



Financial litigation roundup

Spring 2016

Welcome to the latest edition of our financial litigation roundup. In this edition, we consider recent judgments and ongoing cases from the banking and financial world in the UK and Asia, as well as legal developments across those jurisdictions.

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Hong Kong

A red flag to rating agencies: Securities and Futures Appeals Tribunal (SFAT) upholds the Securities and Futures Commission's (SFC) decision to fine and reprimand Moody's for Report on Mainland Chinese companies

In the first case of its kind in Hong Kong, the SFAT has confirmed that Moody's Investors Service Hong Kong Ltd's (Moody's) publication in June 2011 of a Report, entitled "*Red Flags for Emerging-Market Companies: A Focus on China*", fell within the "Type 10" regulated activity of providing credit rating services. The SFAT upheld the SFC's decision to publicly reprimand and fine Moody's for breaches of the SFC's Code of Conduct.¹

The Report shone a spotlight on certain Mainland Chinese issuers of fixed-income securities, adopting a system of allocating "red flags" to identify potential areas of concern with those companies. Those red flags covered matters such as weaknesses in corporate governance, fast growth, risky business models and concerns over the quality of financial reporting.

The Report focused in particular on six companies with the highest number of red flags – so-called "negative outliers".

Following publication of the Report, the share prices of more than half of the Hong Kong-listed companies red-flagged in the Report suffered substantial falls.

In the aftermath, concerns were raised about the validity of the red flag framework adopted in the Report. In addition, the accuracy of the Report was called into question. This led to an SFC investigation. In its Decision Notice dated 3 November 2014, the SFC determined that Moody's had breached the Code of Conduct. Specifically:

- **General Principle 1:** the SFC found that the red flag framework gave an unfair and misleading impression of the companies concerned. For example, no commentary was provided on the red flags, and there was no significant correlation between the number of red flags and credit risk. Moody's was stated to have failed to act fairly, in the best interests of its clients and the integrity of the market
- **General Principle 2:** the SFC found that the Report contained numerous errors, which had created a wrong and potentially harmful impression in the eyes of the market. Moody's was stated to have failed to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market
- **Paragraph 4.3:** the SFC found that Moody's did not have in place sufficient internal control procedures.

The SFC imposed a public reprimand and a fine of HK\$23m.

Moody's appealed to the SFAT on jurisdictional grounds. They argued that preparation and publication of the Report did not fall within the "Type 10" regulated activity of providing credit rating services, and that the SFC's Code of Conduct, therefore, did not apply.

The SFAT rejected this argument, finding that "even if unintended, in its preparation and publication of the Report, Moody's was carrying on its regulated activities".² The SFAT found that the red flag system adopted by Moody's was a form of credit rating, or at least a method by which the market could assess risk and act on that risk.

1. SFAT's Reasons for Determination, dated 31 March 2016.
2. Reasons for Determination, at paragraph 200.

The SFAT, therefore, upheld the SFC's decision to fine and publicly reprimand Moody's, although it reduced the original HK\$23m fine imposed by the SFC to HK\$11m. The SFAT also overturned the SFC's finding that Moody's did not have in place sufficient internal control procedures in breach of paragraph 4.3 of the Code of Conduct (albeit on technical grounds).³

The case marks the first disciplinary action against a credit rating agency since the activities of such firms became regulated by the SFC in June 2011. The SFAT's confirmation that the SFC's jurisdiction encompasses more than just rating services of the "classic kind" is likely to encourage rating agencies to consider more carefully the potential impact of their publications on the market.

At the time of writing, press reports stated that Moody's intends to appeal the SFAT's decision. Any such appeal will be to the Court of Appeal and is likely to focus on the application of the law (for example, the scope of the SFC's jurisdiction). Few SFAT decisions have been appealed to the courts. If an appeal does proceed, market watchers will wish to review what the Court of Appeal's judgment may mean for (among other things) the scope of public research reports in Hong Kong.

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Bank's standard term for customer due diligence due to be tested in court

In *Pa Sam Nang v HSBC Ltd*,⁴ the plaintiff was a customer of the bank. His account had been suspended pending the bank's due diligence and risk management review of transactions on his account. The bank's standard terms of business provided for such suspension, apparently without reference to a particular timeframe.

The plaintiff's lawyers failed to persuade the bank to lift the suspension. Therefore, the plaintiff commenced legal proceedings against the bank, in order obtain a ruling that his account had been wrongfully suspended. Interestingly, the plaintiff applied for summary judgment (judgment without trial); therefore, the bank was only required to show (at this stage) that it had a credible defence, such that the proceedings should be allowed to proceed to trial.

What may have made things rather difficult for the bank was that the plaintiff's account had been suspended for almost a year by the time of the court hearing. The bank also appears to have been hampered in what evidence it could deploy, in its defence to the plaintiff's application, for fear of compromising the investigation before it had concluded.

Not surprisingly, the court granted the bank permission to defend the plaintiff's action. In short, the bank had a contractual right to suspend the operation of a customer's account and, in all the circumstances, it could not be said that the bank had acted irrationally, despite the ongoing period of the suspension.

Interestingly, the court declined to dismiss the plaintiff's application for summary judgment outright; this suggests some judicial acknowledgment of the bank's lack of engagement with the plaintiff as to reasons for the suspension of his account. Indeed, a principal concern of the plaintiff appears to have been what he regarded as the bank's "big brother" treatment or "high handed" manner.⁵ In passing, it should be noted that the plaintiff appears to be a wealthy and well connected individual who has found the resources and lawyers (not always an easy task) to take on the bank on its "home turf".

3. In light of its Reasons for Determination, the SFAT also directed that the SFC edit its public reprimand ("Reasons" at paragraph 228).
4. HCA 1020/2015, 7 March 2016.
5. *Pa Sam Nang v HSBC Ltd*, at paragraph 62 (summarising some of the plaintiff's lawyer's more emotive submissions and allowing for some advocate's licence).

At the time of writing, the plaintiff has applied for permission to appeal the court's refusal to grant summary judgment. Even if granted permission to appeal to the Court of Appeal, an appeal faces significant challenges. The lower court exercised a wide discretion (based on the evidence before it) in refusing the plaintiff's application and the bank's terms of business appear to be standard in the industry. There is also the point that, in the current regulatory environment, most banks in Hong Kong are taking their due diligence responsibilities more carefully. If the case does proceed to trial (rather than settlement), or to an appeal, it will be one to watch. Even if the plaintiff succeeds in attacking (for example) the period of the suspension of his account, he will still have to establish his loss and the bank will, presumably, seek to rely on the usual contractual provisions purporting to limit that loss.

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Investor sets-up advisory duty against bank

As we have reported in previous editions of this Financial Litigation briefing,⁶ investors have generally had a hard time pursuing so-called "mis-selling" claims against banks and other financial intermediaries in Hong Kong. To date, the banks and intermediaries have been able to rely on their standard terms of business to exclude liability and to assert that they are acting on an execution only basis (ie, no advisory duty), even where the evidence suggests that they have given advice on which an investor has relied.

In *Li Kwok Heem v Standard Chartered International (USA) Ltd*,⁷ the plaintiff lost all of his investment in a hedge fund that turned out to be part of the Madoff "Ponzi" scheme. He had made the investment on the recommendation of the bank's representatives. However, the bank's official position was that it was not "advising" and that its standard terms prevented the plaintiff from claiming otherwise.

In an interesting judgment, the court held that the bank's representatives had, as matter of fact, made representations to the plaintiff as to the suitability of his investment in the hedge fund and he had relied on those representations. Further, the court held that the bank could not rely on its standard term to the effect that it was acting on an execution only basis because, based on the wording of the term, it applied to higher risk investments; not lower risk investments of the type in question. It is worth noting that the plaintiff was not looking for high risk; nor was he looking to trade his investments. Rather, he was a balanced investor looking for some capital appreciation and the bank's representatives appreciated this as part of his customer profile.

Therefore, the bank did assume a duty of care towards the plaintiff and had a duty to exercise reasonable care and skill.

The court also held that the bank was unable to rely on the exemption clauses in its standard terms because they failed to satisfy a test of reasonableness.⁸

Ultimately, however, the plaintiff's claim failed because the court considered that the bank's representatives had not been negligent. They had relied on the audited financial statements prepared by (among others) the auditors of the hedge fund and were entitled to do so, in the absence of anything untoward.

There is no appeal in *Li Kwok Heem*. It is a rare example in Hong Kong of a claimant investor managing to establish an advisory duty on behalf of a bank with respect to an investment with a third party, albeit ultimately in vain. It is important to stress that the plaintiff was not a high risk investor.

6. For example, Spring 2015.
7. HCA 498/2010, 5 January 2016.
8. Sections 7 and 8 of the Control of Exemption Clauses Ordinance (Cap. 71) and section 4 of the Misrepresentation Ordinance (Cap. 284).

Going forward, the “fiction” whereby some banks make recommendations as to clients’ investments, but seek to rely on their acting on an execution only basis, will shortly come to an end in Hong Kong. The Securities and Futures Commission (SFC) in Hong Kong has mandated that by 9 June 2017 all financial intermediaries governed by its Code of Conduct must include a new “suitability clause” in all client agreements. The expectation is that financial intermediaries will do this before that date. The new clause includes a “non-derogation” provision. This will be complemented by a new provision in the Code of Conduct that will provide that a financial intermediary may not include in a client agreement any provision which is inconsistent with its obligations under the Code or which misdescribes the actual services to be provided to a client.⁹

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Anti-money laundering suspicious transaction reports update

As we noted in our [December 2015 Financial Litigation](#) briefing, Hong Kong was well on course to break her “PB” (personal best) for anti-money laundering suspicious transaction reports (STR) in 2015. Based on statistics available from the Joint Financial Intelligence Unit (JFIU – the relevant reporting organisation in Hong Kong¹⁰) there were 42,555 STR in 2015 (compared with 37,188 in 2014); an increase of approximately 15%.¹¹ In the first quarter of 2016, there have been 13,297 STR; therefore, one can confidently predict that the number of STR this year will exceed 2015.

The statistics need some perspective. The number of STR in Hong Kong has increased annually in the last five years. This is as much a reflection of the heightened awareness in Hong Kong of the need to report “suspicious” transactions in the finance industry and other business sectors. The vast majority of STR are (of course) made by the banks. However, there is an increased level of reporting in other sectors, including professional service providers. For example, in 2015 there was a fourfold increase in the level of STR made by the legal sector (which is principally law firms). Further, “intel” suggests that in the run-up to the Financial Action Task Force’s next mutual evaluation of Hong Kong (thought to be in the Spring of 2018), local regulators may have (among others, for example) some money service operators, estate agents and company secretarial service providers in their sights.¹²

For regulatory reasons, RPC operates as a registered foreign law firm in Hong Kong and in association with Smyth & Co.

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9. See SFC Circular, dated 21 March 2016 (re “*New Professional Investor Regime*” and “*New Client Agreement Requirements*”). New paragraph 6.5 of the SFC’s Code of Conduct.
10. The JFIU is jointly run by staff of the Hong Kong Police Force and the Hong Kong Customs & Excise Department. It manages the STR regime in Hong Kong. The JFIU’s role is to receive, analyse and store STR and, where appropriate, to liaise with investigative agencies.
11. See [JFIU website](#).
12. FATF, the inter-governmental body, is tasked with (among other things) setting standards for and promoting implementation of legal, regulatory and operational measures in order to combat money laundering and terrorist financing. Hong Kong’s next evaluation may be particularly interesting, given the number of Hong Kong interests alleged to be involved in the so-called “*Panama papers*”.

Singapore

RPC Premier Law opens for business

RPC's joint law venture (JLV) with leading Singapore firm Premier Law opened for business on Monday 1 May, doubling the firm's size in Singapore and adding significant additional capability for clients. Together the JLV will be known as RPC Premier Law Pte Ltd, and will include four partners amongst a team of 27 overall, based in Singapore.

Building on RPC's existing expertise in the region, the JLV will now see the firm able to offer a much greater range of services, covering:

- banking and financial dispute resolution
- international arbitration and dispute resolution
- corporate, mergers and acquisitions and finance
- insurance and reinsurance
- marine and international trade
- corporate insurance
- restructuring and insolvency.

In particular, Premier Law is one of very few firms in Singapore with the capability and freedom from conflicts to take on the major banks and financial institutions, gelling perfectly with RPC's existing banking disputes practice, which is a market leader in both the UK and Asia.

Additionally, the Premier Law team – shortlisted as Boutique Law Firm of the Year at the Asian Legal Business SE Asia Law Awards 2016 – support blue chip organisations doing business across Singapore, Indonesia, Malaysia, Hong Kong and China.

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This roundup is intended to give general information only and may be of general common law or regulatory interest. It is not a complete statement of the law. It is not intended to be relied upon or to be a substitute for legal advice in relation to particular circumstances. Specific circumstances require specific advice.

English judgments

*Banco Santander Totta SA v (1) Companhia De Carris De Ferro De Lisboa SA (2) Sociedade Transportes Colectivos Do Porto SA (3) Metroropolitano De Lisboa Epe (4) Metro Do Porto SA*¹³

Summary: The High Court held that Article 3(3) of the Rome Convention 1980 (Article 3(3)) could not be used to displace a contractual choice of English law with certain mandatory provisions of Portuguese law even where both contracting parties were Portuguese.

The claimant was Banco Santander Totta (BST) and the defendants were Portuguese public sector transport companies (Transport Companies). Between 2005 and 2007, the Transport Companies entered into several interest rate “snowball” swaps with BST under ISDA Master Agreements subject to English law and jurisdiction.

Under the swap agreement, BST paid the Transport Companies an interest rate of 3% on terms that, after a two year period, the Transport Companies would be liable to pay an additional increased rate on top of their fixed rate.

After the expiry of the two year period in 2009, the Transport companies had to pay interest at a very high rate (up to 40%) under the swap agreement at a time when Euribor rates were around 1%.

By 2013, the Transport Companies had failed to make payments under the swaps with the total unpaid amount stated to be €272.5m.

BST brought proceedings seeking a declaration that the Transport Companies’ obligations under the swaps agreement were valid and enforceable and for payment of the sums due to it pursuant to those obligations.

The Transport Companies’ defence was that:

- all of the relevant elements of the swaps were connected to Portugal and that under Article 3(3), certain Portuguese laws relating to gaming and betting, and rules dealing with an “abnormal change of circumstances” (Portuguese Mandatory Rules), would apply to the case. As a result, the swaps contravened the Portuguese Mandatory Rules and were void
- under Portuguese law, they lacked capacity to enter into the swaps, and that BST had acted in breach of duties owed to customers under the Portuguese Securities Code in presenting the swaps to them. As a result, the Transport Companies were entitled to claim against BST in damages which would extinguish their liabilities under the swaps.

The Court concluded that Article 3(3) was not engaged because all the elements relevant to the situation were not solely connected with Portugal. The swaps were not purely domestic contracts. In particular, the Court relied upon:

- the right to assign BST’s rights and obligations to a bank outside Portugal
- the use of standard international documentation (the ISDA Master Agreements)
- the practical necessity for the relationship with a bank outside Portugal
- the international nature of the swaps market in which the contracts were concluded
- the fact that back-to-back contracts were concluded with a bank outside Portugal in circumstances in which such hedging arrangements were routine.

13. [2016] EWHC 465.

Accordingly, the Portuguese Mandatory Rules did not apply and the swaps were binding on the Transport Companies.

The Court rejected the Transport Companies' arguments on lack of capacity and held that they had had legal capacity to enter into the swaps. The swaps were capable, at the time of their execution, of assisting the Transport Companies to achieve their purpose of pursuing profit or operating a transport system.

Further, the Court commented that it is the nature of interest rate swaps that a movement in interest rates that is positive for one party will be negative for the other. It stated that a bank cannot be expected to give preference to the counterparty's interests over its own when it is dealing on its own account. On this basis, the Court concluded that the alleged duties under the Portuguese Securities Code did not exist. Thus there was no issue of breach of duties.

It is interesting to note that the use of standard ISDA Master Agreements was considered by this Court to be a relevant factor with regard to Article 3(3) in the present case, which is a departure from a previous decision in *Dexia Crediop SpA v Comune di Prato*¹⁴.

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LSREF III Wight Ltd v Millvalley Ltd¹⁵

Summary: The case concerned a restructured swap agreement that had mistakenly referred to the wrong version of the International Swaps and Derivatives Association (ISDA) Master Agreement. The High Court held that the drafting had not gone so wrong that there was a clear mistake that required correction. However, the agreement could be rectified as the parties had a continuing common intention about which version of the Master Agreement applied.

The Defendant was Millvalley Ltd, a private property development company based in the Isle of Man. The Claimant was LSREF III Wight Limited, a successor in title to the Irish Bank Resolution Corporation Ltd (IBRC).¹⁶

The Defendant wished to acquire property in Glasgow and, in order to finance this venture, the Defendant obtained a loan facility and an accompanying swap from the IBRC on 10 November 2006 (the Original Swap).

The Original Swap was subsequently confirmed in a long form swap confirmation on 2 January 2007 incorporating the terms of a 1992 ISDA Master Agreement.

The parties agreed to extend the Original Swap, following partial repayment of the loan by the Defendant, and executed a finalised 2002 ISDA Master Agreement and Schedule on 13 December 2011.

The key difference between the 1992 ISDA Master Agreement and 2002 ISDA Master Agreement was that the latter included additional termination events which gave rise to an entitlement on the part of the Claimant to terminate in the event of repayment of the loan.

Almost a year later, on 14 December 2012, IBRC and the Defendant entered into a restructured swap on the same commercial terms as the Original Swap (the Restructured Swap). The Restructured Swap was, like the Original Swap, a long form confirmation containing wording referring to the 1992 ISDA Master Agreement.

14. [2015] EWHC 1746 (Comm).

15. [2016] EWHC 466 (Comm).

16. IBRC was the successor corporation to Allied Irish Banking Corporation plc (AIB). During the period when the Original Swap and its extension were entered into IBRC was known as AIB.

In June 2014, Millvalley repaid the loan in full earlier than agreed. IBRC was in liquidation and, relying on the additional termination events in the 2002 ISDA Master Agreement, terminated the Restructured Swap and assigned its claim to the Claimant.

In response, the Defendant asserted that the Restructured Swap was governed by the 1992 ISDA Master Agreement and, therefore, no early termination events were available to the Claimant.

Subsequently, the Claimant brought a claim seeking a declaration from the Court that, whether by way of construction or rectification, the Restructured Swap incorporated the 2002 ISDA Master Agreement and, consequently, the early termination amount was due and payable to the Claimant by the Defendant.

In summary, the issues before the court were whether:

- the Restructured Swap was governed by the 1992 or 2002 ISDA Master Agreement
- the Restructured Swap should be rectified so as to be subject to the 2002 ISDA Master Agreement.

Construction

The judge made clear that the reference to the 1992 ISDA Master Agreement as part of the Restructured Swap was, on the facts, a mistake. He stated that there was no possible reason for changing the terms on which the extension of the swap had been agreed in 2011 and pointed to the fact that its inclusion was merely an administrative error on the part of IBRC.

The judge ultimately held that, as a matter of construction:

- it could not be concluded that the parties' objectively expressed intention had been for the Restructured Swap to be governed by the 2002 ISDA Master Agreement
- it could not be said that something had gone so wrong with the language that there was a clear mistake that required correction
- on the face of the documents, there was no ambiguity or difficulty in construing the language used and the reference to the 1992 ISDA Master Agreement could not be said to be such a commercial nonsense as to make it absurd for the parties to refer to it.

As a result, the court could not construe the Restructured Swap in such a way as to incorporate the 2002 ISDA Master Agreement.

Rectification

The judge highlighted that the requirements a party must show for rectification are those set out in *Daventry District Council v Daventry & District Housing*¹⁷, namely that:

- the parties have a common continuing intention in respect of a particular matter in the instrument to be rectified
- there was an outward expression of accord
- the intention continued at the time of execution of the instrument
- by mistake, the instrument did not reflect that common intention.

The parties' common intention was to be ascertained objectively, by reference to what a hypothetical reasonable observer, aware of all the relevant facts known to both parties, would conclude the intentions of the parties to be.

17. [2012] 1 WLR 1333.

The judge held that it was clear from the parties' exchanges leading up to entry into the Restructured Swap that there was a common continuing intention and an outward expression of accord that the Restructured Swap should be governed by the 2002 ISDA Master Agreement.

As a result, the Restructured Swap was rectified to include express reference to the 2002 ISDA Master Agreement and the early termination amount was due and payable to the Claimant by the Defendant under the Restructured Swap with costs and interest.

It should be noted that the evidence demonstrating the intention of the parties to rely on the 2002 ISDA Master Agreement was overwhelming and that, as a result, this case should not encourage readers to rely on rectification to fix faulty drafting. By way of example, the Defendant and its solicitors actually relied on the 2002 ISDA Master Agreement in correspondence prior to the termination and the parties accepted that the 1992 ISDA Master Agreement was only referred to in the Restructured Swap due to an administrative error of IBRC.

Finally, the case highlights the importance of correctly wording swap confirmations. If parties fail to do so it can lead to costly litigation or, at worst, can bind them to an incorrect contract.

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*WW Property Investments Limited v National Westminster Bank plc*¹⁸

Summary: The High Court confirmed that interest rate hedging agreements are not wagers in law where at least one party enters into the contract for a genuine commercial purpose and not to speculate. Additionally, the High Court struck out a claim that the bank had breached an implied term of the swap agreement that it would not manipulate the London Interbank Offered Rate (Libor).

Between 2004 and 2010 the defendant bank lent money to the claimant. During the same period, the claimant executed three interest rate hedging agreement (the Collars) with the bank, before closing these out and entering into a further interest rate agreement in 2010 (the Swap).

In 2014, the agreements were reviewed pursuant to an agreement that the major banks had reached with the Financial Services Authority (now the Financial Conduct Authority (FCA)). In August 2014, following this review, the Claimant accepted an offer of redress from the bank in relation to the Collars. The claimant signed a compromise agreement in full and final settlement of claim connected with the sale of the Collars, but reserved its rights to claim for additional losses under the review. A claim in the FCA review for such additional consequential loss was subsequently made by the claimant and a claim for redress in relation the swap; both were rejected by the bank.

Following this, the claimant brought legal proceedings against the bank alleging that:

- the Collars and Swap amounted to contracts for differences and were wagers at common law. As a result, the contracts were subject to implied terms that the chances are equal and the parties possess equal ignorance and/or equal knowledge of the odds. These implied terms had been breached as the bank had not disclosed to the Claimant that the market value on day one was in the bank's favour and there was not equal uncertainty to both sides. Therefore the contracts were voidable and damages payable by the bank
- the bank was subject to an implied term in the swap that it would not manipulate Libor and it had breached that term by manipulating Libor to its advantage causing the Claimant loss

18. [2016] EWHC 378 (QB).

- the bank owed the claimant a duty of care in tort in connection with the manner in which it conducted the review of the Collars and Swap, which it had breached, causing the Claimant loss.

The bank applied to strike out the claim, relying on the terms on the compromise agreement.

The judge held that the claims in relation to the Collars had been settled under the compromise agreement.

In respect of the remaining claims relating to the Swap, the judge found:

- the High Court and Court of Appeal had previously rejected the argument that interest rate hedging agreements are wagers and that this claim attempted to raise substantially the same arguments. He noted that the test for such matters comes from *Morgan Grenfell v Welwyn Council (2)*¹⁹ that an interest rate swap agreement is not a wager where at least one party enters into the contract for a genuine commercial purpose and not to speculate. Therefore, he held this claim had no real prospect of success
- the Libor claim was vague, generalised, unclear and not properly pleaded. He was also of the view that there was no relevant breach clearly alleged. Therefore, he held this claim had no real prospect of success
- the tort claim as initially advanced was vague and incoherent. The judge ruled that the case had no prospect of success as presently formulated. In oral submissions, the Claimant attempted to advance that the bank had not complied with the FCA's requirements for the FCA Review. The bank objected as this claim was not pleaded and the Claimant sought permission to amend the claim.

Accordingly, the judge refused permission to amend and struck out the claimant's claim in its entirety.

The court has now made it very clear that it will not entertain swaps claims based on the proposition that interest rate hedging agreements should be treated as wagers at law, as long as at least one party entered into the relevant agreement for a genuine commercial purpose and not to speculate.

In relation to the claims based on breach of implied terms not to manipulate Libor and for breach of duty of care owed in respect of conduct of the review, the court's decision to strike out was based on the way they were pleaded and only gives limited insight into the court's approach to these claims more generally. For the court's approach to swap claims arising to manipulation of Libor, the case of *Property Alliance Group v Royal Bank of Scotland* (discussed below) should be monitored.

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***Sivagnanam v Barclays Bank plc* (unreported)**

The Commercial Court held that where a company had entered into interest rate hedging products with a bank, the company's sole shareholder and director could not bring a claim for loss said to have been suffered as a private person as a result of breach of the conduct of business rules under s138D Financial Services and Markets Act 2000 (FSMA).

Mr Sivagnanam was the sole shareholder and director of a company (the Company) that had purchased three interest-rate hedging products (the Transactions) from Barclays Bank plc

19. [1995] 1 All ER 1.

(Barclays) in 2006, 2007 and 2008. Following a review of the Transactions by the FSA, the Company accepted a full and final settlement of any claim howsoever arising in return for £2.4m. Barclays paid this compensation pursuant to a redress scheme.

Mr Sivagnanam then brought proceedings alleging that as a private person he had suffered loss as a result of Barclays' contravention of the relevant conduct of business rules within s138D FSMA. The definition of "private person" in reg 3 FSMA (Rights of Action) Regulations 2001 (the Regulations) includes an individual, unless he suffered the loss in question in the course of carrying on a regulated activity, and a person who was not an individual, unless he suffered the loss in question in the course of carrying on business of any kind.

Barclays applied for summary judgment or to strike out the claim, arguing that Mr Sivagnanam was not within the class of persons intended to have a right of action under the relevant statutory provisions; alternatively that the claim was barred as merely reflective of the Company's loss.

Cooke J granted summary judgment in favour of Barclays. Firstly:

- every alleged breach of FSMA was clearly pleaded by reference to the position of the Company, which was the client or customer. It was clear that the rules protected customers who were private persons and not their shareholders. No breach of duty towards Mr Sivagnanam was pleaded and no duty was owed to him; the only plea relating to Mr Sivagnanam was that Barclays had required him to inject money into the Company and put up security
- the court accepted Barclay's submission that Mr Sivagnanam had to be within the category of person which the rule, as a matter of interpretation, was intended to protect. Mr Sivagnanam was not within that category. It was not necessary to consider whether the Company had a claim under FSMA or whether Mr Sivagnanam had a common law claim
- furthermore, the conclusion that Mr Sivagnanam had no cause of action because he was not within the class intended to be protected was in accordance with authority under the previous regulatory regime. The claim had no real prospect of success and Barclays was entitled to summary judgment.

Secondly, the court considered the rule against reflective loss:

- the claim fell foul of the principle that a shareholder cannot recover loss that is merely reflective of a company's loss if the company could, itself, put forward a claim for that loss. If a defendant wrongdoer owes duties to both a company and a shareholder, it is irrelevant that the duties owed might be different in content if the loss is merely reflective
- it was clear from the pleadings that the alleged breaches were in respect of duties owed to the Company, and that it was the Company that had been deprived of moneys which it would have used as shareholders' funds to pay dividends or repay loans. Therefore, the loss was the Company's loss which was reflected in a reduced ability to make payments to Mr Sivagnanam or in a reduced value of his interest
- the Company was not a private person for the purposes of s138D FSMA and it had no common law claim. However, it had received compensation for any rights that it might have had and it could not be said that it had not had a claim with no reasonable prospect of success. That conclusion was consistent with two purposes of the rule against reflective loss: to prevent double recovery and to preserve the autonomy of the Company for the benefit of creditors, employees and shareholders.

This decision reinforces the restrictive approach to the definition of “private person” under the Regulations, holding that the definition does not cover the sole shareholder and director of a company as that is not a category of person which the rule was intended to protect. However, with the appeal of *MTR Bailey Trading Ltd v Barclays Bank plc*²⁰ pending, and the recent decision in *Suremime Ltd v Barclays Bank plc*²¹ (the former on the scope of s138D FSMA as it applies to companies, and the latter on a tortious claim to run parallel to s138D FSMA for corporate claimants – [click here](#) for further detail), this is a developing area to watch.

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Ennismore Fund Management Limited v Fenris Consulting Limited²²

Summary: The Privy Council dismissed an appeal from the Cayman Island Court of Appeal (the CICA). The court upheld the decision of the CICA that the Claimant could only claw back a discretionary bonus paid to an individual fund manager if it could establish a causal link between the losses sustained by the funds for which that manager was responsible and a reduction in its own performance fee.

The claimant was Ennismore Fund Management Limited (the Claimant), a company incorporated in England and Wales that acted as the investment manager of two Cayman Island funds and an Irish mutual fund (the Funds.) The defendant was Fenris Consulting Limited (the Defendant), a company incorporated in Belize that provided fund management consultancy services to the Claimant under a Consultancy Services Agreement (CSA) dated 24 June 2004.

The CSA contained no provision for the payment of bonuses but it was common practice at the time for the Claimant to pay annual performance bonuses to its fund managers, including the Defendant. The bonuses were based on the performance of the individual funds or portfolios for which each fund manager was responsible. A portion of the bonus payable to each fund manager in respect of each year was held back and invested by the Claimant on the fund manager’s behalf on the basis that the retained investments were subject to clawback by the Claimant in the event that the portfolio for which that fund manager was responsible under-performed in the subsequent 3 years.

In 2006, the parties signed a clawback agreement to formalise the above arrangement.

In 2007 and 2008, following the global financial crisis, the funds for which the Defendant was responsible suffered losses. As a result, the Claimant attempted to invoke the clawback agreement to repossess assets it held on behalf of the Defendant.

The issue in these proceedings was whether the Claimant was entitled to exercise rights of clawback against investments which it has retained out of the bonus payable to the Defendant in respect of the three years prior to 2008. This proved complex as it was unclear under the clawback agreement what conditions were required to trigger the clawback. Lord Clarke noted that the clawback agreement itself did “not contain a sufficient statement of the conditions giving rise to clawback because there is no formula for the relevant calculation”.

As a result, the case turned on the construction of the clawback agreement, namely:

20. [2015] EWHC 2882 (QB).

21. [2015] EWHC 2277 (QB).

22. [2016] UKPC 9.

“Whether clawback depended upon a reduction in Ennismore’s own performance fee or whether clawback applied if the individual fund manager’s portfolio generated a loss regardless of the effect on Ennismore’s performance fee.”

In determining this point, the court applied the principles of construction from *Arnold v Britton*²³ and identified a section of the agreement that provided the formula to compute the clawback fees which was a percentage “of the reduction in the performance fee earned by the Company attributable to any net investment losses”. Its conclusion was based on the principle that a reasonable person in the position of the parties would have given the words in the agreement their ordinary meaning and come to this conclusion.

Therefore, the court upheld the decision of the CICA that the Claimant could only claw back a discretionary bonus paid to an individual fund manager if it could establish a causal link between the losses sustained by the funds for which that manager was responsible and a reduction in its own performance fee.

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Wood v Sureterm Direct Ltd²⁴

Summary: The court held that an indemnity clause under a sale and purchase agreement should be given its plain meaning, even if it is uncommercial for one party.

The Claimant and Defendant entered into a sale and purchase agreement (SPA) under which the Defendant indemnified the Claimant “against all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and all fines, compensation or remedial action or payments imposed on or required to be made by the Company following and arising out of claims or complaints registered with the FSA, the Financial Services Ombudsman or any other Authority against the Company, the Sellers or any Relevant Person and which relate to the period prior to the Completion Date pertaining to any mis-selling or suspected mis-selling of any insurance or insurance related product or service”.

Following the completion of the sale of the target company, the company became aware of potential mis-selling practices carried out by the previous owners. The company undertook an internal investigation and, following this, both the company and the Claimant were obliged to inform the Financial Services Authority of their findings. As result, the company and the buyer became liable under the SPA to pay a substantial amount of compensation to customers.

The Claimant brought proceedings seeking to claim the amount payable under the indemnity from the Defendant. The key issue was whether the indemnity covered compensation paid arising out of self-reporting by the company, as opposed to claims or complaints registered with the FSA.

The Court of Appeal held that the relevant principles for consideration were those in *Arnold v Britton*²⁵. As a result, the court considered the ordinary and natural meaning of the indemnity and found that the indemnity excluded claiming for self-reporting. The court added that there was no real basis linguistically or grammatically to interpret the indemnity in another way.

Additionally, the court rejected the buyer’s argument that this interpretation would lead to an uncommercial result for the buyer because it is not the Court’s role to make good a poor deal.

23. [2015] UKSC 36.

24. [2015] EWCA Civ 839.

25. [2015] UKSC 36.

The Court of Appeal highlighted that business people often make bad bargains for a variety of reasons (for example being in a weak negotiating position) and it is not the court's place to reject the natural interpretation of a clause for the purposes of achieving what it perceives to be a more commercial outcome.

The decision emphasises that the courts will look to the wording of the contract and commercial business sense does not override plain words in a contract.

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*David Anderson v Openwork Limited*²⁶

Summary: This case found that the common law duty of care in tort is in addition to existing statutory duties under FSMA and the COB Rules.

Mr Anderson (the Claimant) invested in a Newcastle Guaranteed FTSE Bond (the Bond) on the basis of advice provided by his financial advisor, a Partner with the network Openwork Limited (the Defendant). Subsequently, the investment in the Bond resulted in substantial losses for the Claimant.

As a result, the Claimant brought a claim against his financial advisor for the losses that arose out of his investment in the Bond, on the basis that:

- his financial advisor had made negligent misstatements in relation to the Bond
- the advice given breached the COB rules
- the advisor breached his common law duty of care by failing to take reasonable steps to ensure that the Bond was suitable for the Claimants' needs.

At first instance, the judge held that:

- there had been no negligent misstatement
- when considering the duty of care owed by the financial advisor, regard should be given to the standards set out in the COB rules. Although the sale was not regulated under FSMA, the court applied the FSA's (now FCA's) Conduct of Business rules (COB) by analogy
- the financial advisor had satisfied its duty to ensure that the relevant information about the Bond was known to the Claimant
- the financial advisor had not satisfied its duty to take reasonable steps to ensure the Claimant understood the risks associated with the Bond.

The Claimant was awarded damages of £5,459 plus interest. Consequently, the Defendant appealed and the key issues for the court's consideration were:

- whether a common law duty of care can exist where there is a statutory duty of care which covers more complicated investments (in this case, the COB rules)
- whether the standards in the COB Rules should be considered when assessing the common law duty of care the applied
- whether there was a breach of the common law duty of care on the facts of this case.

26. [2015] EW Misc B14.

The judge found that:

- previous case law did not preclude a common law duty of care whether there is a pre-existing statutory duty of care in circumstances like these
- the first instance judge had “simply and understandably made reference to them (the COB Rules) in considering the duty applied” which he found was the correct approach
- the first instance judge was entitled to find that the financial advisor had breached its common law duty of care by not taking reasonable care to ensure that the Claimant understood the nature of risks relating to the Bond.

This case reinforces the courts’ view that, whilst the question of whether a duty of care exists is largely fact-dependent, there is a general consensus that once found, the scope of that duty should be informed by the regulatory framework.

We can therefore expect the interrelationship between common law and financial regulation to continue to play a significant role in future mis-selling claims. In circumstances whether there is no directly applicable regulatory regime, the court may look to an analogous regime for guidance as to the scope of the common law duty.

This cases also emphasis that a common law duty of care can be imposed in addition to a statutory duty of care.

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Ongoing cases and current awareness

Property Alliance Group v Royal Bank of Scotland

As mentioned above, this case will provide valuable insight into the courts' approach to swap claims arising out of the manipulation of Libor.

The claimant alleges that the defendant made representations concerning Libor in relation to interest rate hedging product agreements entered into by the parties and that the defendant:

- breached the implied warranty that these representations were true
- breached various implied terms of the relevant customer agreement in relation to Libor.

In January 2016, on application of the bank, the case was transferred to the new Financial List. The trial in this case commenced on 26 May 2016. It will be worth monitoring this case to identify the wider approach of the court to claims based on breach of implied terms not to manipulate Libor.

The claimant has instructed Brick Court's Tim Lord QC, Kyle Lawson, Ben Woodgar and XXIV Old Building's Adam Cloherty. The defendant has instructed Fountain Court's David Railton QC and Adam Sher.

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Bank St Petersburg PJSC and Alexander Savelyev v Vitaly Arkhangelsky, Julia Arkhangelskaya and Oslo Marine Group Ports LLC

A team from RPC's Banking and Financial Disputes group led by Tom Hibbert and Andy McGregor are representing Bank St Petersburg in its dispute with Russian Vitaly Arkhangelsky.

Russia's largest private bank is seeking to enforce a series of guarantees and loans against the defendants. In response, the defendants have counterclaimed that the Bank conspired with government officials to perform a corporate raid on assets of the Oslo Marine Group worth allegedly more than £500m.

The team at RPC has instructed Brick Court Chambers' Tim Lord QC, Simon Birt QC and Richard Eschwege to represent the Bank. The Defendants, previously represented by Withers, are now represented by Pavel Stroilov (a McKenzie Friend).

The trial started at the end of January and is due to finish in July of this year.

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Marme Inversiones v Royal Bank of Scotland, HSH Nordbank, AG Bayerische Landesbank, ING Bank and Caixa D'Estalvis

Property tycoon Glenn Maud has brought an £800m claim against the Royal Bank of Scotland (RBS) over alleged losses arising from Euribor rigging. The case is likely to be the most valuable Euribor rigging and swaps mis-selling dispute litigated in London.

The action relates to a finance package entered into as part of the purchase of Santander's global headquarters for £1.5bn by Maud's property vehicle Marme Inversiones. RBS led as the majority lender on the provision of the finance package with the other defendants.

Maud alleges that RBS knew it was manipulating the European interest rate benchmark and, as a result, the interest rate swaps entered into with the bank should be rescinded and damages paid "for fraudulent or negligent misrepresentation or deceit".

The claimant has instructed 4 Stone Buildings' Richard Hill QC and Alastair Tomson. The first Defendant, RBS, has instructed 2 Verulam Buildings' Adrian Beltrami QC and Laura John.

The case is due to be heard in the Chancery Division of the High Court in May.

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Libyan Investment Authority v Goldman Sachs and ors

The Libyan Investment Authority (LIA), a North African sovereign wealth fund, has brought an action against Goldman Sachs for \$1.2bn over losses it made during the reign of Colonel Gaddafi.

The LIA allege that Goldman Sachs abused their relationship of trust and role as advisors to the fund. LIA argue that, as a result of this abuse, the LIA entered into deals that caused the fund to lose billions of dollars but resulted in the banks receiving substantial payoffs.

Specifically, the management of the fund have accused executives at Goldman Sachs of persuading unsophisticated LIA officials to enter into complex derivative trades that they did not understand, pocketed fees for this personally and improperly courted the fund with expensive trips abroad.

The Claimant has instructed Brick Court's Roger Mansfield QC, Edward Harrison and Craig Morrison, 20 Essex Street's Philip Edey QC, Blackstone's Andrew George QC and XXIV Old Buildings' Edward Cumming and Robert Avis.

The Defendant has instructed 4 Stone Buildings' Robert Miles QC and Greg Denton-Cox and One Essex Court's Orlando Gledhill.

The case is due to be heard in the Chancery Division of the High Court from 13 June for seven weeks.

Separately, the LIA is also bringing a claim against Societe Generale for \$2.1bn losses caused by derivative trades it advised the sovereign wealth fund to enter into before Libya's 2011 uprising. The claimant has instructed Brick Court's Roger Mansfield QC, Richard Blakeley, Craig Morrison and Blackstone Chambers' Andrew George QC. The Defendant has instructed 3 Verulam Buildings' Adrian Beltrami QC, Sandy Phipps QC and One Essex Court's Alexander Polley. The case is due to be heard in early 2017.

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Lloyds Bank Shareholders action over the takeover of HBOS

A group of shareholders are bringing an action against the Lloyds banking group for allegedly misleading them during their acquisition, in January 2009, of Halifax Bank of Scotland (HBOS). The shareholders, including private investors, pension funds and insurers, are seeking around £350m in damages.

Specifically, the shareholders argue that the directors of Lloyds failed to disclose fully the perilous state of HBOS's finances when they provided shareholders with a document on the acquisition and, consequently, breached their duties to the shareholders. The shareholders claim that, as a result of the takeover, their investments decreased in value by £1 per share.

A case management conference is listed for a day and a half on 22 July 2016.

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Legal developments

Predictive coding receives further court approval

In February 2016 the English court, for the first time, gave formal judicial approval of the use of predictive coding technology for disclosure reviews in English proceedings. RPC, alongside Robert Miles QC and James Knott of 4 Stone Buildings, acted for the claimants in those proceedings.²⁷

Subsequently the High Court in May 2016 further affirmed the use of predictive coding technology as part of a substantial document review.²⁸

As widely reported, predictive coding has the potential to drastically reduce the costs of conducting a disclosure review of electronic documents and these rulings are a huge step forward for its acceptance by the UK judiciary.

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CFA success fees and ATE premiums no longer recoverable for insolvency cases

From 6 April 2016, conditional fee agreements (CFA), after the event premiums and success fees will no longer be recoverable in insolvency cases.

The legislative change is set to have the biggest impact on lower-value insolvency cases (damages less than £500,000 and legal costs lower than £200,000).

In addition, the ratio between the estimated value of a claim to legal costs of pursuing a claim (including the insurance premium covering personal exposure for the insolvency practitioner) will be of critical importance when deciding whether to commence litigation on a creditor's behalf.

For higher-value cases where recovery runs into the millions there will be more flexibility in seeking alternative funding costs. Although these large cases provide greater flexibility, they will likely involve substantial legal and insurance premium costs.

Consequently, the difference between being able to recover the cost of the ATE premium as part of costs, as opposed to paying for the premium out of the damages or settlement, will have a significant impact on the net recovery for creditors.

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27. *Pyrrho Investments Ltd v MWB Property Ltd* [2016] EWHC 256 (Ch)

28. *David Brown v BCA Trading* [2016].

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