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Litigation and Dispute Resolution

Review

EDITORIAL

The start of 2017 heralded further developments in the financial crime sphere, with the government unveiling a Call for Evidence for the reform of corporate criminal liability.[1] One of the options being considered is extending the 'failure to prevent' model in the UK Bribery Act 2010 to a more general offence of failing to prevent economic crime. This, along with the failure to prevent the facilitation of tax evasion offence proposed in the Criminal Finances Bill (and likely to come into force this year), shows a clear trend for increased corporate criminal liability. At the same time, we see it becoming increasingly difficult for businesses to investigate facts giving rise to potential liability, under the cloak of privilege – a recent decision by the High Court in the *RBS Rights Issue* litigation has ruled that notes of interviews by lawyers with employees, made in the context of an internal investigation, were not privileged. There is a real tension here between an avowed legislative policy of encouraging businesses to have internal processes that encourage openness and at the same time making it difficult to fact-find without the threat of any record becoming disclosable in subsequent litigation.

This month's Review also considers important rulings on basis (or "duty-negating") clauses, contractual notice provisions and governing law and jurisdiction clauses in finance related disputes. In particular they consider the extent to which mandatory laws or foreign bank resolution arrangements can affect agreements governed by English law.

We cover the UK Supreme Court's ruling on 24 January that the UK Government cannot trigger the formal process of leaving the European Union without an Act of Parliament. Our article considers the practical implications for commercial parties as they begin to refine and implement their Brexit contingency plans.

Finally, see our annual review of the top finance litigation and contract law developments from 2016.

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[1] http://www.allenovery.com/publications/en-gb/Pages/Reform-of-corporate-criminal-liability-for-economic-crime.aspx

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Conflicts of law

PLAYING BY WHOSE RULES? THE APPLICATION OF MANDATORY RULES OF ITALIAN LAW TO INTEREST RATE SWAPS

*Dexia Crediop S.p.A. (**Dexia**) v Comune di Prato (**Prato**)* [2016] EWHC 2824 (Comm), 10 November 2016

In the second and final part of his judgment, Walker J held that further mandatory provisions of Italian law apply to and invalidate an English law-governed interest rate swap. The decision is a reminder to parties of the risk that the governing law of a contract may not limit the obligations of the parties nor the grounds upon which to challenge its validity. The scope of Article 3(3) of the Rome Convention on the law applicable to contractual obligations (the **Rome Convention**) in finance transactions is at the top of the Court's agenda, with the Court of Appeal having recently upheld Blair J's decision in *Banco Santander Totta SA* v *Companhia de Carris de Ferro de Lisboa SA* that it does not apply to a series of swaps.[1]

Between 2002 and 2006, Dexia (an Italian bank) and Prato (an Italian local public administration) entered into a number of interest rate swaps, including an interest rate collar entered into in 2006 to hedge against rising interest rates by allowing Prato to fix the floating rate of interest payable on its bond debt. Prato would pay an interest rate no higher than the cap rate but no lower than the floor rate. The swap comprised an ISDA Master Agreement and confirmations incorporating an express choice of English law and jurisdiction.

Following the financial crisis and the fall of interest rates to historical lows, the floor payable by Prato exceeded the floating rates prevailing in the market. In 2010, Prato took steps in Italy to set aside the swaps and Dexia brought a claim for payment and declaratory relief in the English Commercial Court. Prato's defence and counterclaim were based primarily on arguments relating to capacity and provisions of Italian law. In reliance on Article 3(3) of the Rome Convention (**Article 3(3)**), Prato argued that the swaps should be held invalid or unenforceable by reason of mandatory rules of Italian law.

Article 3(3) of the Rome Convention

Article 3(3) provides that the choice of English law as the governing law of a contract shall not prejudice the application of the "*mandatory rules*" of the law of the one country with which "*all the other elements relevant to the situation at the time of the choice are connected*".

If your contract was entered into after 17 December 2009, the Rome I Regulation will apply.[2] Rome I includes a similar provision to Article 3(3) of the Rome Convention, although it refers to laws that "*cannot be derogated from by agreement*" rather than "*mandatory rules*". Rome I also provides that the "*overriding mandatory provisions*" of the law of the place of performance (ie those provisions of the law which are regarded as crucial by the relevant state to safeguarding its public interest) can be taken into account by a Member State court when determining a contractual dispute even where the parties have chosen a different governing law for their contract. For more detail on the approach under Rome I, please see our article on the CJEU decision in *Hellenic Republic v Nikiforidis*.[3]

All other elements pointed to Italy – so Italian mandatory rules apply

Dexia argued that Article 3(3) did not apply to the swap because it was not the case (as asserted by Prato) that, other than the choice of English law and jurisdiction, "*all the other elements relevant to the situation*" at the time the parties entered into the contract were connected only with Italy. In particular,

Dexia relied on the fact that: (i) the ISDA Master Agreement is an internationally-recognised industry-standard form; and (ii) it entered into back-to-back hedging swaps with banks outside Italy in connection with the swaps, using the same documentation.

Walker J held that neither the international nature of the ISDA Master Agreement, which did not amount to a connection with any specific country other than Italy, nor the back-to-back swaps, which were not within the contemplation of the parties at the time of the choice of governing law, were elements "*relevant to the situation*". Accordingly, Prato was permitted to rely on its defences and counterclaims based on "mandatory rules" of Italian law.

The "mandatory rules" defences

Walker J held that Dexia failed to comply with the following "mandatory rules" of Italian law applicable to retail investors, resulting in the nullity of the swaps:

(1) Article 30 of Decree 58/1998 (the *Testo Unico della Finanza*) (**TUF**), which requires certain investment contracts placed by so-called "door-to-door selling" to contain a written notice of the investor's seven-day right of withdrawal;

(2) Article 32 of TUF, which requires contracts concluded exclusively by distance marketing techniques to include the same seven-day right of withdrawal; and

(3) Article 23 of TUF and Article 30 of Consob Regulation 11522 of 1998 (the **Consob Regulation**), which impose a requirement to include certain information and wording in financial contracts.

Different view reached by Blair J – an "international situation"

In his judgment in the *Banco Santander* case,[4] Blair J held that mandatory rules of Portuguese law did not apply where there were other elements that point to an "*international situation*". Blair J disagreed with the narrower approach of Walker J to the question of which "*elements*" were "*relevant to the situation*".

In particular, Blair J noted that "*the wording of Art. 3(3) focuses on whether the "situation" is linked to one country only*". Applying the interpretation adopted in the Caterpillar case[5] that the phrase "'*relevant to the situation"[…] is wider than "elements relevant to the contract*'", Blair J held that the court's "*enquiry is not limited to elements that are local to another country, but includes elements that point directly from a purely domestic to an international situation*". In financial transactions, the court may take into account the use of ISDA or other standard documentation used internationally and the fact that "*the transactions are part of a back-to-back chain involving other countries*" (ie the use of back-to-back swaps in this case).

In upholding Blair J's judgment, the Court of Appeal expressed support for his reasoning. Sir Terrence Etherton MR noted that Blair had correctly approached Article 3(3) "*as a limited exception to the […] starting point of party autonomy and, as such, it is to be construed narrowly*". The Court of Appeal agreed with Blair J's conclusion that "*the enquiry under Article 3(3) includes elements that point directly from a purely domestic to an international situation*" and expressly disagreed with Walker J's approach of "*confining "elements of the situation" to those with a connection to a particular country in a conflict of laws sense*".

Further, the Court of Appeal confirmed that Blair J had not committed any error of principle in concluding that the back-to-back swaps with banks outside of Portugal, the use of the multicurrency ISDA and the reliance on Santander's Spanish banks in the calculation of the credit risk exposure were elements relevant to the situation.

COMMENT

Dexia defeated most of the major defences raised by Prato, including the purported lack of capacity and the alleged existence of hidden costs comprising the negative mark-to-market value of the swap at inception. However, pursuant to Article 3(3), Prato was able to rely and prevail on Italian law "mandatory rules" defences which are arguably of limited relevance to swap contracts.

For example, Prato argued successfully that the ISDA Master Agreement was null and void for breach of the requirement in Article 30.2 of the Consob Regulation to include prescribed wording (including detail of the procedures by which the investor may give orders and instructions and a stipulation of the frequency, type and content of the documentation to be sent to the investor to report on the activity carried out). Dexia had argued that the wording was unnecessary and irrelevant since, among other things, the swaps were the only transactions contemplated between the parties and Dexia did not carry out any "*activity*" under the swaps on which it could be expected to "*report*" to Prato. However, the Court interpreted the provision widely given its focus on consumer protection and underlined that the ISDA Master Agreement's status as an internationally accepted standard form agreement did not remove the need to provide the required protections to retail investors (which was the classification given to Prato by Dexia).

For commercial parties, the long reach of mandatory rules of the jurisdiction where the transaction is performed and their use as a means of contesting the validity of contracts remains a challenge. While parties are advised to thoroughly understand and comply with the mandatory rules which may apply to their transactions, that may not provide complete protection, particularly in the case of long-term contracts. For example, the Court acknowledged that, at the time Dexia and Prato entered into the swaps, Italian case law appeared to indicate that the correct interpretation of Article 30 of TUF was that it did not require the inclusion of a seven-day right of withdrawal in the swaps – but relied on case law subsequent to the contract in finding it to be null for breach of that provision.

The decision of the Court of Appeal in *Banco Santander* shows that the courts are willing to construe Article 3(3) more narrowly and provides further guidance on the elements which are "*relevant to the situation*". It is expected that the evolution of case law in this area will offer parties further clarity on the scope of "mandatory rules" pursuant to Article 3(3) in finance transactions. The *Dexia* case is listed for appeal later this year.

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[1] [2016] EWHC 465 (Comm).

[2] Regulation (EC) No 593/2008 on the law applicable to contractual obligations (Rome I).

[3] http://www.allenovery.com/publications/en-gb/Pages/Testing-legal-certainty-under-Rome-I.aspx.

[4] *Banco Santander Totta SA v Companhia de Carris de Ferro de Lisboa SA & ors* [2016] EWHC 465 (Comm).

[5] *Caterpillar Financial Services Corporation v SNC Passion* [2004] EWHC 569 (Comm).

Constitutional

ARTICLE 50 NOTIFICATION – UK SUPREME COURT JUDGMENT

On 24 January 2017, the UK Supreme Court confirmed that the UK Government cannot trigger the formal process of leaving the European Union without an Act of Parliament. The Supreme Court's judgment was widely anticipated and provides helpful clarity on the constitutional requirements for the UK to begin the process of leaving the EU, although some important questions remain unanswered. In this article, we summarise the decision and the reaction to it so far and consider the effect it may have on commercial parties as they begin to refine and implement their Brexit contingency plans.

The arguments before the Supreme Court turned on the correct application of fundamental constitutional principles relating to the scope and nature of prerogative power exercisable by the UK Government and the role of the UK's devolved legislatures in the decision to serve an Article 50 notice.

The case was heard by all 11 members of the Supreme Court (a constitutional first, at least in modern times) over four days in December 2016. The Supreme Court dismissed the Government's appeal and upheld the decision of the English High Court (the **Divisional Court**) on the role of Parliament in the process by an eight to three majority. The Court also determined that the devolved legislatures have no legal veto over any decision to give notice.

Immediately after the judgment was handed down, the Government confirmed that it will comply with the decision of the Court.

The Judgment

The majority view

Lord Neuberger (with whom Lady Hale and Lords Mance, Kerr, Clarke, Wilson, Sumption and Hodge agreed), gave the leading judgment. He began by summarising the history of the relationship between the EU and the UK, outlining the parties' arguments and describing the background to the UK's constitution, which he described as having developed over time in "*a pragmatic as much as in a principled way, through a combination of statutes, events, conventions, academic writings and judicial decisions*". Among other things, Lord Neuberger discussed the role of the King in meetings of his Council in the 11th Century, the Case of Proclamations (1610) and the Bill of Rights in 1689. He noted that Parliamentary sovereignty is a fundamental principle and that the prerogative encompasses the residue of powers which remain vested in the Crown, and which are now exercisable by the Executive, provided that the exercise is consistent with Parliamentary legislation. He also noted that, consistently with Parliamentary sovereignty, a prerogative power, however well established, may be curtailed or abrogated by statute and that it is a fundamental principle of the UK constitution that, unless primary legislation permits it, the prerogative does not enable ministers to change statute law or common law.

Lord Neuberger then commented on the status and effect of the European Communities Act 1972 (**ECA 1972**). He said that the ECA 1972 provided for a new constitutional process for making law in the UK. It authorised a dynamic process by which, without further primary legislation, EU law becomes a source of UK law and takes precedence over domestic sources of UK law, including statutes. Thus the ECA 1972 is "*the conduit pipe*" by which EU law is introduced into domestic law, rather than the originating source of that law. Accordingly it is a statute with a constitutional character.

Turning to the nub of the issue before the Court, it was the majority's view that Parliament endorsed and gave effect to the UK's membership of the EU in the ECA 1972 in a way which was inconsistent with the future exercise by ministers of any prerogative power to withdraw from the EU Treaties. Specifically, the majority considered that:

- *"…the fact that EU law will no longer be part of UK domestic law if the United Kingdom withdraws from the EU Treaties does not mean that Parliament contemplated or intended that ministers could cause the United Kingdom to withdraw from the EU Treaties without prior Parliamentary approval. There is a vital difference between changes in domestic law resulting from variations in the content of EU law arising from new EU legislation, and changes in domestic law resulting from withdrawal by the United Kingdom from the European Union. The former involves changes in EU law, which are then brought into domestic law through section 2 of the 1972 Act. The latter involves a unilateral action by the relevant constitutional bodies which effects a fundamental change in the constitutional arrangements of the United Kingdom*."
- Although the ECA 1972 provided for the application of EU law as it stands from time to time in domestic law, it did not follow from this that prerogative powers could be used to withdraw from the Treaties and so "*cut off the source of EU law entirely*."
- "*A complete withdrawal represents a change which is different not just in degree but in kind from the abrogation of particular rights, duties or rules derived from EU law. It will constitute as significant a constitutional change as that which occurred when EU law was first incorporated in domestic law by the 1972 Act. And, if Notice is given, this change will occur irrespective of whether Parliament repeals the 1972 Act. It would be inconsistent with long-standing and fundamental principle for such a far-reaching change to the UK constitutional arrangements to be brought about by ministerial decision or ministerial action alone. All the more so when the source in question was brought into existence by Parliament through primary legislation, which gave that source an overriding supremacy in the hierarchy of domestic sources*."

The majority therefore found that such a major change to UK constitutional arrangements could only be effected by Parliamentary legislation and that this conclusion appeared to follow "*from the ordinary application of basic concepts of constitutional law to the present issue*."

They went on to consider and reject the more specific and subsidiary arguments put forward by the Government in relation to the ECA 1972, and to reject arguments based on the effect of legislation and events since 1972.

The majority then turned to the question of the form that the legislation approving the service of an Article 50 notice should take. They held that this was entirely a matter for Parliament, noting that "*the fact that Parliament may decide to content itself with a very brief statute is nothing to the point. There is no equivalence between the constitutional importance of a statute, or any other document, and its length or complexity*."

The dissenters

Each of the dissenting Justices (Lords Reed, Carnwath and Hughes) delivered separate judgments, but came to the same conclusion in relation to scope of the ECA 1972. In their view, the effect of Parliament's inclusion of EU law into domestic law under the ECA 1972 is inherently conditional on the UK remaining a member of the EU, and therefore does not affect the exercise of prerogative powers in respect of the UK's membership. Accordingly, they would have allowed the Government's appeal.

No "legal veto" for devolved legislatures

The Supreme Court confirmed (unanimously) that it was "*not a legal requirement*" to seek or obtain the consent of the devolved legislatures in Scotland, Wales or Northern Ireland. The Court concluded that the "Sewel Convention" under which the Westminster Parliament will "*not normally legislate with regard to devolved matters"* without the consent of the relevant devolved

legislature was merely a "*political restriction on the UK Parliament"*, notwithstanding that it now, at least as far as Scotland is concerned, appears in the Scotland Act.

Rejecting arguments from the Scottish Government and the Northern Irish claimants, the Justices said that they are "neither the parents nor the guardians of political conventions; they are merely observers". While they could recognise the operation of the convention, they "cannot give legal rulings on its operation or scope" because it "does not lie within the constitutional remit of the judiciary".

Implications for commercial parties

Political dimension and timing

The immediate practical significance of this decision for commercial parties lies in its potential to delay the commencement of the Brexit process.

The Prime Minister has repeatedly indicated that the Government intends to serve an Article 50 notice by the end of March this year. The House of Commons itself also passed a resolution on 7 December 2016, which, according to the Court, resolved to recognise that the House should respect the wishes of the UK as expressed in the referendum and to call on the Government to invoke Article 50 by 31 March. The Supreme Court's decision makes it clear that, before that can happen, the Government will have to complete the process of obtaining Parliamentary approval via a formal Act of Parliament.

The passage of an Act of Parliament requires multiple readings, debates and votes in both Houses of Parliament. This is achievable by the end of March, provided there is sufficient Parliamentary support.

Political commentators have reported that it is very unlikely that the number of Members of Parliament voting against the Bill will be large enough to prevent the legislation being passed and, if the December resolution by the House of Commons is anything to go by, there does seem to be political will to trigger the process sooner rather than later.

However, Sir Keir Starmer QC MP (the Labour Party's Shadow Brexit Secretary) stated that, while his party will not seek to frustrate the process of leaving the EU, it will seek to propose amendments to the Article 50 Bill with a view to ensuring proper scrutiny of the Government's plans. Other opposition parties have also indicated they intend to propose amendments, including the Scottish National Party, which announced that it expects to propose fifty "*substantive"* amendments. If there are lengthy debates on proposed amendments to the legislation, this could still potentially derail the Government's timetable.

In any case, the increased scrutiny of the Government's plans that will inevitably occur in the Parliamentary debates may give observers further clues as to the UK's negotiating position and objectives and hence the potential shape of the final deal.

Indeed, in commenting on potential amendments to the Bill, Sir Keir Starmer QC MP called for the Government to bring forward a White Paper (ie a detailed Government report) on its strategy for Brexit. He also suggested an amendment aimed at ensuring a procedure for reporting back to Parliament on negotiations and one requiring a "*meaningful vote"* on the final Brexit settlement agreed. However, if an Article 50 notice is irrevocable, it is difficult to see what sort of "*meaningful vote"* could be held. If Parliament (or the electorate) was given a binding vote on the final exit deal and ultimately rejected it, the current consensus appears to be that the UK would leave the EU with no deal at all.

As we have previously indicated, any delay in triggering the Brexit process may extend the period of uncertainty for commercial parties as to the form that Brexit will take. However, a delay may also provide parties with some breathing space to allow them to reassess their contingency plans in the light of the 12 negotiating objectives articulated by the Prime Minister and in the light of any further clarity obtained during the passage of the Bill and to adjust those plans where necessary.

Position of Scotland and Northern Ireland

The UK Government has welcomed the confirmation by the Supreme Court that it is not legally required to seek the consent of the devolved legislatures in Scotland, Wales and Northern Ireland and the clarity that there can be no veto from the devolved administrations.

However David Davis MP today reiterated the Government's intention to "*work closely with"* the devolved administrations.

It is also worth noting that the Supreme Court itself indicated that it did not "*underestimate the importance of constitutional conventions"* – a statement that could well feature in upcoming Parliamentary debates. The Scottish Government has said that the Scottish Parliament will still vote on Article 50 even though this will have no legal effect.

What might the Article 50 notification look like?

There is no guidance in Article 50 itself as to the form that any Article 50 notice will take. It seems likely that it will simply take the form of a letter to the European Council or potentially a formal statement in a Council meeting. It is unlikely that the Government will seek to include any conditions in an Article 50 notice (for example, a statement that the notice is intended to be revocable), not least because it is unclear whether a conditional notice would be permissible as a matter of EU law. It was certainly common ground in these proceedings that an Article 50 notice cannot be given in qualified or conditional terms, and the Court was willing to proceed on this basis, although it noted that it was not expressing a view of its own on the point.

Wider constitutional implications

While most of the attention on the Supreme Court's judgment will focus on the Article 50 negotiation itself, this ruling has wider significance. It is an important precedent on the limits on the Government's power to act without legislative authority, particularly when granting or curtailing the rights of individuals.

Is there scope for further appeals?

The Supreme Court noted in its judgment that it was common ground that, once given, an Article 50 notice cannot be withdrawn. The Government had asserted that, even if this common ground was mistaken, it would make no difference to the outcome of these proceedings. In light of the Government's position, the Court was content to proceed on the basis that the agreed position was correct, without expressing any view on the point. Thus the Court did not refer the question (which is one of EU law) to the Court of Justice of the EU, and this decision represents the end of the line in these proceedings (although not necessarily the end of all litigation on the Article 50 process, as our post-script below indicates).

A post script on other Brexit litigation

Article 127 claims

We understand that an application for judicial review has been made to the English courts which, if it proceeds, will involve consideration of whether the UK must take specific steps to withdraw from the treaty establishing the European Economic Area (the **EEA Agreement**) in addition to serving notice under Article 50 to withdraw from the EU, or whether withdrawal from the EU will result in the UK's automatic withdrawal from the EEA. We understand the proceedings will also consider whether Parliamentary approval would be required for such a step. As continued membership of the EEA would arguably mean continued membership of the Single Market, this is in theory an important question, in particular given the Prime Minister's confirmation in her recent speech that the Government does not intend to seek to negotiate continued UK participation in the Single Market.

It is unclear at this stage whether, in light of the Supreme Court's decision, the Government will seek Parliamentary approval for a withdrawal from the EEA at the same time as seeking approval in relation to its withdrawal from the EU in order to circumvent the legal issues raised in the Article 127 proceedings. However, if it does it may face opposition from MPs taking the position that, although the referendum may have provided a mandate for withdrawal from the EU, it was completely silent on whether the UK should also leave the EEA.

Irish claim

We understand that separate proceedings may also be commenced shortly before the Irish courts which will consider the issue that the Supreme Court did not have to decide: whether an Article 50 notice can be revoked once served.

If this question were to go before the Court of Justice of the EU it could substantially change the dynamics of the UK's exit negotiations.

If you would like to discuss the issues raised in this paper in more detail, please contact Karen Birch, Sarah Garvey, Andrew Denny, Thomas Cusworth or your usual Allen & Overy contact.

This article is one of a series of specialist Allen & Overy papers on Brexit. To read these papers as they become available, please visit: www.allenovery.com/brexit.

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Contract

DISCLAIMERS EFFECTIVE TO PROTECT ISSUER FROM LIABILITY TO SECONDARY MARKET INVESTOR – IMPORTANCE OF BASIS/DUTY-NEGATING CLAUSES

Taberna Europe CDO II plc v Selskabet (formerly Roksilde Bank A/S) (In Bankruptcy) [2016] EWCA Civ 1262, 8 December 2016

The Court of Appeal has overturned a ruling against the issuer of subordinated notes who, at first instance, was found to be liable to a secondary market professional investor for damages for misrepresentations made in investor presentation/roadshow slides and a quarterly results announcement. At first instance Eder J held that market standard disclaimer wording in the investor presentation slides did not protect the issuer. The Court of Appeal however disagreed. The Court of Appeal ruling makes clear the importance of setting out the basis upon which information is shared prior to entering into a transaction, and emphasises the distinction made by the courts between "duty-negating" (or "basis") clauses and more traditional exclusion clauses ("liability-negating" clauses).

The defendant, Roskilde, a Danish bank (now insolvent and known as Selskabet AF1) (**issuer**) issued subordinated notes (**notes**) under a Euro Medium Term Note (**EMTN**) Programme. They were originally issued to Bank A in December 2006 and subsequently marketed to prospective investors, including Bank B. Taberna, an Irish investment vehicle, purchased notes from Bank B on the secondary market for just over EUR 26 million in February 2008.

The issuer suffered severe financial difficulties shortly after the purchase, and defaulted under the notes. Taberna sued the issuer in England for damages under s2(1) Misrepresentation Act 1967 for misrepresentations made by the issuer in various documents, including a March 2007 Offering Circular (**OC**), the issuer's Q3 2007 Report (**Q3 Report**) and an "Investor Presentation/Roadshow" (**IP**) published around the same time as the Q3 Report although by the time of the appeal the dispute focused exclusively on the IP.

First instance decision

Liability to secondary market

At first instance, Taberna successfully argued that there had been misrepresentations made to it as to the size of the issuer's non performing loans. Even though Taberna had not been one of the original investors marketed to as part of the initial roadshow, and notwithstanding the IP had been produced "solely for use by investors met during the ….roadshow", it was held that the material in the IP had been directed at investors in the secondary market as the issuer had intended to make it available for use by such investors and, in the case of Taberna, it had been specifically directed to the IP on the issuer's website by a third party with the issuer's encouragement.

Disclaimers

In the first instance decision[1] the Issuer was not protected by standard market disclaimer wording (see summary table below). In respect of disclaimers B and E, Eder J held that the issuer could not rely on the disclaimer wording because it was in the IP as opposed to a contract between the parties.

[1] http://www.allenovery.com/publications/en-gb/Pages/Issuer-liability-to-secondary-market-investor-disclaimers-ineffective.aspx

Disclaimer in IP	First instance – sufficient?	
(a) Presentation solely for investors met at roadshows	No	In abstract may work BUT clearly intended to be available to potential investors in secondary market (and specific interactions with Taberna)
(b) No representation as to, and no reliance should be placed on, information	No	Not part of issuer-investor contract so no contractual estoppel, and insufficient to prevent liability if simply a declaration
(c) No liability re errors/omissions /misstatements	No	Could be exclusion clause but not sufficiently clear to exclude s2(1) liability
(d) No liability from use of presentation	No	Could be exclusion clause but not sufficiently clear to exclude s2(1) liability
(e) Reps should not be relied upon/act as inducement	No	Not part of issuer-investor contract so no contractual estoppel, and insufficient to prevent liability if simply a declaration

Court of Appeal

Liability to secondary market – yes, subject to disclaimers

On owing duties to secondary market investors, the Court of Appeal agreed with Eder J. The issuer had extended the IP to the secondary market by directing investors to its website where the IP was found. As such, any disclaimer in the IP to the effect that it was only for roadshow investors had to be disregarded. However, the Court of Appeal made clear that in order for a representation in a document to be actionable there needed to be a connection between the issuer and end investor such that it was clear that the issuer was intending the investor to rely on the document. In an age where much material is available electronically, simply having material accessible on the internet is insufficient, but where an investor is specifically directed to the material then the issuer can hardly complain if the investor seeks to rely on it, subject of course to any disclaimers within the material.

Disclaimers effective – yes

However, the Court of Appeal overturned the first instance decision as it related to disclaimers (b) – (e) (see above), thus enabling the issuer to fully defend Taberna's action for damages.

The Court of Appeal noted that s3 of the Misrepresentation Act 1967[1] applies where a contract contains a term which excludes or restricts liability for any misrepresentation a party may have made before the contract was entered into. It was right, noted the court, that such an attempt to exclude liability, after the misrepresentation has been made, would need to be by agreement, for example a contractual estoppel or by a conventional exclusion clause, and hence form part of the contract between the parties.

Duty-negating/basis clauses

The same reasoning did not apply to a non-contractual notice, such as that contained in the IP. It is possible to limit the scope of a representation or exclude it all together by making clear that no representation was in fact being made upon which there could be any reliance (*IFE Fund SA v Goldman Sachs International* [2007]1 Lloyd's Rep 264 cited). As such, it was held that disclaimers (b) and (e) were not exclusion clauses to which s3 of the Misrepresentation Act applied, or which needed to be incorporated within the terms of a contract, rather they were clauses which qualified the nature of the statements which the IP contained. Or, as the Court of Appeal said, they "limit the nature and scope of the statements contained in the [IP] in a way that made it clear that they could not be relied upon as a basis for a decision of any kind". The Court of Appeal referred to these clauses as "duty-negating clauses" but they are also often referred to as "basis clauses" because they are seen as setting out the basis upon which the parties are dealing.

Liability negating / traditional exclusion clauses

The IP also contained more traditional exclusion clauses, or what the Court of Appeal referred to as liability-negating clauses. The Court of Appeal took the view that a document such as the IP, even though it was not a contractual document, should be able to specify that information was being provided on the basis that the

issuer was not taking responsibility for it, provided this was reasonable. The starting point, they said, was not to invoke the contra proferentem rule and resolve any ambiguity in favour of the investor, but rather to recognise that commercial parties are entitled to make their own bargains and have the court interpret the relevant clauses accordingly. The Court of Appeal found that there was in fact no ambiguity in the exclusion clauses (c) and (d) and it was quite clear that no responsibility was being accepted for the information in the IP.

COMMENT

This is an important decision which makes clear the importance of setting out the basis upon which information is shared prior to entering into a transaction. It is helpful that the Court of Appeal has confirmed that it is possible to share information pre-investment while also limiting the ability of an investor to rely on it. It should be noted, however, that in this case the parties were both sophisticated and great care will be needed where dealing with less sophisticated parties.

It remains to be seen whether it will be possible for investors to run the argument successfully that such clauses fall foul of the Unfair Contract Terms Act 1977 (**UCTA**) on the basis that they should be regarded as excluding or restricting the scope of a duty and hence be treated as exclusion clauses by virtue of s13 UCTA.

While, for sophisticated counterparties, making such distinctions may well continue to prove problematic, all parties should take care in how they draft non-reliance clauses. It may well be wise to make clear that their purpose is to set out the **basis** upon which the parties are dealing and sharing information rather than being an attempt to limit or negate the existence of a **duty** that would otherwise arise.

This case is also a useful reminder that even if a document makes it clear who is entitled to rely on it, if there is any interaction between the issuer and the end investor, including through third parties, or any reference to such material, it will be very hard for the issuer to argue successfully that they did not direct such investors to that material, even where they were not the original intended recipients of it. Much will depend on the precise facts of a particular case and it is of course possible that disclaimers can be used to guard against any formal reliance as they were in this case.

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[1] http://www.legislation.gov.uk/ukpga/1967/7

CONTRACTUAL NOTICE PROVISIONS AND THE "CLOSE OF BUSINESS"

Lehman Brothers International (Europe) v ExxonMobil Financial Services B.V. [2016] EWHC 2699 (Comm), 28 October 2016

When serving notices in deteriorating market conditions, beware more haste and less speed. A recent High Court case on the close-out valuation of a repo transaction under the GMRA 2000 highlights the difficulties that both parties can face when seeking to give valid contractual notices and provides important clarification of the meaning of "close of business"

Lehman Brothers International (Europe) (**Lehman**) entered into a sale and repurchase (ie repo) agreement with an ExxonMobil subsidiary (**Exxon**). The agreement was under the standard terms of the 2000 Global Master Repurchase Agreement (the **GMRA**). Under the terms of the repo agreement, Exxon purchased a portfolio of securities (both equities and bonds) for USD 250 million, with Lehman agreeing to repurchase the portfolio seven days later. The repo agreement was rolled over multiple times – until mid-September 2008,

when Lehman's financial difficulties became widely known.

On Monday 15 September at 7:56 am, Lehman entered administration. Exxon faxed a purported Notice of Default to Lehman at 9:22 am (the **First Notice**). However, this notice did not specify an Event of Default under the GMRA. Exxon then sent a second Notice of Default which did (the **Second Notice**). Unfortunately, by this point the specified Lehman fax number was overloaded as other creditors around the world sought to serve similar notices. Service of the Second Notice was eventually made by email at 9:41 am on 16 September 2008.

Exxon then had a window in which to serve a Default Valuation Notice (**DVN**). The DVN allowed Exxon (as the non-defaulting party) to specify close-out values of the portfolio's securities in accordance with the GMRA.

Lehman's case relied on a number of grounds. In summary, Lehman argued that: (i) the Second Notice was invalid as it was sent to an email address; (ii) the DVN was invalid as it was sent to the wrong fax number; (iii) the DVN was sent after the 'close of business'; and finally (iv) that the definition of 'Appropriate Market' under the GMRA also required that the DVN be sent prior to close of dealing in each individual market where the relevant securities were traded.

Exxon argued that its First Notice was invalid as it did not specify an Event of Default (this would have given Exxon a later window in which to serve the DVN). Exxon also rejected each of Lehman's arguments. Together, the issues impacted the close out value of the portfolio under the GMRA by some USD 5.3 million.

The content of a Notice of Default

Exxon argued that the First Notice had not specified the relevant event (ie administration) necessary for it to constitute a formal Notice of Default.

Blair J appeared sceptical of a party disputing the effectiveness of its own notice for what could be considered tactical reasons. He agreed with Lehman's argument that a notice "*stating that an event shall be treated as an Event of Default*" did not require a specific event to be identified. Further, even if it had been necessary, given that Lehman's demise was global front page news that morning, "*there cannot have been any doubt*" about the event to which the First Notice was referring.

Wrong number, right office

Two issues between the parties centred on whether notices had been sent via the correct means of communication.

Firstly, the Second Notice was sent by email, not fax. As the court had held Exxon's First Notice effective, it was not necessary to decide whether the Second Notice (emailed by Exxon on 16 September 2008) was valid. However, *obiter*, the court indicated that it would have held notice by email effective given the inclusion of email addresses as contact details in Appendix 1 of the GMRA.

Secondly, the DVN was sent to a fax number different from the one specified in the GMRA (the specified number being overloaded). Lehman argued this rendered it invalid. Interestingly, Blair J suggested, notwithstanding the potentially commercial undesirability of such a stringent approach, that in order for a notice to be effective it might indeed need to be sent to the specified number.

However, in a case (such as this) where a notice was sent to an incorrect number but still received by a responsible employee, the receiving party should raise any objections promptly. On the facts, Lehman had not raised objections to the DVN's validity at the time. The issue had only been identified as the matter came to trial. This was, in Blair J's words, six and a half years too late. Lehman had waived any such notice requirement either by inaction and/or failing to challenge the DVN's validity in its initial particulars of claim.

Close of business

As the First Notice was valid, the DVN had to be served by the close of business on the fifth dealing day after Lehman's insolvency (ie close of business, London time on 22 September 2008). Exxon's fax containing the DVN was received at 6:02 pm that day.

Lehman argued that 'close of business' for the purposes of serving the DVN under the GMRA meant 5:00pm. Exxon contended it meant 7:00pm. Lehman, however, failed to provide meaningful evidence of the earlier deadline to the court. Based on Exxon's expert evidence and with a nod to the "*more all consuming hours worked by investment bankers, commercial lawyers and the like*", Blair J held close of business could mean 7:00pm in this particular case.

COMMENT

Validly serving contractual notices under standard form agreements (eg the GMRA, ISDA Master Agreement and GMSLA) is a perennial pitfall for clients. Even a minor delay in effecting notice can have serious financial consequences. While some of the guidance here is *obiter*, there are many practical lessons to be drawn from the case.

First, at the drafting stage, ensure counterparties identify multiple contacts for the receipt of notice. For older standard form agreements it may also be helpful to include email addresses. In contrast to this case, in *Greenclose Ltd v National Westminster Bank PLC* [2014] EWHC 1156 (Ch) no email addresses were included in the relevant Appendix to the ISDA Master Agreement and the notice was therefore invalid.

Secondly, if disputing a notice, do so promptly. This is particularly important where valid service of a later notice is contingent on the earlier notice.

Thirdly, focus on the technical requirements of the notice (eg does an event of default need to be specified and where must it be delivered). In this case, Exxon was only partially successful in its claim. This was because it was also required to serve the DVN prior to close of business in the 'Appropriate Market'. The court held this meant service was required not just in London but by close of business in each country where there was a relevant market on which the portfolio securities were traded.

In determining what close of business meant, the court was clearly wary of setting a wider precedent. Nonetheless, it is an encouraging confirmation of the English courts' willingness to take a sensible approach when dealing with sophisticated commercial parties.

Finally, although Exxon's DVN was only partially effective for other reasons, it was valid despite being received late in the day and to a different fax number. The value of persistence when having difficulty serving notice should not be underestimated.

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Crime

REFORM OF CORPORATE CRIMINAL LIABILITY FOR ECONOMIC CRIME

On 13 January, the UK Ministry of Justice issued a Call for Evidence on the reform of corporate criminal liability for economic crime. This follows statements by the UK government in 2016 about extending corporate criminal liability for economic crime. The Call for Evidence raises important questions for corporates.

Any extension of criminal liability risk for a company would have significant ramifications as it would likely require a company to effect changes to corporate governance, assess its risk of exposure to economic crime by employees and those who provide services on its behalf, and to implement measures across its operations to mitigate this risk. Many companies have already been through a similar process as a response to increased liability risk under the UK Bribery Act 2010.

Our team of corporate economic crime specialists will be analysing the proposals and discussing them with clients in order to formulate a response to the Call for Evidence which reflects both legal and commercial viewpoints.

Identification doctrine difficult to apply to large companies

At present, a company can be held criminally liable for the acts of an individual or individuals who is/are the 'directing mind and will of the company'. This is known as the identification doctrine, and derives from the leading case of *Tesco Supermarkets Ltd v Nattrass*. Some prosecutors, academics and lawyers regard the *Tesco v Nattrass* test as being inadequate as a means of holding companies liable for criminal wrongdoing, particularly large companies with complex management structures. Critics argue that it encourages companies to decentralise responsibilities to avoid liability, making it difficult to identify a senior individual who is in charge of a particular operation.

A partial response to this issue came in the form of s7 Bribery Act 2010 which makes a company criminally liable if it fails to prevent bribery by someone (employee or third party) acting on its behalf. This is a strict liability offence, subject only to the defence of having adequate anti-bribery procedures in place. There is also draft legislation currently being considered in the UK Parliament which makes it a corporate criminal offence to fail to prevent the facilitation of tax evasion by a person acting on the company's behalf. Both of these are inroads into the identification doctrine.

Options for reform

The Call for Evidence seeks views on a number of different options to reform the law, these are described as follows:

Option 1: Amendment of the identification doctrine

Legislation could amend the identification doctrine by broadening the scope of those regarded as a directing mind of a company. However, this does not appear to be a favoured option as the consultation states that 'retaining the identification doctrine in any form...would encourage corporate efforts to limit potential liability through the adoption of evasive internal structures. It would not promote the prevention of economic crime as a component of corporate good governance.'

Option 2: Strict (vicarious) liability offence

The creation of a strict liability offence based on the principles of vicarious liability would make the company guilty, through the actions of its employees, representatives or agents, of the substantive offence, without the need to prove any fault element such as knowledge or complicity at the corporate centre. The U.S. has a similar doctrine.

Option 3: Strict (direct) liability offence

A strict direct corporate liability offence would focus on the responsibility of a company to make sure that offences are not committed in its name or on its behalf. A company would be convicted without the need for proof of any fault element, not of the substantive offence, as with vicarious liability, but of a separate offence akin to a breach of statutory duty to ensure that economic crime is not used in its name or on its behalf.

Option 4: Failure to prevent as an element of the offence

In this option the concept of a failure on the part of those managing the company to prevent the occurrence of the relevant offending is an element of the offence. It is for the prosecution to prove not only that the predicate offence occurred but also that it occurred as a result of a management failure, manifest either as negligent conduct or as systemic inadequacies in the mechanisms that the company relies on to prevent the relevant predicate offences occurring.

In effect this model takes the principles of option 3 but places on the prosecution the burden of proving that the company had not taken adequate steps to prevent the unlawful conduct occurring rather than placing the burden on the defence to prove that the company had done so. This option is considered further below.

Option 5: Investigate the possibility of regulatory reform on a sector by sector basis

There has been significant reform in the regulation of the financial services industry in order to deter misconduct through strengthening individual accountability, particularly at senior manager level. There is the potential for lessons to be learned from the experience of strengthening the regime for financial services which may be applicable more broadly.

The 'failure to prevent' model

The Call for Evidence covers the failure to prevent model (Option 4) in more detail – and is certainly the option that was discussed by the UK Government in 2016.

The Government's starting position, stated in the Call for Evidence, is that the offence should initially apply to a short list of the most common serious economic crime offences, which could be added to if necessary by secondary legislation, eg

- the common law offence of conspiracy to defraud;
- the offences at s1 of the Fraud Act 2006;
- the offence of false accounting at s17 of the Theft Act 1968;
- the money laundering offences at s327 to s333 of the Proceeds of Crime Act 2002.

The Call for Evidence also states that the formulation of a defence appropriate for economic crimes other than bribery and the facilitation of tax evasion and the extent to which it would have similar policy benefits would also need to be carefully considered.

What next?

The deadline for responses to the Call for Evidence is 24 March. Allen & Overy will be submitting a response. Anyone wishing to discuss the consultation should contact Lawson Caisley, Jonathan Hitchin or Michelle de Kluyver at Allen & Overy.

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Insolvency

FOREIGN BANK RESOLUTION: EFFECT ON LOAN ENFORCEMENT IN ENGLAND AND WALES

Guardians of New Zealand Superannuation Fund & 11 ors v Novo Banco, S.A. [2016] EWCA Civ 1092, 4 November 2016

This Court of Appeal ruling considers the effect of bank resolution measures on an English law governed facility agreement. The question of whether the claimant was able to recover under the facility agreement depended on whether certain bank resolution steps taken in Portugal were recognised by the English Court. The English Court concluded that a resolution measure taken in another Member State should be given the same effect in England that it would have had in that Member State.

Struggling Portuguese bank

In June 2014, Oak Finance Luxembourg, S.A. (**Oak**), as lender, entered into a facility agreement with Portuguese bank Banco Espirito Santo, S.A. (**BES**), with English governing law and English jurisdiction clauses. Under the facility, BES drew down approximately USD 784 million. BES was facing financial difficulties, so the Portuguese central bank, Banco de Portugal (**BdP**), established Novo Banco, S.A. (**Novo Banco**) by resolution on 3 August 2014, and transferred to it some, but not all, of BES's assets and liabilities. Liabilities to shareholders holding at least 2% of BES shares were excluded from the transfer. The resolution also provided that BdP may "*… transfer or re-transmit assets [or] liabilities … between BES and Novo Banco …*" in certain circumstances.

Liability to Oak not transferred due to Goldman Sachs' involvement

By late December 2014, BdP had concluded there were "*… serious and well-grounded reasons to believe*" that Oak had acted on behalf of Goldman Sachs International (GSI) in entering the facility, and GSI held at least 2% of the share capital in BES at the time. On 22 December 2014, BdP resolved that, with effect from 3 August 2014, the Oak liability had not been transferred to Novo Banco. It also resolved that consequential amendments be made to the accounts of BES and Novo Banco.

In February, September and December 2015, BdP purported to take further steps to affirm its December 2014 decision, transfer the liability back to BES (to the extent required for recognition under United Kingdom and other European Member State laws), and amend its original August 2014 decision to expressly exclude the transfer of the Oak liability to Novo Banco.

Oaks' assignees claim under facility agreement

The respondents on the appeal, Guardians of New Zealand Superannuation Fund and others are assignees of Oak's rights under the facility agreement. They commenced proceedings in England against Novo Banco on 26 February 2015 (after BdP made its February 2015 decision).

Novo Banco disputed jurisdiction on the basis the liability under the facility agreement had not been transferred from BES. It alternatively sought to stay the English proceedings pending resolution of Portuguese administrative proceedings concerning the efficacy of the transfer.

Hamblen J decided that the respondents had established English jurisdiction because they had the better of the argument that the Oak liability had been transferred to Novo Banco by virtue of BdP's 3 August 2014 decision. Further, the judge decided that disputes about the effect

of BdP's December 2014 and February 2015 decisions fell within the English jurisdiction clause.

On appeal the main issue was the extent to which the August and December 2014 and February 2015 decisions (which purported to transfer the liability back to BES) should be recognised.

Legislative framework for bank resolutions

Both Directive 2001/24/EC concerning the reorganisation and winding-up of credit institutions (the **Reorganisation Directive**) and Directive 2014/59/EC, the European Recovery and Resolution Directive (**EBRRD**), are part of the domestic law of Portugal and the United Kingdom.

In Portugal, the relevant legislation[1] gave BdP power to transfer assets and liabilities from an institution under resolution (here, BES) to a bridge institution (here, Novo Banco), subject to a prohibition on transferring liabilities owed to certain creditors, including those (or those acting on behalf of those) who at the time of transfer owned 2% or more of the share capital of the institution under resolution.

The relevant United Kingdom legislation (including the Credit Institutions (Reorganisation and Winding up) Regulations 2004, the Bank Recovery and Resolution Order 2014 and the Bank Recovery Resolution (No 2) Order 2014), in substance, recognises measures taken in relation to any debt or liability of an EEA credit institution as if it were part of the general law of insolvency of the United Kingdom.

On appeal, the parties accepted that BdP's decision in August 2014, which established Novo Banco as a bridge institution, involved the application of a resolution tool so should be recognised by the English Court.

English court should follow approach of Portuguese court

Moore-Bick LJ held that it was necessary to give BdP's August 2014 decision the same effect in the United Kingdom as it would have in Portuguese law. Hamblen J had decided that the December 2014 decision was effective in Portuguese law until set aside by the Portuguese administrative Courts. As such, Moore-Bick LJ decided that the English courts, under the Reorganisation Directive, EBRRD and the implementing legislation in the United Kingdom, were bound to give the December 2014 decision the same effect as it had in Portugal – and, as such, it (when considered alongside the August 2014 decision) effectively precluded a transfer of the Oak liability to Novo Banco.

December 2014 decision susceptible to recognition as a reorganisation measure in its own right

Secondly, Moore-Bick LJ considered whether the December 2014 decision could, on a standalone basis, be a reorganisation measure that was susceptible to recognition under the Reorganisation Directive.

Article 2 of the Reorganisation Directive defines 'reorganisation measures' as, among other things "… *measures which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties' pre-existing rights* …". Moore-Bick LJ referred to the European Court of Justice decision in *Kotnik & ors v Državni zbor Republike Slovenije* (Case C-526/14), where 'burden sharing measures', akin to bail-in measures under the EBRRD, were held to be 'reorganisation measures' for the purposes of the Reorganisation Directive. In contrast to the position in *Kotnik*, BES was not intended to continue to operate as a going concern and the December 2014 decision was "… *no more than one element in a process leading to its orderly winding up*". However, as it was accepted that the August 2014 decision was a reorganisation measure, and the December 2014 decision purported to clarify the August 2014 decision, Moore-Bick LJ held that it should be recognised as, or part of, a reorganisation measure that is to be recognised under the Reorganisation Directive.

Novo Banco could not rely on subsequent events

Thirdly, Novo Banco sought to rely on its decisions in September and December 2015 to further its position that the Oak liability was either not transferred to Novo Banco or had been re-transferred to BES. Moore-Bick LJ determined that, as to jurisdiction, the position must be judged at the time the proceedings were commenced in February 2015. As such, Novo Banco was refused permission to rely on those decisions on appeal.

As to the timing of BdP's decisions, Sales LJ took the view that the August 2014 decision gave rise to a transfer of the Oak liability to Novo Banco which took effect, and was to be recognised in the United Kingdom, under Article 3 of the Reorganisation Directive and Article 66 of the EBRRD, from 3 August 2014. As such, Sales LJ's view is that, from 4 August 2014, "… *everyone knew that it was Novo Banco who was the debtor in respect of the Oak liability*". Accordingly, by the December 2014 decision, Sales LJ's view is that BdP 'rewrote history' by transferring back the Oak liability, as it was entitled to do under Portuguese law, but that doing so was consistent with and permissible under European law.

While Sales LJ's comments are consistent with the decision to refuse Novo Banco permission to rely on the September and December 2015 decisions, it is to be contrasted with Moore-Bick and Gloster LJJ's view that the proper construction of the August 2014 decision was that the Oak liability was not transferred at all.

COMMENT

The overriding point to come out of the judgment is that in view of the desire to facilitate recognition of bank resolution measures in each of the European Union Member States, where a bank resolution step is taken that is valid under domestic law, it is likely it will be recognised as a valid exercise of that domestic law in relation to foreign law obligations; here an English law governed loan.

As to jurisdiction, in circumstances where an English law obligation (eg, to repay a loan) subject to an express English jurisdiction clause is said to be transferred to a new creditor under a foreign bank reorganisation law, the English court will recognise the effect of the transfer by reference to the position under the foreign law in the jurisdiction where the transfer is purportedly made. In short, if a transfer is ineffective as a matter of the relevant foreign law, the English court will decline jurisdiction in proceedings against the purported new creditor. In making that judgment, all events taking place prior to the commencement of proceedings will be taken into account by the English Court, but parties disputing jurisdiction will be unable to rely on subsequent events.

We may see more disputes concerning restructured banks, given the amount of restructuring in some parts of Europe caused by the global financial crisis. See, for example, recent claims by investors in Spain: http://www.allenovery.com/publications/en-gb/european-finance-litigation-review/southern-europe/Pages/Court-dismisses-investor-claims-relating-to-restructured-bank.aspx.

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[1] Title VIII of the Legal Framework of Credit Institutions and Financial Companies Decree-Law No. 298/92 of 31 December 1992 by Decree-Law 31-A/2012 of 10 February 2012.

Privilege

INVESTIGATIONS: NOTES OF EMPLOYEE INTERVIEWS NOT PRIVILEGED

The RBS Rights Issue Litigation, Re [2016] EWHC 3161 (Ch), 8 December 2016

Lawyers' notes of interviews with a bank's employees conducted as part of two investigations were not privileged since the employees were not the "client" and the notes were not lawyers' working papers, according to the High Court. Although the interview notes may have been privileged as a matter of U.S. law, the court held that English law, and not U.S. law, was the proper law to determine the question of privilege in this case. The court accepted that it could exercise a discretion to not permit disclosure of the interview notes if they were privileged as a matter of U.S. law. However, the court declined to exercise this discretion. We understand that this judgment is likely to be appealed. However, in the meantime firms that wish for records of their internal investigation interviews to be privileged will need to think carefully about how such records are prepared in light of the comments made in this judgment.

The back drop to this hearing is the various actions, all subject to a Group Litigation Order, against RBS (the **Bank**) over its 2008 rights issue.

The Bank claimed privilege over notes of interviews which related to two investigations: one in response to U.S. SEC subpoenas relating to sub-prime exposures and the other in relation to allegations made in relation to the marketing of '*Super Seniors CDOs*'. The notes were made, variously, by in-house lawyers, external lawyers and non-lawyers who, the Bank maintained, were acting as agents of its external lawyers.

The Bank argued that the interview notes were protected:

- by English law legal advice privilege as a record of communications between a lawyer and its client for the purposes of obtaining legal advice; or
- as lawyers' privileged working papers under English law; or
- as privileged under U.S. law,

and, even if they were not privileged under English law, the Bank said the court should exercise its discretion not to order disclosure or inspection because of the rights under U.S. law that would be breached. No litigation privilege was claimed.

The Bank lost on all grounds and has indicated an intention to seek permission to appeal.

A reminder of *Three Rivers (No 5)*

The facts surrounding *Three Rivers (No 5)* [2003] QB 1556 were that creditors of BCCI had brought an action against the Bank of England for misfeasance in public office in respect of the Bank of England's supervision of BCCI before its collapse. They sought disclosure of documents which had been produced for an inquiry into the Bank's supervision of BCCI conducted by Bingham LJ. A special unit within the Bank of England had been specifically established to deal with inquiries and to seek and receive advice from Freshfields, known as the Bingham Inquiry Unit (**BIU**). All of the BIU's communications with the Bingham Inquiry were the subject of legal advice from Freshfields and counsel instructed by them. This advice covered all aspects of the preparation and presentation of the Bank of England's evidence and submissions to the Bingham Inquiry. The documents that the creditors of BCCI sought were documents prepared by employees that were not part of the BIU. They did not seek disclosure of documents passing between the BIU and Freshfields or

vice versa or of any of Freshfields' internal memoranda or drafts.

The Court of Appeal in *Three Rivers (No 5)* rejected the notion that the Bank of England itself could be regarded as the "client" for privilege purposes. Accepting the arguments of the creditors, it treated the BIU as the "client". As a result, information gathered by an employee who was not part of the BIU could not be protected by legal advice privilege, since that employee would be no different to a third party. Accordingly, even if the Governor himself of the Bank of England had noted down what he remembered in relation to the supervision of BCCI with the intention of giving it to the BIU for transmission to Freshfields, such a document would not be subject to legal advice privilege.

The attack on *Three Rivers (No 5)*

The Bank in this case pointed to the sustained criticism of *Three Rivers (No 5)* by commentators and most recently the Singapore Court of Appeal. The High Court, while accepting the force in this criticism, felt bound by the Court of Appeal.

Distinguishing *Three Rivers (No 5)*

In what the High Court described as a cogent submission, the Bank argued that *Three Rivers (No 5)* was confined to what it described as "*purely internal documents, that is, documents which Bank employees sent to other Bank employees (such as members of the BIU), not to Freshfields*". Accordingly it would not be contrary to *Three Rivers (No 5)* to treat as protected by legal advice privilege, instructions or factual information communicated in confidence to a company's lawyers, with the authority of the company and at the request of the lawyers, for the purpose of enabling the company to seek or receive legal advice. Here, the Bank argued, the individual was an emanation of the client.

The essential question was then did either the fact of authority to participate in an information gathering process, or the fact that the interview notes recorded a direct communication, distinguish the present case from *Three Rivers (No 5)* and so as to justify the employees being treated as "the client" or a qualifying emanation of the client, rather than "third parties"? The court held, not. The interview notes comprised information gathering from employees preparatory to and for the purpose of enabling the Bank, through its directors or other persons authorised to do so on its behalf, to seek and receive legal advice. In other words the present case could not be distinguished from *Three Rivers (No 5)*.

Were the interview notes lawyers' working papers?

It was not disputed that verbatim transcripts of unprivileged interviews would also themselves not be privileged. So the Bank had to show something more. The court, relying on previous authority, contrasted a note which "*records the substance of a conversation*" (which would not be privileged) with a note which also records "*the note-taker's own thoughts and comments on what he is recording with a view to advising his client*" (which almost certainly would be privileged).

Since the Bank was claiming privilege, the burden of proof lay with it. The evidence needed to be as specific as possible without making disclosure of the very matters that the claim for privilege was designed to protect.

The court found that the Bank's evidence was conclusory in nature. The Bank was saying the interview notes must be working papers since they were not a verbatim record. But that was not enough. There was nothing to substantiate any legal analysis. The annotation that the notes reflected the "*mental impressions*" of the lawyers (deriving from the U.S. case of *Upjohn*) was not sufficient of itself. The sort of detail that might be appropriate in the evidence, which had not been forthcoming, was illustrated by reference to the Upjohn case: "*Thomas described his notes of the interviews as containing* '*what I considered to be the important questions, the substance of the responses to them, my beliefs as to the importance of these, my beliefs as to how they related to the inquiry, my thoughts as to how they related to other questions. In some instances they might even suggest other questions that I would have to ask or things that I needed to find elsewhere*'". Moreover the court felt that there was a real difference between reflecting "*a train of inquiry*" and reflecting or giving a clue as to the trend of legal advice, and that this difference was recognised and approved by the Court of Appeal in *Sumitomo* [2001] EWCA Civ 1152.

On the evidence before it, the court did not accept that the interview notes were lawyers' working papers.

Did U.S. law apply?

The court accepted that the interview notes would probably be protected by privilege under U.S. law. However, the court concluded that whether described as a rule, a convention or practice, it was the approach of the English Court to apply the law of the forum to issues of privilege, and had been so since the mid-19th century. It would be altogether too drastic and unsupported a departure to adopt an entirely new "*choice of law rule*". English law, and not U.S. law, was the proper law to determine the question of privilege.

Should the court as a matter of discretion refuse to permit disclosure?

Finally, the Bank argued that, since the interview notes were privileged as a matter of U.S. law, the court should use its inherent jurisdiction not to permit disclosure since if the notes were disclosed this would breach the Bank's rights under U.S. law and the interviewees had a reasonable expectation of privilege. Whilst accepting that it could exercise such a discretion, the court declined to do so. It would have needed an exceptional concern such as a fear that disclosure could lead to violence, intimidation, interference with witnesses and destruction of evidence in order to exercise this discretion. While it was troubled by the apparent assurances given to the interviewees, and what may have been the Bank's own expectations, this case was not sufficiently exceptional to merit exercise of the discretion.

COMMENT

This case is an important reminder of quite how restrictive the definition is of the "client" for the purposes of legal advice privilege as a result of the much-criticised decision in *Three Rivers (No 5)*. It also demonstrates the challenges of responding to international investigations where what may be privileged in one jurisdiction may well not be in another.

Claims to privilege over notes of internal investigation interviews is a topic that has vexed UK authorities such as the FCA and the SFO for several years. In particular, in a speech given in late 2015, the FCA expressed frustration at what it perceived to be a lack of transparency on some firms' parts regarding documents produced during an internal investigation. The FCA cited firms' reluctance or refusal to hand over notes of internal investigation interviews on the basis that they are privileged as an example of this lack of transparency. On this topic, the FCA stated that it "f*ully understand[s] and respect[s] the needs and the rights to firms to claim and protect their rights to legal privilege where appropriate*" but warned that firms should not allow "*legal privilege to become an unnecessary barrier to sharing the output [of an internal investigation] with the FCA*". A practice adopted by a number of firms in recent years has to be read aloud the output from internal investigations (including summaries of interviews conducted) to the FCA in meetings or over the telephone, as opposed to providing this information to the FCA in writing. During the same speech in late 2015, the FCA described this practice as "*an absurd way to suggest that a public authority should operate*".

We understand that the Bank may appeal the court's decision in this case. However, in the meantime, firms conducting interviews as part of internal investigations will need to think carefully about how they record the output of those interviews if they wish such materials to attract privilege. In particular, this judgment indicates that for materials like a lawyer's note of an interview to constitute lawyers' working papers and for legal advice privilege to apply, substantive legal advice needs to be interwoven into those notes. A summary of the interview without this kind of additional information is unlikely to suffice.

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Top Finance Litigation and Contractual Developments in 2016

This is a summary of the most interesting banking litigation and contractual developments in 2016. The selection is necessarily subjective and draws from a wide range of cases that are of direct relevance to finance parties.

Banks and customers

Lender under no duty to advise borrower about onerous terms in loan agreement

In *Finch & anr v Lloyds TSB Bank plc & ors* [2016] EWHC 1236 (QB), the Court found that a lender did not owe a contractual or tortious duty to advise a borrower about a potentially onerous clause in a loan agreement which made the borrower liable for the lender's hedging break costs if the borrower chose to repay the fixed rate loan early. This is a welcome judgment for lenders, emphasising the difficulty for a borrower to establish that a lender had a duty to advise on potentially onerous terms, even if a lender emphasises in its marketing strategy a willingness to co-operate with a borrower to find the best solution for their borrowing requirements. It is even more challenging for a borrower to prove that a lender has such a duty when they are represented by solicitors and financial advisors, as was the case here.

Basis clause in investor presentation slides protects issuer against secondary market investor claim

In *Taberna Europe CDO II Plc v Selskabet (Formerly Roskilde Bank A/S) (In Bankruptcy)* [2016] EWCA Civ 1262, the Court of Appeal overturned a ruling against the issuer of subordinated notes who, at first instance, was found to be liable to a secondary market professional investor for damages for misrepresentations made in investor presentation/roadshow slides and a quarterly results announcement. At first instance Eder J held that market standard disclaimer wording in the investor presentation slides did not protect the issuer. The Court of Appeal however disagreed. The Court of Appeal ruling makes clear the importance of setting out the basis upon which information is shared prior to entering into a transaction, and emphasises the distinction made by the courts between "duty-negating" (or "basis") clauses and more traditional exclusion clauses ("liability-negating" clauses).

A new standard for advising on investment risk

There has been a change in how the Court will assess whether a financial advisor has used reasonable care and skill when giving investment advice. In *O'Hare & ors v Coutts & Co* [2016] EWHC 2224 (QB), Kerr J, following *Montgomery v Lanarkshire Health Board* [2015] AC 1430 (a Supreme Court medical negligence case), declined to rely on the traditional test (ie the standard of a reasonably competent practitioner in the same field). Instead, the judge extended the application of the test in *Montgomery* (to take reasonable care to ensure that the patient is aware of any material risks involved in any recommended treatment, and of any reasonable alternative or variant treatments) to define the standard of care to be applied in the explanation of risk in investment advice. The regulatory regime was "strong evidence" of what the common law required on the part of an investment advisor, as a duty to explain (analogous to *Montgomery*) was already found in the relevant Conduct of Business rules. This new test in the financial services sector reflects a move over time in professional negligence cases away from essentially a self-certified standard set by the relevant professionals to an objective standard, set principally on regulatory rules. In cases where investors are exercising discretion, compliance with both the *Montgomery* standard and regulatory rules will prove key in defending future negligence actions.

Refinancing loans and negligent valuations

Liability for a negligent valuation relied upon by a lender in refinancing a pre-existing loan facility would not be limited to any new funds advanced but extends to the entire refinanced facility. Had there not been a negligent valuation, the lender would not have made the refinancing loan. The fact that the purpose of the loan was in part to discharge an earlier (potentially loss making) loan on the part of the same lender was irrelevant in fact and law to the valuer, who was fully liable in respect of the full amount of the loan (*Tiuta International Ltd v De Villiers Surveyors Ltd* [2016] EWCA Civ 661). Lenders should consider, when advancing new funds in reliance on an updated valuation, clearly structuring any fresh advance as a refinancing such that the second transaction does result in the redemption of the first loan in the lender's books and ensures the clear transfer of full liability to the later valuation.

Contract law developments relevant to banks

Rectification used to correct drafting error in interest rate swap

A mistaken reference in an interest rate swap confirmation to the 1992 ISDA Master Agreement instead of the 2002 ISDA Master Agreement could not be corrected by interpretation. However, on the facts, the mistaken reference could be corrected by rectification. *LSREF III Wight Ltd v Millvalley Ltd* [2016] EWHC 466 (Comm) highlights that interpretation is unlikely to cure a drafting error unless there is some ambiguity or linguistic mistake which makes the drafting commercially absurd. However, rectification may work where interpretation does not, and has the added benefit of allowing evidence of the subjective intentions of the parties and their negotiations to be admitted.

No variation clauses weakened by Court of Appeal

In *Globe Motors Inc v TRW Lucasvarity Electric Steering Ltd* [2016] EWCA Civ 396, the Court of Appeal considered a potential issue that arises frequently in practice but has only infrequently been considered by the courts: the effect of so called "no variation" clauses (ie a clause which states that no variation can be made to a contract except in writing). The court ruled that, whilst "no variation" clauses may make it harder to show that the parties intended their oral negotiations to result in a change to a contract, the clause cannot preclude that outcome.

The Court of Appeal in *MWB Business Exchange Centres Ltd v Rock Advertising Ltd* [2016] EWCA Civ 553 also confirmed the limited value of "no variation" clauses. It ruled that an oral agreement to defer payments under an existing contract, which also contained a "no variation" clause, was legally binding. In addition, the court made it easier for a party to establish the critical elements of consideration or estoppel when seeking to show a contractual variation – the consideration for the agreement in this case was simply the benefit to the landlord of not having empty premises. The Court of Appeal also confirmed that part payment of a debt may now discharge the whole debt, especially where there will be an on-going relationship between the parties. The rule in *Foakes v Beer* is arguably not such an absolute bar as it once was.

Employees – privilege and bonuses

Scope of legal advice privileged confirmed

The High Court confirmed in *The RBS Rights Issue Litigation, Re* [2016] EWHC 3161 that records of interviews conducted variously, by in-house lawyers, external lawyers and non-lawyers who, RBS maintained, were acting as agents of its external lawyers, with RBS employees pursuant to internal investigations were not covered: (i) by legal advice privilege; or (ii) as lawyers' privileged working papers under English law. The court followed the reasoning in *Three Rivers DC v Bank of England (Disclosure) (No.3)* [2003] EWCA Civ 474 because the notes did not contain any indication of the legal advice which had been given. The Court reaffirmed that "client" for these purposes was narrowly defined. It held that: (i) the client consists only of those employees authorised to seek and receive legal advice from the lawyer; and (ii) legal advice privilege does not extend to information provided by employees and ex-employees to or for the purpose of being placed before a lawyer.

Further, the Court held that whilst the notes would probably by privileged under U.S. law the proper law to determine privilege in this case was English law. Lastly,

the Court determined that it was not appropriate in this case for the Court to exercise its discretion to refuse to permit disclosure as there was no exceptional concern that disclosure could lead to violence, intimidation, interference with witnesses etc.

This case confirms the strict application of "client" for the purposes of legal advice privilege. It also demonstrates the challenges of responding to internal investigations where what may be privileged in one jurisdiction may well not be in another.

Challenging bonus discretion post-Braganza: two recent decisions

The case of *Braganza v BP Shipping Ltd* [2015] UKSC 17 established that courts may look into the process that is undertaken by employers when reaching decisions that involve the exercise of a discretion. Prior to Braganza, when determining the reasonableness of an exercise of bonus discretion, the courts tended to focus on the outcome. Two recent cases, *Patural v DG Services (UK) Ltd* [2015] EWHC 3659 (QB) and *Hills v Niksun Inc* [2016] EWCA Civ 115, were the first to consider *Braganza*-based arguments in a bonus/commission context where employees were challenging the process behind their awards as well as the awards themselves. In the *Hills* ruling, the Court of Appeal found in favour of the employee, thus potentially leaving the door open for courts to take a more interventionist approach to an employer's decision-making process.

Costs and settlement

Third part funders held liable for costs on an indemnity basis

Third party funding is becoming a more frequent feature in commercial litigation. In *Excalibur Ventures LLC v Texas Keystone Inc & ors* [2016] EWCA Civ 1144, the Court of Appeal provided important guidance on the extent to which third party litigation funders may be liable to pay the costs of a defendant who has successfully defended a funded claim. In particular, it found that a commercial funder should ordinarily be required to contribute to a successful defendant's costs on the same basis as a funded claimant; that it was appropriate to include funds provided in order to furnish security for costs in calculating a funder's liability under the *Arkin* cap; and that an order could be made against a party who in reality had funded the litigation, irrespective of whether they were a party to any funding agreement.

Although users of commercial litigation funding may now find their cases subject to more thorough and on-going scrutiny, given that professional commercial funders do not typically fund cases as unmeritorious as *Excalibur's*, the case is unlikely to have a seismic impact on the funding industry. In this regard it is worth noting that the Funders were not members of the Association of Litigation Funders (the **ALF**) (who had intervened in the appeal) and that only one of the Funders had any litigation funding experience. Indeed, the decision has been welcomed by the professional funding community, including the ALF, as a welcome reaffirmation that funding is not only part of the modern legal landscape but also, in Tomlinson LJ's words, "an accepted and judicially sanctioned activity perceived to be in the public interest".

Claimant ordered to disclose identity of third party funder

In *Stuart Barrie Wall v The Royal Bank of Scotland plc* [2016] EWHC 2460 (Comm), the Commercial Court ordered a claimant to disclose the identity of a third party funding the litigation he had commenced against RBS where, armed with that information, RBS had a serious prospect of succeeding in an application for security for costs from the funder. It therefore serves as a reminder to defendants to English court proceedings to consider whether the claimant may be in receipt of funding and, if so, to consider seeking security for costs from the funder.

Effect of currency fluctuations on settlement offer

Novus Aviation Ltd v Alubaf Arab International Bank BSC(c) [2016] EWHC 1937 (Comm) is relevant when unforeseen fluctuations in the currency exchange rate between the time of a Part 36 offer and the time of judgment affect whether the Part 36 offer has been 'beaten or not'. The Court confirmed that the value comparison between a judgment and a Part 36 offer should be done on the date of the Court's order. The only reason that the claimant obtained a judgment (in

U.S. dollars) which was more advantageous than its Part 36 offer (in pound sterling) was as a result of the post-Brexit vote fall in pound sterling. However, in these circumstances, the Court found it unjust to order the normal Part 36 costs consequences which apply where an offer has been beaten at trial.

Disclosure

Potential cost and time saving from predictive coding in large disclosure exercise

In *Pyrrho Investments Ltd & ors v MWB Property Ltd & ors* [2016] EWHC 256 (Ch), a Chancery Master approved the use of "predictive coding" in a large disclosure process. Although not completely replacing manual review (for example, to train the software and check relevance or privilege), the use of such technology can vastly cut down the cost of (and time taken for) large disclosure exercises.

Although this may be the first published judgment on the subject, it is not the first time that the Court has approved its use. In 2009, when acting for a major financial institution, Allen & Overy used predictive technology successfully (with the blessing of the Court and the opposing party) in a Commercial Court case. It is likely that it has also been used in other cases that have not resulted in formal public judgments.

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