. The central bank intends to keep interest rates at their current low level, though underutilisation in the labour market is "gradually diminishing" – *Independent, 30 October 2014*

The Basel Committee on Banking Supervision is speeding up its leverage ratio work, with Secretary-General William Coen revealing that work on the calibration of the ratio will start in 2015, earlier than had been planned – *Financial Times, 21 October 2014*

This publication is a general overview and discussion of the subjects dealt with. It should not be used as a substitute for taking legal advice in any specific situation. DLA Piper UK LLP accepts no responsibility for any actions taken or not taken in reliance on it. Where references are made to external publications, the views expressed are those of the authors of those publications or websites which are not necessarily those of DLA Piper UK LLP, and DLA Piper UK LLP accepts no responsibility for the contents or accuracy of those publications.

QUOTE OF THE MONTH:

"I think what this review is saying is it is not just a few bad apples, it is actually the barrel in which they are operating, and we need to fix the barrel as well as track down the bad apples."

Minouche Shafik, on the UK Fair and Effective Markets Review; FT 28/10/14

Deals

Our monthly round up of industry news, major transactions, their significance and the players involved

Slaughter and May, working as a team with European Best Friend firm Bonelli Erede Pappalardo, is advising ITAS Mutua Societa Capogruppo on its proposed acquisition of the Italian branches of Royal & Sun Alliance Insurance plc and Sun Insurance Office Ltd from RSA Insurance Group plc. The Slaughter and May team is led by corporate partners Paul Dickson and Oliver Wareham who are supported by associates Tom O'Neill and William Oates.

Freshfields Bruckhaus Deringer has advised an ad-hoc committee of first lien lenders in relation to the £930m restructuring of the PHS group. Under the restructuring, the lenders have carried out a debt for equity swap implemented pursuant to a scheme of arrangement. The Freshfields team was led by London finance partners Ryan Beckwith, Sean Lacey and Richard Tett and corporate partner Gareth Stephenson, alongside senior associate James Watson.

Allen & Overy advised Bank of China, HSBC and Standard Chartered as joint arrangers on the RMB3bn bond issue by the UK government. The 2.70% three year bonds were almost twice oversubscribed, with strong demand enabling an issue size of RMB3bn, making it the largest ever RMB issue by a non-Chinese issuer. The team was led by London-based capital markets partners Geoff Fuller and Matthew Hartley with support from senior associate Peter Crossan and associate Kerry Fitzgerald.

Clifford Chance has advised the lead managers and the fiscal agent on Bank of China Limited's US$6.5bn (RMB39.94bn) offering of Basel III-compliant additional tier 1 preference shares. The lead managers were BOCI, BNP Paribas, China Merchants Securities, CITIC Securities, Citigroup, Credit Suisse, HSBC, Morgan Stanley and Standard Chartered Bank. The fiscal agent was The Bank of New York Mellon, London Branch. This is the first offshore additional tier 1 capital issue from a Chinese bank. Fang Liu and consultant Angela Chan co-led the team.

White & Case LLP (Paris) has advised the syndicate of banks led by Deutsche Bank and Morgan Stanley and including Barclays, BNP Paribas, Credit Agricole Corporate and Investment Bank, Credit Suisse Securities Limited, Goldman Sachs and JP Morgan Securities, acting as Joint Lead Managers and Joint Bookrunners, on Numericable Group's €4.7bn capital increase. The capital increase with preferential subscription rights is the largest in France since 2009 and will allow Numericable Group to finance the €13.5bn cash element of its acquisition of SFR. SFR is the leading alternative telecommunications operator in France, with a combined turnover of €10.2bn during 2013 and more than 21 million mobile customers in June 2014. The White & Case team in Paris which advised on the transaction was led by partners Thomas Le Vert and Séverin Robillard with support from associates Tatiana Uskova, François Carrey and Antonin Deslandes.

Ashurst has advised Lloyds Banking Group on the £70m development financing of Emerald Gardens, at Wembley Park. This is part of the Quintain 50:50 joint venture with Keystone Developers S.A. to deliver the next 306,000 square feet phase of homes at Wembley Park, which will comprise seven buildings. The Ashurst team was led by banking partner Sarah Watkinson.

Shearman & Sterling advised Bank of America, N.A., as administrative agent, and Merrill Lynch, Pierce, Fenner & Smith Incorporated, The Bank of New York Mellon, Mizuho Bank, Ltd and JP Morgan Securities LLC, as joint lead arrangers and joint bookrunners, in connection with a $750m multi-currency financing, including a $375m four-year credit facility and a $375 five-year credit facility, for Tiffany & Co. The Shearman & Sterling team included partners Maura O'Sullivan (New York-Finance) and Larry Crouch (Palo Alto-Tax), and counsel Susan Hobart (New York-Finance) and Sharon Lippett (New York-Executive Compensation & Employee Benefits).

Linklaters advised UniCredit Bank AG and Crédit Industriel et Commercial SA as Lenders on the project financing of a portfolio of two wind farms with a total capacity of 22MW located in the North of France. This portfolio was developed by Sorgenia France and was acquired immediately prior to closing by a fund managed by Glennmont Partners (ex-BNPP Clean Energy Partners). The Linklaters team was led by François April, partner in banking and projects. He was assisted by Samuel Bordeleau on banking and projects matters.

King & Wood Mallesons advised Woolworths (an ASX Top 10 corporate) on an innovative syndicated fronted bank guarantee facility. The transaction is believed to be the world's first facility under which a syndicate of global insurers provided back-to-back indemnities for bank guarantees issued by banks. The KWM team was led by Yuen-Yee Cho (Partner), Elizabeth Hundt Russell (Senior Associate), Tracy Liu (Solicitor) and Michael Spurritt (Solicitor).

COUNTRIES COVERED
Spain » Reform of the Spanish Insolvency Law: helping to build economic recovery p 741

International Briefing

Spain

Authors: Javier Ruiz-Cámara (Partner, Uría Menéndez) and Jon Armendariz Román (Associate, Uría Menéndez)

Reform of the Spanish Insolvency Law: helping to build economic recovery

OVERVIEW

This International Briefing examines the latest round of amendments to the Spanish Insolvency Law. Official statistics reveal that currently over 90% of companies commencing insolvency proceedings in Spain are put into liquidation, where assets are usually sold individually, culminating in industries being destroyed and jobs being lost.

In order to tackle this undesirable outcome, the Spanish government recently approved Royal Decree-Law 11/2014 of 5 September regarding urgent measures on insolvency. It was published in Spain's *Official Gazette* on 6 September 2014 and came into force the following day, although some provisions will not apply to insolvency proceedings already under way.

The underlying objective of this new development of the Insolvency Law is to encourage the survival of economically viable industries or at least, of viable business units, with due regard to the protection of creditors at the same time. For these purposes, the reform:

(i) makes in-court creditors' agreements more flexible; and
(ii) where the company's liquidation cannot be avoided, it facilitates the sale of the company's business or a part of it by, among others, establishing the mandatory subrogation of contracts, licences and authorisations necessary to carry out the business activity.

The following are the most important amendments of the reform.

IN-COURT CREDITORS' AGREEMENTS

Scope

Prior to the reform, the Insolvency Law imposed certain limitations in terms of content to proposed in-court creditors' agreements (*convenio concursal*): as a general rule, the proposals for discharge of debts (*quita*) could not exceed half of their amount and the proposals for stay of payments (*espera*) could not operate in excess of five years. In addition, these proposals could not consist of the assignment of assets to creditors to settle their "credit rights" (ie rights to receive payments deriving from loans or other credit facilities, commercial receivables, etc – *derechos de crédito*).

The reform introduces important revisions in this regard by, among others, making the content of proposed in-court creditors' agreements more flexible and bringing them into line with pre-insolvency refinancing agreements.

The limits to the discharge of debts (*quitas*) are removed and the stay of payments (*esperas*) is extended to a maximum of ten years.

In-court creditors' agreement proposals may include debt-for-asset deals provided that:

(i) the assets assigned are not considered necessary to carry out the debtor's business activity;
(ii) their reasonable value (calculated as set out in the Insolvency Law) is not higher than the extinguished "credit right" or, if so, any excess is then used for the insolvency estate; and
(iii) they are not imposed on public creditors.

Creditors' meeting quorum

One of the most important measures of the reform is the granting of voting rights, within the creditors' meeting, to those creditors who acquired their "credit rights" after the declaration of insolvency of the company (except for creditors considered specially related to the debtor). The logic behind this amendment is to stimulate the trading of distressed debt.

Additionally, privileged creditors have also been granted the right to vote for the amount of their "credit right" that exceeds the "value of the relevant security" (ie the "non-covered amount" and the "covered amount", respectively). The concept "value of the relevant security", newly introduced into the insolvency proceeding itself, reproduces the meaning of the concept already existing within the framework of pre-insolvency refinancing agreements (as mentioned in the May 2014 Spain International Briefing [2014] 5 JIBFL 349).

Majorities necessary for the approval of in-court creditors' agreements

The new majorities necessary for the approval of in-court creditors' agreements depend on the specific content of the relevant agreement, as follows:

(i) the favourable vote of *creditors representing a* ***simple majority*** *of claims* (*pasivo*) is required for: (a) the full payment of ordinary "credit rights" with a stay of payment (*espera*) not exceeding three years, or (b) the immediate payment of the ordinary "credit rights" with a discharge of debts (*quita*) not exceeding 20%;
(ii) the favourable vote of *creditors representing* ***at least 50% of the ordinary claims*** (*pasivo ordinario*) is required for: (a) discharges of debts (*quitas*) not exceeding 50%, (b) stays of payments (*esperas*) either of principal, interest or any other amount due, for a period not exceeding five years, or (c) conversions of "credit rights" (excluding those held by public and labour creditors) into profit participating loans not exceeding five years; and
(iii) the favourable vote of *creditors representing* ***at least 65% of the ordinary claims*** (*pasivo ordinario*) is required for (a) discharges of debts (*quitas*) exceeding 50%, (b) stays of payments (*esperas*) either of principal, interest or any other due amount, for a period exceeding five years (up to a maximum of ten years), (c) the conversion of "credit rights" (excluding those held by public and labour creditors) into profit participating loans exceeding five years (up to a maximum of ten years), or (d) other permitted measures such as the assignment of certain assets to the creditors to settle their "credit rights" under certain circumstances.

Furthermore, all lenders under a syndicated loan will be deemed to have voted in favour of the in-court creditors' agreement if it is approved by lenders holding at least 75% of the outstanding debt under the loan, or a lower (but not higher) majority, if so established in the relevant syndicated loan agreement.

The cram-down mechanism: privileged creditors

Another important measure is the possibility of extending the effect of in-court creditors' agreements to privileged creditors who have not voted in favour of the proposal, even in relation to the "covered amount" of the relevant "credit right". This is a significant innovation in comparison to the previous legal regime, under which in-court creditors' agreements only affected those privileged creditors who voluntarily accepted them.

To this end, the in-court creditors' agreement requires the favourable vote of:
(a) *creditors representing at least 60% of the corresponding class of privileged creditors* (ie based both on the kind of the privilege and the nature of the "credit right": labour, public, financial and the rest of the creditors), if the measures in the proposal include any of those indicated in paragraph (**ii**) above, or
(b) *creditors representing at least 75% of the corresponding class of privileged creditors*, if the measures in the proposal include any of those indicated in paragraph (**iii**) above.

As regards creditors with a "special privilege" (ie security *in rem* over a specific asset), the majority will be calculated on the basis of the "value of the security" voting favourably, over the aggregated "value of the relevant security" of creditors of the same class. For creditors with a "general privilege" (ie security unrelated to a specific asset), the majority will be calculated on the basis of the amount of the claims (*pasivo*) corresponding to creditors voting favourably, over the aggregated amount of the claims (*pasivo*) benefiting from general privilege within the same class.

Amendment of (some of) the breached in-court creditors' agreements

As mentioned above, most companies commencing insolvency proceedings in Spain are put into liquidation. In fact, even when an in-court creditors' agreement is reached, the company is sometimes put into liquidation because the agreement is breached, since there is no legal mechanism available to renegotiate or amend its terms and conditions.

The reform introduces the possibility of amending those in-court creditors' agreements approved prior to the reform, which are breached within a term of two years following the date on which the reform enters into force.

The amendment must be requested by either the insolvent debtor itself or creditors representing at least 30% of all the outstanding claims (*pasivo*) existing when the agreement is breached.

The majorities required to approve the amendments of in-court creditors' agreements depend on the specific amendment in question, as follows:
(a) the favourable vote of *creditors representing at least 60% of the ordinary claims* (*pasivo ordinario*) and 65% of the corresponding class of privileged creditors, if the measures included in the proposal include any of those indicated in paragraph (**ii**) above; and
(b) the favourable vote of *creditors representing at least 75% of the ordinary claims* (*pasivo ordinario*) and 80% of the corresponding class of privileged creditors, if the measures included in the proposal include any of those indicated in paragraph (**iii**) above.

The amended in-court creditors' agreement will also affect creditors (either ordinary or privileged) who did not vote in favour of the proposal and subordinated creditors, except for public creditors.

SALE OF BUSINESS UNITS DURING THE INSOLVENCY PROCEEDINGS

The reform also implements certain measures to incentivise the sale by the debtor of business units during the insolvency proceedings, thus maintaining economically viable industries and avoiding the sale of each of the assets individually.

Notably, the reform sets out that the transferee of the relevant business unit will acquire, *ex lege* (*ipso iure*), the debtor's

rights and obligations arising out of any agreements, licences or administrative authorisations (ie without the relevant counterparties' consent being required), provided that they are related to the debtor's business activity and the acquirer does not reject the subrogation.

As regards transfers of undertakings, the reform expressly considers the resulting labour and social security consequences, ie it establishes that the acquirer will assume not only the labour liabilities (as under the previous regime), but also all social security liabilities of the business and any other amounts legally imposed on the acquirer. This is another significant addition in comparison with the previous regime, under which the transfer of all social security claims gave rise to many disputes.

On the contrary, acquirers are exempted from assuming – unless expressly accepted by them – the debts acquired by the debtor prior to the sale of the relevant business unit (regardless of their classification in the insolvency proceedings).

Finally, the fall-back rules applicable to the liquidation plan are also amended. In particular, among others, the regulation applicable to the transfer of assets and rights linked to specially privileged "credit rights" is modified and now depends on whether or not these are included in the transferred industry or business unit, and whether or not the relevant security survives.

OTHER AMENDMENTS

The reform also addresses other matters, such as the insolvency of companies operating public concessions (namely, motorway tolls), the broadening of the definition of the concept of "creditors specially-related to the debtor" and the introduction of the valuation of secured claims.

CONCLUSION

The comprehensive structural reforms undertaken over recent years seem to be addressing the difficult economic situation that Spain has been facing. Within this framework, the reform of the Insolvency Law represents a step forward towards reversing the overwhelming tendency of companies starting insolvency proceedings to be put into liquidation and maintaining economically viable industries. ■

Corporate Rescue and Insolvency

SUBSCRIBE TODAY TO CRI FOR JUST £385

Corporate Rescue and Insolvency is an authoritative, well-researched and incisive journal which offers commentary and analysis on all areas of insolvency and restructuring law (domestic and international) for the busy insolvency practitioner and professionals in related industries.

CRI focuses on insolvency and corporate rescue issues in line with market changes and offers an excellent mix of in-depth features; In Practice articles covering both technical and practical pieces; and International articles. Other CRI sections include: Cases Alerter; Cases Reporter; Legislative Update; Turnaround; Market Spotlight; and Sector Focus – prepared and written by top City law firms to keep you up-to-date with the latest developments. The new cover and internal layout design allows easy navigation and is well-suited to a time pressured day.

CRI is an essential companion in helping the insolvency and restructuring practitioner and other related professionals meet and maintain the requisite standards of excellence.

1 ☐ YES! I would like a 12 month subscription of Corporate Rescue and Insolvency (ILP), please invoice me for £385.00 for 6 issues.

2 My Delivery Details *Required Fields

*Title (Mr/Mrs/Ms) *First Names
*Surname
*Job Title
*Company
*Address 1
*Address 2
*Address 3
*Town *Postcode
Telephone
Email

Signature Date

3 Return Your Order

Marketing Department, LexisNexis, Freepost RSJB-BCTH-ZGUB Quadrant House, The Quadrant, Sutton SM2 5AS
Tel +44 (0)845 370 1234
Fax +44 (0)20 8212 1988
Email newsales@lexisnexis.co.uk

Please quote response code
AD6526

Privacy Policy
We have a commitment to protecting your privacy. We may use the information we collect from you to keep you informed of LexisNexis products and services. We do not sell, trade or rent your email address to others, but we may pass your postal details to trusted third parties. If you do NOT wish to be kept informed by mail ☐ phone ☐ fax ☐ email ☐ or other LexisNexis products and services, please tick the relevant box. If you do NOT wish your mailing details to be passed onto companies approved by LexisNexis, to keep you informed of their products and services, please tick the box ☐. For further details of our privacy policy please visit our website at: www.lexisnexis.co.uk/contact_us/privacypolicy.html

Lexis® Note.
Take it personally.

www.lexisnexis.co.uk/lnlja

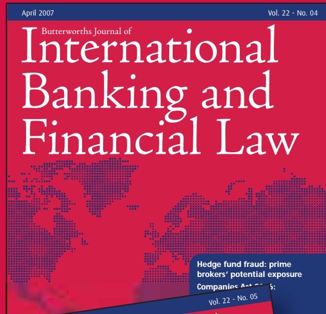
The Future of Law. Since 1818.

A division of Reed Elsevier (UK) Ltd. Registered office 1-3 Strand London WC2N 5JR Registered in England number 2746621 VAT Registered No. GB 730 8595 20. LexisNexis and the Knowledge Burst logo are trademarks of Reed Elsevier Properties Inc. © LexisNexis 2014 0314-120. The information is subject to change without notice.

Is this your copy of

Butterworths Journal of International Banking and Financial Law?

No. Then why not subscribe?



JIBFL is the leading monthly journal providing practitioners with the very latest on developments in banking and financial law throughout the world that is also practical, in tune with the industry, and easy to read – re-designed for you, the busy practitioner.

Subscribe today and enjoy:

- Your own copy, delivered direct to you, every month.
- *JIBFL* keeps you right up-to-date with key developments relevant to international banking and financial law.
- Written by leading practitioners, each issue contains more features and cases than ever plus a new 'In Practice' section containing high value 'know how' articles.

Subscribe today only £946

Subscribe today
for your own copy of *JIBFL*
for just £946!

PRIORITY ORDER FORM

1 ☐ YES! I would like a 12 month subscription to JIBFL, please invoice me for £946 – 11 issues.

2 **My Delivery Details** *Required Fields

*Title (Mr/Mrs/Ms) *First Names
*Surname
*Job Title
*Company
*Address 1
*Address 2
*Address 3
*Town *Postcode
Telephone
Email
Signature Date

3 **Return Your Order**

Marketing Department, LexisNexis
Freepost RSJB-BCTH-ZGUB, Quadrant House
The Quadrant, Sutton SM2 5AS

Tel +44 (0)845 370 1234
Fax +44 (0)20 8212 1988
Email newsales@lexisnexis.co.uk

Privacy Policy
We have a commitment to protecting your privacy. We may use the information we collect from you to keep you informed of LexisNexis products and services. We do not sell, trade or rent your email address to others, but we may pass your postal details to trusted third parties. If you do NOT wish to be kept informed by mail ☐ phone ☐ fax ☐ email ☐ or other LexisNexis products and services, please tick the relevant box. ☐ If you do NOT wish your mailing details to be passed onto companies approved by LexisNexis, to keep you informed of their products and services, please tick the box.For further details of our privacy policy please visit our website at :
www.lexisnexis.co.uk/contact_us/privacypolicy.html

Please quote response code
AD5521