serle**speak**
ISSUE NO.6

"Welcome to this new edition of Serlespeak, on developments in the law of banking and financial services. In the first article I consider the significant volume of litigation that has emerged from the financial crisis, and in particular the problems faced by prospective claims against banks for mis-selling and bad advice. Geraldine Clark also considers mis-selling claims, this time focussing specifically on the selling of SCARPs to retail investors. Later Conor Quigley QC examines the interaction between the law of EU State Aid and the effects of the credit crunch, whilst Elizabeth Jones QC looks at aspects of the law of money-laundering in Jersey, Guernsey, and England. Finally, John Machell discusses the creditor's obligation of disclosure to a prospective surety." **NICHOLAS LAVENDER QC**

Claims against Banks after the Financial Crisis

THE CONSEQUENCES OF THE GLOBAL FINANCIAL CRISIS OF 2008 WILL BE WITH US FOR MANY YEARS TO COME AND WILL CONTINUE TO BE FELT WELL BEYOND THE BANKING COMMUNITY.

Within the banking community, however, one consequence of the financial crisis has been a great deal of litigation of various kinds. The most obvious example is the insolvency of Lehman Brothers and others (e.g KSF for which see *Mills v Sportsdirect.com Retail Ltd* [2010] 2 BCLC 143), which has been a major source of litigation, as have the well-known collapses of the likes of Allen Stanford's bank and Bernie Madoff's investment schemes. Insolvency has also been the fate of many structured investment vehicles (see, e.g., *Re Sigma Finance Corp.* [2010] 1 All ER 571; and *Re Golden Key Ltd* [2009] EWCA Civ 636).

In addition, several of the financial instruments which became increasingly popular in the run-up to the crisis have been the subject of post-crisis litigation. This includes CDOs (e.g. *UBS AG v HSH Nordbank AG* [2009] 2 Lloyd's Rep. 272; and *RBS v Highland Financial Partners LP* [2010] EWCA Civ 809; EWHC 3119 (Comm)), credit default swaps (e.g. *JP Morgan v Berliner Verkehrsbetriebe (BVG)* [2010] EWCA Civ 390; *Depfa Bank plc v Provincia di Pisa* [2010] EWHC 1148 (Comm); and *UBS AG v Kommunale Wasserwerke Leipzig GmbH* [2010] EWHC 2566 (Comm)) and SCARPs (see Geraldine Clark's article).

However, the financial crisis has not, so far at least, generated as many claims against banks for mis-selling or bad advice as might perhaps have been expected. To some extent, this may be a matter of timing. Relevant limitation periods have not yet expired, and many potential claimants may still be too busy dealing with the business effects of the crisis to devote significant resources to uncertain litigation.

Perhaps more significant, however, as a cause of the relative absence of claims is the deterrent effect of a series of judgments in favour of banks accused of negligent advice or misrepresentation concerning sophisticated financial products. The most significant is *JP Morgan Chase Bank v Springwell Navigation Corp*. [2008] EWHC 1186 (Comm). Gloster J gave judgment in May 2008, only a few months before the crisis peaked in September 2008, and the Court of Appeal recently upheld her judgment ([2010] EWCA Civ 1221).

The *Springwell* judgment highlights obstacles for potential claimants in establishing all of the essential elements of a claim, i.e. duty, breach and causation.

A duty to advise will be difficult to establish unless (a) there is an express agreement to advise or (b) the customer is an individual or other "private person" (an expression considered and given a narrow meaning in *Titan Steel Wheels Ltd v RBS* [2010] 2 Lloyd's Rep 92), who has a statutory right of action under section 150 of the Financial Services and Markets Act 2000 for any breach of the FSA's rules.

In particular, while individuals employed on a bank's trading desk express opinions or make recommendations or other statements which could as a matter of ordinary language be characterised as advice or representations, this in itself is unlikely to give rise to a duty of care in the absence of exceptional circumstances. The context also makes it difficult to characterise such statements as actionable misrepresentations.

This position is likely to be reinforced by the bank's standard documentation, which usually contains disclaimers and agreements to the effect that the bank has not given advice or made representations and that the customer has not relied on any advice or representation from the bank. The *Springwell* judgment emphasises the difficulty of going behind such provisions. In particular, the Court of Appeal has affirmed that such an agreement will take effect as a contractual estoppel, and will be effective even if the parties know that advice is in fact being given.

Assuming that a duty of care is established, it is not enough for the claimant to say, "You advised me and I lost money". The claimant must show negligence on the part of the bank. Three points are worthy of note.

First, the more knowledgeable and sophisticated the customer, the harder it will be to show negligence. An advisor is not obliged to tell his client what the client already knows.

Second, the bank's duty will be to advise on suitable investments. It is the customer's investment objectives and attitude to risk which determine suitability. A customer who wants to pursue an aggressive investment policy has expressed a preference for riskier investments. He will find it difficult to allege that the bank ought to have recommended conservative investments.

Third, the extent of the financial crisis was difficult to predict. Although not so unexpected as to constitute force majeure (as the defendant somewhat hopefully contended in *Tandrin Aviation Holdings Limited v Aero Toy Store LLC* [2010] EWHC 40 (Comm)), the crisis clearly caught out many major financial institutions.

As for causation, claimants need to establish (a) that they relied on the bank's allegedly negligent advice and (b) that they would have acted differently if they had not been given that advice. The *Springwell* judgment shows how a sophisticated and aggressive investor may face difficulties in demonstrating this. (As always, a claimant who can establish fraud will usually be in a stronger position: see *Parabola Investments Ltd v Browallia Cal Ltd* [2010] 3 WLR 1266, in which damages were assessed on the basis that, but for the fraud, the claimant would have traded successfully, making annual profits up to 109%.)

The result is that potential claimants who lost out in the crisis need to think carefully before proceeding against their banks. The obstacles should be identified in advance and claims need to be carefully and realistically framed and supported by cogent expert evidence. It is no wonder that many potential claimants are taking their time before bringing proceedings.

NICHOLAS LAVENDER QC has acted in a broad range of commercial litigation and arbitration. This includes many banking disputes, such as the *Springwell* trial. He is recommended by Legal 500 and Chambers and Partners in the fields of Banking and Finance and Commercial Litigation/ Dispute Resolution.

The Mis-selling of SCARPs to Retail Clients

THE FINANCIAL CRISIS FOLLOWING THE COLLAPSE OF LEHMAN BROTHERS IN SEPTEMBER 2008 HAS RESULTED IN NUMEROUS MIS-SELLING AND MISREPRESENTATION CLAIMS BROUGHT AGAINST BANKS BY WEALTHY INDIVIDUALS WHO WERE SOLD STRUCTURED CAPITAL AT RISK PRODUCTS ("SCARPS") AND OTHER DERIVATIVE INVESTMENTS BETWEEN 2001 AND 2008.

Usually the claimant will have invested large sums in structured products on the advice of a so-called "financial adviser" – in reality a salesman with an impressive title – employed by a bank. SCARPs were often sold as safe investments when, in fact, they were gambles on the volatility of a share index or a currency rate or interest rate over a three or five year term. The products were so complex and obscurely documented that retail investors were utterly dependent on the bank's employees to explain the risks.

Usually, the investor would receive a fixed rate of interest provided that a specified market index, interest rate or exchange rate stayed within a specified range. However, if the underlying index or rate moved outside the limits for even one day, the investor would receive no interest for the remainder of the term and would lose capital on redemption. The issuing bank's liability to pay interest if the market stayed within the range was limited by an early redemption option while the investor would be locked in for the term of the investment.

The retail investors who lost the most were those whom the bank persuaded to leverage their investments. By investing funds borrowed from the bank in addition to their own capital, investors received enhanced returns when the market was within the range. However, when market volatility increased during the financial crisis, they lost heavily. They remained liable to pay interest on their loans, received no return on their investments to offset it, and stood to lose capital on redemption. Further, the banks applied mark-to-market accounting and the loan agreements gave them the right to call for additional collateral on the loans at short notice. Where those investors would not or could not deposit large sums of cash on demand, the bank could sell their investments at the bottom of the market and close out their accounts. Such investors lost all the capital invested and the interest earned to date and found themselves owing money to the bank.

Few investment mis-selling cases against banks have come to court. Such authorities as there are tend to involve sophisticated investors with an understanding of markets and extensive investment experience. This was the case in *Springwell Navigation Corp. v JP Morgan Chase and Ors* [2010] EWCA Civ 1221 (see Nicholas Lavender QC's cover article).

In my experience, SCARPs mis-selling claims brought by unsophisticated customers have good prospects of success. As "retail clients" they have enhanced statutory protection and they can challenge the bank's terms and conditions under the Consumer Contract Regulations 1999 and UCTA 1977. It is no accident that none of these cases has come to trial. No bank can risk a commercial court judgment criticising its sales team's tactics, its internal record-keeping and management controls, and finding breaches of the FSA's Conduct of Business Sourcebook. Moreover, an adverse judgment against one bank would have ramifications throughout the whole industry.

GERALDINE CLARK specialises in Commercial/Chancery litigation particularly financial services, insurance, professional negligence, commodities trading, shipping and company law. During 2010 she was engaged in two major derivative mis-selling actions involving investment banks.

Banks, the financial crisis and EU State Aid law

EU STATE AID LAW WAS UNTIL RECENTLY REGARDED AS A RELATIVELY ESOTERIC SUBJECT, FORMING A PART OF THE COMPETITION RULES ENFORCED BY THE EUROPEAN COMMISSION, AND HAVING ONLY LIMITED IMPACT ON COMMERCIAL LIFE. THE FINANCIAL CRISIS HAS, HOWEVER, GIVEN IT AN EXPOSURE THAT HAS CATAPULTED STATE AID INTO THE WIDER WORLD, WITH HUGE RAMIFICATIONS ACROSS THE FINANCIAL SECTOR.

Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU") essentially prohibits State aid, i.e. Government subsidies, that distort competition in the EU. Any plans to grant aid must first be notified to the Commission for approval, and such approval is only permitted in certain strictly defined circumstances. There have been a number of breaches of these rules, not least by the UK authorities, which could still give rise to litigation in the UK courts by affected parties.

The most common example of permitted aid is normally that which promotes the development of an economic sector, such as R&D&I, environmental protection, regional aid and aid for SMEs. However, the Commission has classified aid to the financial sector as coming under the much more liberal regime of Article 107(3)(b) TFEU which permits aid to remedy a serious disturbance in the economy of a Member State.

In the initial stages of the credit crisis, rescue aid to Northern Rock and to Bradford & Bingley was permitted. Technically, such aid was illegal because it was implemented overnight, without advance permission from the Commission. Despite the Commission's subsequent approval, it is not inconceivable that competing financial institutions suffered loss of trade, as even for that short period prior to Commission approval deposits were shifted in order to be covered by the Government's intervention.

In Ireland, an even more blatant breach of EU law was committed in the early stages of the crisis, when the Irish Government declared that it would guarantee the deposits of all the main Irish-owned banks, giving rise to the likelihood of a flood of transfers from British-owned banks in Ireland. The EU Competition Commission, on foot of angry complaints from the UK Chancellor of the Exchequer, insisted that the discrimination in favour of Irish banks be removed.

As the financial crisis has continued, other steps to deal with it have given rise to further complaints based on breaches of State Aid law. Thus, the initial bankers' bonus tax was criticised for imposing liability on investment banks, whereas similar competing economic activity of hedge funds was not so liable. Its replacement, the recently proposed bank levy, has also been amended in order to avoid being construed as favouring small banks as against large banks, although whether the thresholds for liability also amount to State aid for the smaller banks must remain a live issue. The Irish solution, NAMA, consisting of a State-owned bank taking over toxic loans from the banking sector, has effects in the UK market, where a considerable number of the properties to which these loans relate are situated. With high level litigation already commenced in Ireland, it is unlikely the UK litigation can be far behind.

CONOR QUIGLEY QC specialises in all aspects of EU-related commercial law and is the author of European State Aid Law (Hart Publishing, 2nd ed., 2009).

"potential claimants who lost out in the crisis need to think carefully before proceeding against their banks"

Held on Suspicion

A FINANCIAL INSTITUTION SUSPECTS A CUSTOMER TO BE ENGAGED IN MONEY LAUNDERING. UNDER THE LAWS BOTH OF JERSEY AND GUERNSEY, THE INSTITUTION WILL COMMIT A CRIMINAL OFFENCE IF IT NONETHELESS OBEYS AN INSTRUCTION FROM THE CUSTOMER TO ADVANCE MONEY TO HIM. THE INSTITUTION WILL HAVE A DEFENCE IF THE POLICE HAVE FIRST CONSENTED TO THE ADVANCE, BUT SUCH CONSENT MAY WELL BE REFUSED. THE RESULTING SCENARIO POSES DIFFICULTIES FOR THE CUSTOMER, BUT HARDLY LESS SO FOR THE INSTITUTION.

A customer aggrieved by the institution's refusal to make payment could, in theory, commence public law proceedings against the police attacking their refusal to consent to it. Yet even the suspicion that funds are proceeds of crime will sufficiently ground a proper refusal of consent. That mere suspicion would itself need to be shown to be irrational, which in general will be no easy task.

Potentially more fruitful is a private action against the institution seeking a declaration that the moneys concerned are not proceeds of crime. The statutes do not spell out that, where the institution makes payment pursuant to an order at the conclusion of a successful civil claim of this kind, it would not still be at risk of having committed an offence where the criminal proceedings subsequently established that the money concerned was in fact tainted. Both Jersey and English civil courts, however, have agreed that a prosecution in such circumstances would be inconceivable.

Proceedings of this kind will nonetheless be far from welcome for institutions, because they will tend to be lengthy and expensive. That is because it will be necessary for the customer to prove on the balance of probabilities that the funds concerned do not represent proceeds of crime. It will not suffice simply to point to an absence of evidence that the funds do represent such proceeds and instances in which the matter can be determined without full trial will be comparatively rare. Where the institution emerges as the losing party, it seems distinctly possible that a costs order will be made against it, even though it had little choice as to what stance to take.

On the other hand, the unfairness to the customer of what amounts to an informal freeze on his assets – without any court order being made and without limit of time – is considerable.

"the unfairness to the customer of what amounts to an informal freeze on his assets is considerable"

Claimants' attacks on the provisions based on human rights law have so far proved unsuccessful, though courts in both Jersey and England have expressed concern about the operation of their respective regimes. In England, under the Proceeds of Crime Act 2002, the freeze can last only an initial 7 days, and if the relevant authority objects in that period, a further 31 days, after which the money may be paid unless the relevant authority applies for a restraint order. The shortness of the period of the freeze on the basis of "suspicion" was considered by the court in *re K Limited* [2007] Bus LR to be an important factor in deciding that the legislation is a proportionate response to the threat of money laundering; but nonetheless the Court of Appeal in *R (UBMS Online Ltd) v SOCA* [2007] Bus LR 1317 expressed considerable concern about the working of the legislation, and left open an argument that the challenged decision of SOCA in that case offended against Article 1 of the First Protocol to the Human Rights Convention. In *Gichuru v Walbrook Trustees (Jersey) Ltd* [2008] JLR 131, Deputy Bailiff Birt (as he then was) observed wryly that "We in Jersey still have to wrestle with these difficulties", and urged reform. To date this does not seem to have been a matter of urgency for the Jersey or Guernsey authorities: it is to be hoped that it becomes so.

ELIZABETH JONES QC regularly acts in matters involving fraud and proceeds of crime both onshore and offshore.

Non-disclosure in guarantees revisited

THE SCOPE OF A CREDITOR'S OBLIGATION OF DISCLOSURE TO A PROSPECTIVE GUARANTOR HAS BEEN THE SUBJECT OF FURTHER JUDICIAL ANALYSIS IN *NORTH SHORE VENTURES LTD V ANSTEAD HOLDINGS INC* [2010] EWHC 1485 (CH); [2010] 2 LLOYD'S REP 265, A CASE INVOLVING THE WELL KNOWN RUSSIAN OLIGARCH, BORIS BEREZOVSKY.

Mr Berezovsky's company, North Shore, made a loan of US$50m to Anstead Holdings, which was guaranteed by a Mr Fomichev and a Mr Peganov The loan was paid in tranches into a Swiss bank account. The first tranches were used without difficulty, but the final tranche of US$18m was frozen by the Swiss authorities because of perceived links with Mr Berezovsky, who, at the time, was the subject of investigation in Switzerland in connection with suspected money-laundering offences. The US$18m was frozen for several years and, when released, was paid back to North Shore. The dispute related to interest claimed by North Shore on the money while it was frozen.

Mr Justice Newey's judgment contains interesting discussion of issues relating to implied terms of usability in loan agreements, frustration and conclusive evidence clauses; but the primary issue related to North Shore's obligation of disclosure. Mr Fomichev's and Mr Peganov's case was that the risk of the loan being frozen in Switzerland was an unusual and highly relevant feature that should have been disclosed. The judgment sets out a detailed analysis of the law in this area (paragraphs 99 to 123) and the Judge expressed his conclusions in five propositions.

First, the obligation of a creditor to make disclosure to a prospective guarantor need not, even in the case of a guarantee for a loan (as opposed to a fidelity bond), be limited to features of the contract between the creditor and the principal debtor. Secondly, a creditor need not, on the other hand, disclose anything which the prospective guarantor could reasonably be expected to know. Thirdly, it is immaterial that a prospective surety could be expected to be ignorant of a particular matter if he could be expected to know of the risk in general terms. Fourthly, while a creditor does not have to disclose every material risk (guarantees not being contracts *uberrimae fidei*), a risk must be material to be disclosable. Fifthly, a guarantee can be avoided only if the non-disclosure was in fact significant to the guarantor. The Judge rejected the non-disclosure defence of Mr Fomichev on the basis that he knew of the risk and of Mr Peganov on the basis that North Shore was entitled to assume that he was aware of the risk. Mr Fomichev and Mr Peganov have appealed and the appeal is due to be heard in February 2011.

> "A creditor need not disclose anything which the prospective guarantor could reasonably be expected to know"

JOHN MACHELL acted for Mr Fomichev and Mr Peganov.

Chambers news

People

We are pleased to be able to announce that since our last Serle Speak Julian Burling, previously Counsel to Lloyd's, and Paul Chaisty QC – whose practice covers commercial fraud, insolvency, banking and sports law – have both joined.

Julian Burling, called to the Bar in 1976, has over 30 years experience of litigation, advisory and transactional work in the London insurance market. His advisory practice covers in particular all aspects of participation in the Lloyd's market, including UK and overseas regulatory trusts and financing arrangements. He led the Lloyd's team on the FSMA Part VII transfer to Equitas of all 1992 and prior year business written at Lloyd's. He is immediate past Chairman of the British Insurance Law Association and will practise as a barrister, arbitrator and mediator.

Paul Chaisty QC, called to the Bar in 1982, took silk in 2001. He has also been called to the Bar in the BVI and, on an ad hoc basis, the Bahamas and is authorised to sit as a Deputy High Court Judge in the Chancery and Queen's Bench Divisions. Chaisty's practice covers commercial fraud, insolvency, commercial litigation, company, banking and sports law. Recent high profile cases include acting for Wayne and Coleen Rooney against their former agents, West Ham United in respect of claims relating to Sheffield United and the "Carlos Tevez affair" and against their former manager Alan Curbishley. He is highly recommended in the legal directories and Chambers & Partners describes him as "a powerful and punchy advocate with a mind like a stiletto" and "a tough fighter whom you certainly want in your corner in a difficult dispute." Recognising the importance of both the Cities of London and Manchester, he will practise from Kings Chambers in Manchester as well as Serle Court in London.

Directories

The 2011 Chambers & Partners directory was published in October and Serle Court now has 100 individual recommendations placing us 6th in "sets with most barrister rankings" and 4th in the "recommendations per member" table. As a set we are recommended in 10 practice areas and only 5 other sets in the country are recommended in more. We were also delighted to be included in the inaugural Client Service at the Bar section, 1 of only 10 sets selected. Individual highlights include Philip Jones QC and Philip Marshall QC who are both ranked as "stars at the bar"; only 15 other barristers are included in this prestigious category.

In the 2011 Citywealth Leaders List, covering leading wealth managers and advisors, we now have 7 barristers recommended as being prominent in the field of trusts.

We continue to be extremely grateful to all our clients for recommending us so highly.

Edited by Jonathan Fowles

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