Financial institutions
Energy
Infrastructure, mining and commodities
Transport
Technology and innovation
Life sciences and healthcare

NORTON ROSE FULBRIGHT

Banking and finance disputes review

Issue 07 / November 2015

In this issue:

Contents

From the editor

In this edition of the *Banking and finance disputes review*, there are a number of articles which highlight the risks and benefits of different jurisdictions as centres for dispute resolution by banks and financial institutions.

Many countries now compete to offer an efficient and reliable service for the resolution of complex financial disputes.

In *The Financial List: resolving financial markets disputes in London*, we examine a new court that is specifically aimed at attracting complex financial litigation of importance. England is already the first choice for much litigation important to the international financial markets – the new financial list shows that it aims to maintain its reputation in the face of increasing competition. One new source of competition is shown by *The Singapore International Commercial Court: a challenge to arbitration?* This initiative in Singapore may attract banks that would otherwise have chosen arbitration or litigation elsewhere, especially for disputes centred in Asia.

Against the backdrop of increasing competition for complex financial disputes, banks are keen to avoid exposure to less developed or uncertain legal systems. Flexible jurisdiction clauses enable banks to take advantage of these beneficial jurisdictions in the right circumstances. *France and the unilateral jurisdiction clause* highlights one potential local law risk that affects this choice – a much publicised problem that has been given new impetus by another decision of the French *Cour de cassation*. *Derivatives mis-selling claims by public authorities in Italy* discusses a different local law risk in another European jurisdiction and demonstrates the sort of jurisdictional battles that arise. Local law overriding the ISDA Master Agreement is dealt with in our case note on *SwissMarine Corporation Ltd v OW Supply & Trading A/S [2015] EWHC 1571 (Comm)*. Finally, *Local law risk: overriding mandatory provisions and Article 9 of the Rome I Regulation* takes an overarching look at how local law considerations can affect international contracts irrespective of their governing law.

Two new legislative developments are explored in *Insolvency update: the recast Insolvency Regulation*, which summarises the key issues for banks arising from this major forthcoming European regulation, and *Damages for late payment of insurance claims*, which follows up a particular point adverted to in an article in the May 2015 edition: *The Insurance Act 2015: a banking case study*. Our two other case notes are on *Fondazione Enasarco v Lehman Brothers Finance SA [2015] EWHC 1307 (Ch)*, addressing a point of construction of the ISDA Master Agreement, and on *Titan Europe 2006-3 plc v Colliers International UK plc [2015] EWCA Civ 1083*, confirming that a securitisation issuer can recover damages for a negligent property valuation.

David Lee
Partner
Tel +44 20 7444 3181
david.lee@nortonrosefulbright.com

The Financial List: resolving financial markets disputes in London

The Financial List should present an opportunity for London to build on its reputation as a pre-eminent global centre for the resolution of large financial disputes.

Litigation in England

Parties across the world regularly choose the English courts to resolve international disputes. English courts have a reputation for consistency, honesty, transparency and technical knowledge. English judges are seen as impartial and independent. There are no juries in civil cases, no awards of punitive or exemplary damages and there is a 'loser pays' system. Although costs and fees have risen in recent years, against this background they still compare favourably with other jurisdictions and with arbitration.

England is a global financial centre and it is natural that litigation relating to complex financial transactions should find its home in England. The High Court in London has been one of the principal locations for large-scale financial litigation for many years and data made available for the year to March 2015 shows a further increase in litigation in the Commercial Court where 63 per cent of litigants were foreign nationals.

However, this position is increasingly under threat. New York law is regularly selected in contracts and claimants often see the New York courts as offering them advantages. Specialist commercial courts have been established in a number of Middle Eastern and Asian jurisdictions, such as the courts of the Dubai International Financial Centre and the Singapore International Commercial Court (see *The Singapore International Commercial Court: a challenge to arbitration?*). Arbitration is also an alternative, with initiatives such as PRIME Finance aiming directly at complex financial disputes that might otherwise be heard in England.

The Financial List

In a speech in July 2015, the Lord Chief Justice announced the creation of a new Financial List for complex and important financial markets cases of high value or which raise market issues. This followed a speech the previous year announcing the initiative and a consultation during the first half of 2015. The Financial List is intended to improve dispute resolution for these cases and ensure that the English courts continue to meet the needs of the international financial community. The Financial List started operation on October 1, 2015.

Cases intended for the Financial List may be started in the Commercial Court or Chancery Division. Cases may be transferred into or out of the Financial List at the request of the parties or at the judge's initiative. Once a case is in the List, it will be allocated at the first case management conference to a designated judge who will manage it through to trial and enforcement. The nominated Financial List judges will receive additional guidance on market developments; currently this set of judges consists of five Commercial Court judges and five Chancery judges together with the head of the Commercial Court and the Chancellor of the High Court.

A claim is suitable for the Financial List if it is for more than £50 million and relates to one of a specified list of financial categories or if it requires particular expertise in the financial markets or raises issues of general importance in the financial markets. Although there is no minimum amount for claims requiring expertise or of general importance, it is unclear how this will be applied in practice, particularly for claims that are well below the £50 million threshold. And even if a case is worth more than £50 million and falls within the relevant categories, it is clear from guidance published with the new rules that it will not be suitable for the list if it is 'straightforward'.

There will be a pilot Financial Markets Test Case Scheme to allow issues of general market importance to be resolved without waiting for an appropriate case to be litigated. Courts will be able to grant declaratory relief against, if possible, an agreed set of facts. The court must be satisfied it has heard full argument from all sides. In general, parties will bear their own costs.

Challenges and opportunities

The creation of the Financial List represents a significant opportunity for London to build on its reputation as a global centre for financial litigation. The concentration of cases into a select group of judges who have control of cases throughout their lifetime and benefit from additional market guidance will enhance the reputation of the English courts for technical excellence and industry and market awareness. The test case procedure could allow English courts to give definitive guidance on issues of market importance that influence practice around the world.

Proper implementation of the Financial List inevitably involves challenges as well as opportunities. The allocation to a single judge will allow continuity but in some ways is less flexible than the existing system. Financial List cases will often be difficult and complex with long-running trials and ensuring availability of an allocated Financial List judge to deal with urgent applications in other cases may be problematical. These cases may also need to be dealt with on an expedited basis, since delays in fixing a trial date or in handing down judgment after trial might be particularly damaging. A concentration of expertise in a small group of Financial List judges might enhance the quality of justice, but there must be a special effort to ensure it does not introduce additional cost through delay.

Similarly, the test case procedure must be implemented with care. Any hypothetical scenario should be wide enough to apply generally yet clear enough to be determinative of issues that arise in future disputes – any ambiguity will simply enable disputing parties to argue that the result of the test case does not apply to them. Interested parties should be able to intervene. In some cases, this right will be clear: the intervention of ISDA in a case on the construction of the ISDA Master Agreement, for instance. But in others it may involve a delicate balance between ensuring all interested parties are heard and multiplying the cost and complexity of litigation.

For the Financial List to thrive, it should take advantage of the technological developments that are being planned for English courts. Online systems for case and document management are crucial for dealing with the large and complex litigation likely to be included in the Financial List.

Overall, the Financial List should be seen as an opportunity for the English courts to leverage their expertise and reputation for complex financial litigation.

For more information contact:

Chris Warren-Smith
Global head of investigations
Tel +44 20 7444 5992
chris.warren-smith@nortonrosefulbright.com

Adam Sanitt
Head of disputes knowledge
Tel +44 20 7444 2269
adam.sanitt@nortonrosefulbright.com

The Singapore International Commercial Court: a challenge to arbitration?

The new Singapore International Commercial Court (SICC) was officially launched on January 5, 2015. The SICC is intended to be the Asian centre for resolving international commercial disputes, in particular, international banking and financial disputes.

Whilst Singapore has for some time enjoyed success as the leading regional centre for international arbitration, financial institutions have traditionally been resistant to arbitration, preferring litigation as their chosen method of dispute resolution. Accordingly, the SICC may be attractive to financial institutions as a new forum for international banking and financial disputes. Even though the SICC typically enjoys jurisdiction via a contractual jurisdiction clause, the Singapore High Court may on its own motion order a transfer of a case to the SICC where 'it is more appropriate for the case to be heard in the Court'.

The Singapore High Court has seen several high profile international banking and financial disputes in recent years. These include suits brought by Filipino, Taiwanese and Chinese investors against different international banks and a suit brought by a Singapore public-listed infrastructure company against a Middle Eastern-based bank arising out of credit facilities for a construction project in Libya.

The number of cross-border disputes involving financial institutions is only set to increase as the Singapore government continues to actively promote Singapore as a major Asian financial centre. Singapore is home to over 700 financial institutions offering a myriad of products and services across various asset classes. This includes over 200 banks, a growing number of which have also chosen to base their operational headquarters in Singapore to service their regional group activities. Singapore is the third largest foreign exchange centre globally and the largest foreign exchange centre in Asia Pacific. Singapore is also ranked the largest over the counter (OTC) interest rate derivatives centre in Asia Pacific excluding Japan by turnover. Assets under management in Singapore rose by 30 per cent from S$1.8 trillion in 2013 to over S$2.3 trillion in 2014.

Given this trend, the Singapore High Court may face increasingly technical and complex international banking and financial disputes. Should such disputes be filed before the Singapore High Court in the future, it is plausible that the High Court may transfer the dispute to the SICC.

The SICC

The SICC has several advantages for international users over the domestic courts. For example, key distinguishing features of the SICC include a panel of international judges, the possibility of having foreign legal representation, the determination of foreign law on the basis of submissions rather than expert evidence, the exclusion of Singapore's laws of evidence and the ability to limit or vary the right of appeal. These features are discussed in more detail below.

The judges of the SICC comprise both the local judiciary and a panel of international judges. The inaugural panel of eleven international judges contains both civilian and common law jurists from around the globe. They are:

Carolyn Berger, former judge of the Delaware Supreme Court and vice chancellor of the Delaware Court of Chancery (United States).

Patricia Bergin, chief judge of the Supreme Court of New South Wales (Australia).

Roger Giles QC, former judge of the Court of Appeal of the Supreme Court of New South Wales and judge of the Dubai International Financial Centre Courts (Australia).

Irmgard Griss, former president of the Austrian Supreme Court (Austria).

Dominique Hascher, judge of the French Supreme Court (France).

Dyson Heydon AC QC, former judge of the High Court of Australia and the New South Wales Court of Appeal (Australia).

Sir Vivian Ramsey, former judge of the High Court and judge in charge of the Technology and Construction Court (England and Wales).

Anselmo Reyes, former judge of the Court of First Instance in Hong Kong in charge of the construction and arbitration list and the commercial and admiralty list.

Sir Bernard Rix, former judge in charge of the Commercial Court and Lord Justice of Appeal in the Court of Appeal (England and Wales).

Yasuhei Taniguchi, former chairman of the Appellate Body of the World Trade Organization Dispute Settlement Body and professor emeritus at Tokyo University (Japan).

Simon Thorley QC, IP law specialist and former deputy High Court judge and deputy chairman of the Copyright Tribunal (England and Wales).

Advantages of the SICC

Rules and practice directions have been specifically formulated for the SICC and will provide it with the framework to hear cross-border commercial disputes. Some of the salient features are:

Joinder of third parties

Unlike arbitration, the SICC has the power to join third parties to an action, even if the third parties are not parties to a written jurisdiction agreement and do not consent to being joined as a party. Arguably the SICC will not exercise this power if the third party will be in breach of an arbitration agreement. In any event, a State or the sovereign of a State may not be made a party to an action in the SICC (whether by joinder or otherwise) unless it has submitted to the jurisdiction of the SICC under a written jurisdiction agreement.

Foreign legal representation

Parties may be represented by foreign lawyers in cases which have no substantial connection to Singapore (known as 'offshore cases'), as well as in cases where the subject matter or issues in dispute give rise to questions of foreign law.

Laws of evidence and foreign law

Parties may apply to exclude the application of Singapore's laws of evidence. As with arbitration, the SICC may allow parties to choose to apply alternative rules of evidence, with which they may be more familiar. The SICC may, upon the application of a party, order that any question of foreign law be determined on the basis of submissions, without requiring formal proof by experts.

Confidentiality of proceedings

Proceedings will generally take place in open court, but parties will have the option to apply for the proceedings to be confidential. In deciding to make a confidentiality order, the SICC will take into account whether: (i) the case is an offshore case; and (ii) there is an agreement between the parties on the making of such an order.

Right of appeal

Decisions of the SICC may be appealed to the Singapore Court of Appeal, although parties will be allowed to contractually exclude or limit this right of appeal. If the parties agree in writing to waive, limit or vary the right to appeal against any judgment or order of the SICC, then an appeal may be brought only to the extent as agreed between the parties.

Enforcement

The Supreme Court of Judicature (Amendment) Act 2014 stipulates that parties who have agreed to submit to the jurisdiction of the SICC shall, unless expressly stated otherwise, also be considered to have agreed to submit to the exclusive jurisdiction of the SICC, to carry out any SICC judgment without undue delay and to waive any recourse to any court or tribunal outside Singapore against any SICC judgment and the enforcement of such a judgment.

In contrast to international arbitral awards that are enforceable by way of the New York Convention on the Enforcement of Foreign Arbitral Awards, SICC judgments have the status of a Singapore High Court judgment. Their enforceability in a foreign jurisdiction would be dependent on the principles governing the recognition of foreign judgments in that jurisdiction. This is a possible disadvantage of an SICC judgment compared to an arbitral award. The current disparity between the enforceability of SICC judgments and arbitration awards may restrict the circumstances in which parties will prefer the SICC to situations where enforcement will take place in Singapore itself, or in a country where parties are relatively confident a Singapore judgment will be enforced.

Conclusion

The SICC's combination of international expertise and commercially focussed rules should make it an attractive forum for resolving international banking and finance disputes.
For multi-party disputes involving jurisdictions that allow enforcement of Singapore judgments, the SICC may be preferred to arbitration. And for complex financial disputes centred in Asia, the SICC may be more practical than litigation in London or New York.

For more information contact:

KC Lye
Partner
Tel +65 6309 5304
kc.lye@nortonrosefulbright.com

Darius Chan
Senior associate
Tel +65 6309 5301
darius.chan@nortonrosefulbright.com

France and the unilateral jurisdiction clause

A unilateral jurisdiction clause, also known as an asymmetrical jurisdiction clause or a one-sided jurisdiction clause, provides that one party must sue the other party in the courts of a specified country while the other party remains free to sue the first one in the jurisdiction of its choice. These clauses are very common in financial agreements where they generally provide that the borrower can only sue the lenders in a specific country while the lenders can sue the borrower in that country or in any other country which has jurisdiction over the dispute.

A unilateral jurisdiction clause is therefore an advantage given to the lenders since they may only be sued by the borrowers in their home jurisdiction whereas they can start proceedings against the borrowers in any country which will accept jurisdiction. In particular, this enables the lenders to take action against the borrower wherever its assets are located, in order to facilitate enforcement.

French Supreme Court and unilateral jurisdiction clauses: part 1

On September 26, 2012, in its decision *Mme X v Banque Privée Edmond de Rothschild*, the *Cour de cassation*, the French Supreme Court, decided that unilateral jurisdiction clauses are invalid both under the French civil code and the Brussels I Regulation (Regulation No 44/2001, the 'Regulation': note that this has now been replaced by Regulation No 1215/2012, the 'recast Regulation', but the reasoning in *Rothschild* should apply also to the recast Regulation). The Regulation is the principal source of law on jurisdiction for EU Member States. This decision was widely reported and criticised.

Rothschild concerned a jurisdiction clause in an investment management agreement between a Spanish client domiciled in France and a Luxembourg bank which gave the Luxembourg courts exclusive jurisdiction but which also gave the bank the right to bring actions against the client in the jurisdiction of the client and any other courts with jurisdiction. The French *Cour de cassation* held that the jurisdiction clause was null and void on the grounds that it was 'potestative' (see below) and contrary to the purpose of the then applicable provisions of the Regulation.

According to article 1170 of the French Civil Code:

'*A potestative condition is one which makes the execution of the agreement depend upon an event that one or the other of the contracting parties has the power to bring about or to prevent*.'

Article 1174 of the same Code adds:

'*Any obligation is null when it has been contracted subject to a potestative condition on the part of the party who binds himself*.'

There appear to be a number of problems with the reasoning of the *Cour de cassation*. First, these Articles apply to contractual obligations – such as performance, payment, transfer of ownership – but it appears doubtful that they apply to jurisdiction clauses. Furthermore, even if they do apply to jurisdiction clauses, the 'party who binds himself' is the party who is bound to take action only in a specific jurisdiction and accordingly the 'potestative' condition is not undertaken by him but by the other party to the contract.

Second, the *Cour de cassation* should have rendered its decision only under the Regulation and not under domestic French law. And it is difficult to see

why a unilateral jurisdiction clause should be seen as contradicting the purpose of the Regulation. On the contrary, the Court of Justice of the European Community held in 1986 that jurisdiction clauses conferring a benefit on one party are valid (*Anterist v Crédit Lyonnais* (Case 22/85)).

There was some hope that this decision was motivated by its particular fact pattern: the claimant was an individual French person pursuing a claim against an international bank which actually had used its French affiliate to negotiate the contract but was now seeking to take advantage of a jurisdiction clause to restrain proceedings in France. Many commentators argued that the effect would be limited to such situations.

These hopes have been somewhat dashed by a new case decided by the *Cour de cassation*.

French Supreme Court and unilateral jurisdiction clauses: part 2

On March 15, 2015, the French Supreme Court held that a unilateral jurisdiction clause entered into between a French company and a Swiss bank was invalid under the Lugano Convention (which is substantially the same in relevant respects to the Regulation and the recast Regulation).

Unlike *Rothschild*, the 2015 case involves a more traditional set of financing arrangements between a French corporate borrower and Crédit Suisse, with an on-demand guarantee issued by Société Générale. The credit agreements contained a market-standard jurisdiction clause giving exclusive jurisdiction to the Zurich courts but providing that Crédit Suisse could bring actions against the borrower before any other competent court. Crédit Suisse raised a jurisdictional objection to an action brought against it by the borrower in the French courts, on the basis of the unilateral jurisdiction clause, which Crédit Suisse argued was consistent with the provisions of the Lugano Convention. This objection was sustained by the lower court but, on appeal, the *Cour de cassation* reversed the result.

The *Cour de cassation* held that the lower court reached its conclusion without considering whether the imbalance criticised by the borrower – namely, that the clause granted the bank the right to bring proceedings before 'any other competent tribunal' but did not specify the objective basis on which this alternative jurisdiction was founded – was contrary to the objectives of foreseeability and legal certainty underpinning the Lugano Convention. Interestingly, the *Cour de cassation* (probably well aware of the criticism of its earlier decision) made no mention of the 'potestative' principle in its decision, despite the argument having been made by the appellant. Instead it focused on: (i) the absence of objective criteria setting out the basis for any alternative jurisdiction, and (ii) the fact that the unbalanced nature of unilateral jurisdiction clauses was, in its view, contrary to the aims of the Lugano Convention. Therefore, the *Cour de cassation* overturned the decision of the Court of Appeal.

Once again, the reasoning of the *Cour de cassation*, even if based only on the article 23 of the Lugano Convention without reference to French law and particularly to the 'potestative' condition, is difficult to understand. On the face of it, unilateral jurisdiction clauses do not appear to be contrary to the object and purpose of the Lugano Convention (or the Regulation). In fact, the decision of the *Cour de cassation* seems to result from philosophical and sociological rather than purely legal considerations. It considered that the weaker party must be protected and therefore a clause which gave an advantage to a bank – which is seen by the *Cour de cassation* as the stronger party – must be rendered null and void.

French Supreme Court and unilateral jurisdiction clauses: part 3

On October 7, 2015, the *Cour de cassation* rendered yet another decision on unilateral jurisdiction clauses, holding this time that a particular unilateral jurisdiction clause was not contrary to the Regulation.

In this case, Apple Sales Ltd ('Apple'), an Irish company in the Apple Computers group, signed an agreement with a French reseller containing the following clause:

'*This Agreement and the corresponding relationship between the parties shall be governed by and construed in accordance with the laws of the Republic of Ireland and the parties shall submit to the jurisdiction of the courts of the Republic of Ireland. Apple reserves the right to institute proceedings against Reseller in the courts having jurisdiction in the place where Reseller has its seat or in any jurisdiction where harm to Apple is occurring.*'

When the reseller brought an action against Apple alleging anticompetitive practices before the French commercial court, Apple argued that this was in violation of the jurisdiction clause and requested that the French court decline jurisdiction. Unsurprisingly, the reseller made the argument that the clause was 'potestative' and that it should be disregarded, meaning that under ordinary jurisdiction principles, the reseller was entitled to bring an action in France, where the harm to the reseller occurred.

The *Cour de Cassation* held that the jurisdiction clause permitted the identification of jurisdictions before which an action could be brought with respect to the performance of the contract, and therefore complied with the requirement of predictability with which jurisdiction clauses must comply. The Court made no mention whatsoever of the 'potestative' nature of the clause.

This is a favourable development which suggests that these clauses may be upheld in France if drafted appropriately. However, the jurisdiction clause was more limited than the usual 'you can sue me only before my home court but I can sue you wherever I find a court that will accept jurisdiction' type clause often found in international contracts. Apple's right to sue the reseller was limited to the courts of the reseller's corporate seat (in this case France) or 'any jurisdiction where harm to Apple is occurring'. This limitation may be what enabled the *Cour de Cassation* to determine that the clause 'permitted the identification of jurisdictions before which an action could be brought with respect to the performance of the contract' and so was sufficiently predictable.

Conclusion

Financial institutions can mitigate the legal risk by using a clause that specifically sets out all the jurisdictions in which they have the right to sue the other party. This avoids the criticism of uncertainty which was the main argument used by the *Cour de cassation*. Another alternative, if it is commercially practicable, is to use a hybrid arbitration clause rather than a unilateral jurisdiction clause – these clauses have previously been upheld by the *Cour de cassation*.

The recast Regulation did not take the opportunity to remove this uncertainty – if anything, it has increased it. One change in the recast Regulation is that a jurisdiction clause must meet not only the formal requirements of the Regulation but also that it must be valid under the law of the Member State whose courts have been designated by the parties. Therefore, applying this new rule, a court undertakes a multi-stage process. First, it must determine whether the jurisdiction clause is valid under the recast Regulation. Then it must determine what law governs the jurisdiction clause. And then, having decided the governing law, it must then decide whether the clause is valid according to that governing law. This new approach may increase the risk of nullity of a unilateral jurisdiction clause.

Clearly, prudence must now be the order of the day in France as far as unilateral jurisdiction clauses are concerned. Any party to a contract with a connection to France must be aware of the fragility of such clauses. Such a connection would include any party to the contract being domiciled in France or any obligations under the contract being performed in France.

For more information contact:

Philippe Hameau
Partner
Tel +33 1 56 59 53 13
philippe.hameau@nortonrosefulbright.com

Derivatives mis-selling claims by public authorities in Italy

Following the financial crisis of 2008, Italian public authorities filed thousands of legal actions against banks and financial institutions seeking redress for the negative consequences they suffered as a result of entering into complex derivatives transactions.

In this article, we examine the course of this litigation and discuss the ramifications for the interpretation of the ISDA Master Agreement and the risks undertaken by banks and financial institutions in dealing with Italian counterparties and facing litigation in Italy.

Use of derivatives by the Italian public sector

The Italian Ministry of Economy and Finance has estimated that, at the end of 2014, 216 Italian public authorities had entered into 433 over the counter (OTC) derivatives contracts with a notional value of approximately €24.8 billion (61 per cent with foreign counterparties and the remaining 39 per cent with Italian banks). The Italian regions were the most active, accounting for about €15 billion (60 per cent of the total), followed by 30 municipalities with €6 billion (24 per cent), 32 provinces with €2.4 billion (10 per cent) and 137 smaller cities with €1.5 billion (6 per cent).

Their use of derivatives had been more extensive in the past (reaching its peak in 2007 with 1,333 contracts involving 798 public entities), decreasing only in the last few years, after the Italian Central Bank in 2008 banned public authorities from entering into swap contracts. Public authorities are now subject to strict limitations when entering into derivatives transactions. The damage, however, has already been done, as shown by the raft of legal proceedings in the recent past.

Claims by Italian public authorities

Derivatives mis-selling claims by Italian public authorities are based on both contractual and tortious liability. They have commonly included the following allegations:

- the public authority's lack of capacity to enter into the swap
- the public authority's lack of expertise in respect of financial instruments, notwithstanding that it signed a declaration that it was a sophisticated investor before executing the derivatives transaction
- the presence of costs associated with the transaction that were not disclosed by banks at the time the derivatives transaction was executed (so-called 'implicit costs')
- the violation of the principle of good faith and the breach of a number of provisions of Italian financial services regulation.

These claims may also include allegations of misconduct by financial institutions, such as that:

- the transaction was vitiated for reasons such as misrepresentation or fraud
- the ISDA Master Agreement was not signed by the bank (although duly performed by both sides) and/or did not contain certain required information
- the bank failed to inform them of the 'cooling off period' under Italian law during which they could have cancelled the contracts
- the bank failed to comply with the duties of care, fairness and transparency and failed to operate so as to obtain the best possible result for the local authority from the investment service provided

- the bank did not communicate the conflict of interest to which it was subject by being both arranger and swap dealer, nor did it obtain the public entity's consent in writing to this conflict
- the transaction, represented by banks as being for the purpose of hedging, was actually speculative and consequently inappropriate for the public authority's risk profile
- the bank did not clearly explain the nature of the derivative products and the related risks
- the banks failed to assess the public authority's investment experience and appetite for risk or provide them with general information on the risks of financial investments.

Focus on jurisdiction

Jurisdiction has been a central, substantive issue arising in almost all the proceedings between Italian public authorities and banks. Public authorities have routinely tried to have derivatives disputes heard in Italy rather than in the UK, perhaps due to a perception of higher litigation costs in England or a belief that English courts would be more favourable to international banks than Italian municipalities. Conversely, banks have turned first to the English courts and, when sued in Italy, have argued that the ISDA Master Agreement confers exclusive jurisdiction on the English courts.

This has resulted in pre-emptive proceedings brought by public authorities before Italian courts, on the grounds that under the Brussels I Regulation (Regulation 44/2001, now replaced by Regulation 1215/2012), the first court to be chosen has the right to determine its jurisdiction, thereby staying any subsequent proceedings in a Member State until that determination is reached. Note that this tactic may not now be effective as under Article 31(2) of the Brussels I Regulation, since the beginning of 2015, the English courts would not be obliged to stay proceedings where exclusive jurisdiction has been conferred on them by the terms of the ISDA Master Agreement.

Italian interpretation of the ISDA Master Agreement jurisdiction clause

Following a number of contradictory Italian local court decisions, the Italian Supreme Court has recently ruled on jurisdiction and forum-shopping issues in two cases involving ISDA Master Agreements entered into by two Italian municipalities (Milan and Venice).

The municipalities claimed damages for tortious liability arising from conduct before the conclusion of the contract (i.e. in the pre-contractual phase). Then both municipalities filed a concurrent claim for damages for contractual liability for breach of collateral consultancy agreements. The defendants disputed the local courts' jurisdiction on the basis of Article 13 of the ISDA Master Agreement, which provided that English courts have jurisdiction for disputes 'relating to this Agreement'.

The Supreme Court found that the Italian courts had jurisdiction in both cases. The first case, involving the Municipality of Milan, was decided by the Supreme Court on February 27, 2012. The Supreme Court held that the jurisdiction clause did not extend to tort claims. First, it decided that in a complex dispute where subordinate claims are also filed, jurisdiction is determined by the main claim. Italian courts had jurisdiction over the main tort claim under the Brussels Regulation, subject to the effect of the jurisdiction clause in the ISDA Master Agreement.

The Supreme Court then set out principles of interpretation of this jurisdiction clause. It clarified, in line with European case law, that jurisdiction clauses must be strictly interpreted and assessed separately from the agreement in which they are contained and, most importantly, that the national judge, before which their interpretation is sought, decides such interpretation. Hence, based on Italian law principles of contractual interpretation, the Court held that the wording 'relating to this Agreement' in the jurisdiction clause under Article 13 of the ISDA Master Agreement did not extend the jurisdiction of English courts to all disputes, whether contractual or tortious, connected to the same derivative contractual framework.

In conclusion, the Italian Supreme Court ruled that in the event of a jurisdiction clause as the one contained in the ISDA Master Agreement, referring to disputes 'relating to this Agreement', English jurisdiction does not extend also to tort claims.

Two years later, in a similar case involving the Municipality of Venice, the Italian Supreme Court reconfirmed the first ruling in full based on the same reasoning.

Administrative and criminal implications

Italian derivatives disputes may also involve administrative claims and criminal liability.

For instance, in a derivatives dispute involving the city of Pisa, one issue was the validity of a public authority's power to exercise self-redress on the grounds that the transaction did not meet the 'economic convenience test' laid down in Italian law. This enabled the public authority to make a unilateral decision to retroactively cancel the resolutions authorising the entry into the derivatives transaction. The Italian Supreme Administrative Court ruled in 2012 that Pisa's exercise of self-redress was void as the existence of 'implicit costs' in a swap was not sufficient in itself to violate Italian law. Another potential violation is that the public authority has exceeded the statutory limitations on entering into derivatives contracts.

Recent cases have shown that Italian administrative courts generally accept jurisdiction over derivatives disputes involving public authorities whenever the exercise of administrative powers (or the procedure to select the swap counterparty) is disputed, irrespective of the fact that the parties agreed to the exclusive jurisdiction of the English courts. Conversely, where the only issue is the validity of the derivatives contract, Italian administrative courts will generally accept that English courts have sole jurisdiction. Where the sole cause of action is administrative, the Brussels Regulation may not apply as it covers only 'civil and commercial' matters.

There have also been proceedings in Italy before the criminal courts, such as one widely publicised case before the Criminal Court of Milan against four international banks, some bank employees and former city officials. Banks and their representatives could face significant risks in criminal proceedings: for instance, seizure of assets, temporary bans from doing business with municipalities, and monetary fines. Criminal actions may also trigger administrative liabilities, which also apply to international corporations doing business in Italy.

Conclusions

There are significant differences between litigation in Italy and litigation in the UK. Legal proceedings in Italy can be extremely lengthy due to the Italian judicial system's 'three instance' structure. Banks involved in legal actions pending before Italian courts have faced reputational damage, following some initial unfavourable judgments on derivatives transactions. In some cases, Italian courts have adopted a highly formalistic interpretation of Italian financial services regulations, which can be disadvantageous to banks. However, in other cases, banks have succeeded in jurisdiction challenges following years of litigation. Accordingly, the outcome of legal proceedings in Italy can be highly unpredictable. Finally, derivatives litigation in Italy often follows a two-track procedure, with claims filed in both civil and administrative courts. This leads to the risk of conflicting judgments from civil, administrative and even criminal courts in respect of the same matter.

The Italian courts have shown a propensity to accept jurisdiction in these cases. Administrative proceedings fall outside the jurisdictional limitations of the Brussels I Regulation. Even where the Brussels I Regulation does apply, the Italian Supreme Court's restrictive interpretation of the ISDA Master Agreement exclusive jurisdiction clause has allowed it to take jurisdiction over tortious claims arising out of derivatives disputes, perhaps surprisingly from an international perspective.

In light of the above and considering the volume of trading in derivatives, its impact on Italian local finance and the uncertainty of case law on many substantial issues, derivatives litigation involving public authorities is a continuing source of risk and liability for financial institutions.

For more information contact:

Ilario Giangrossi
Partner
Tel +39 02 8635 9441
ilario.giangrossi@nortonrosefulbright.com

Chiara Bicci
Senior associate
Tel +39 02 8635 9443
chiara.bicci@nortonrosefulbright.com

Local law risk: overriding mandatory provisions and Article 9 of the Rome I Regulation

Local law risks are a concern for financial institutions that operate across different jurisdictions. They try to mitigate these risks by choosing a particular governing law for their contracts, such as English governing law, and granting exclusive jurisdiction to particular courts, such as the English courts. But there are circumstances where an English court, even considering an English law contract, will apply provisions of a foreign law that render a contract unenforceable. Issues arising from the recent temporary imposition of Greek capital controls show that the scope of this power contains many uncertainties and ambiguities.

Consider an example, which we shall develop throughout this article: a bank lends money to a special purpose vehicle set up as part of a project financing in Greece. The transaction documentation requires the special purpose vehicle to accumulate money in specific accounts in Greece and then to repay the lender from those accounts. The loan is denominated in euros. It is governed by English law and subject to the exclusive jurisdiction of the English courts. The question for the bank is: what Greek law risks is it exposed to, notwithstanding those choices of English governing law and jurisdiction.

Rome Regulation: overriding mandatory provisions

English courts, together with all other courts within the European Union, determine the applicable law of a contract in accordance with the Rome I Regulation (Regulation No 593/2008, the 'Regulation'). Article 9 of the Regulation provides as follows:

'*1. Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation*

...

3. Effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application.'

This Article allows English courts (or the courts of another EU Member State) to apply a foreign law to a contract, irrespective of its governing law. However, it only applies to 'overriding mandatory provisions'. This is generally a small, easily identifiable class of laws and so the extra local law risk imposed by this Article is often seen as limited.

However, the temporary imposition of capital controls in Greece earlier this year provided an example of provisions that arguably fell within this definition. Financial institutions were suddenly faced with urgent questions of interpretation of Article 9. And it emerged that there were a number of hitherto unforeseen ambiguities and uncertainties within this Article. In particular:

- **Whole or part**
  Did the test for a rule of law to count as an 'overriding mandatory provision' apply to a piece of legislation as a whole or to each individual rule within it?

- **Location of obligations**
  What jurisdictions fell within the category of those where the obligations have to be performed and did there have to be any connection between the

performance of that obligation and the obligation which was to be rendered unlawful?

- **Meaning of unlawful**
  What doctrines of local law applied to make a contract 'unlawful'?

- **Unlawful for whom?**
  Did the performance have to be unlawful for a party to the contract or another person?

- **Effect on default provisions**
  Given the discretionary application of Article 9, what was the effect on illegality events of default?

We consider each of these issues below and highlight the resulting risks by reference to our continuing example.

Note that English law may also contain a separate rule that covers the same ground as Article 9(3), although it is of slightly wider scope, but which applies only to English law governed contracts (the rule stems from *Ralli Brothers v Compania Naviera Sota Aznar* [1920] 2 KB 287). There is some doubt as to whether this rule still exists (although recent authority suggests that it does – see *Eurobank Ergasias v Kalliroi* [2015] EWHC 2377 (Comm)). In any case, we will concentrate in this article on Article 9, which is of pan-European relevance.

Whole or part

Suppose that performance of an obligation is contrary to a rule in a piece of legislation in the jurisdiction where it is to be performed. Article 9 requires a determination whether that rule is an 'overriding mandatory provision', using the examples set out in Article 9(1). But does the test apply to the particular rule or the whole piece of legislation? The legislation as a whole may be significant enough to fall within the definition, whereas the particular rule – being only a minor part of it – may not, if considered in isolation.

Using the example of Greek capital controls, the legislation that brought it into effect arguably fell within the definition as 'regarded as crucial by a country for safeguarding its public interests', given the context of Greece's financial and political crisis. However, a particular rule within it, such as, for instance, an obligation to provide information to a regulator, might not, in isolation, fall within this category.

Although there is no authority on this issue, a granular approach does not appear consonant with the aims of Article 9. If a particular sub-rule is of less significance, a court may deal with that by a non-exercise of its discretionary power. Applied to our example, it means that any contravention of capital controls legislation would be relevant, without having to undertake a further analysis of whether that part fell within the definition of 'overriding mandatory provisions'.

Location of obligations

English courts have traditionally taken a strict view as to where payment obligations 'have ... to be performed'. The contract must effectively specify a place of performance for the obligation, so that it cannot be performed in any other country while complying with the contract (see *Tamil Nadu Electricity Board v ST-CMS Electric Company* [2007] EWHC 1713 (Comm)). As a payment obligation will generally only specify where the payment is to be made, rather than where it must originate, mandatory overriding obligations of the payor's country will not be relevant. That is, if the payor is prevented from paying from an account in its own jurisdiction, the English courts will expect it to pay using some other means.

Our case study is a rare example of a payment obligation that is required to be performed in the payor's jurisdiction. The contract specifies a particular transaction account in Greece which must be used to accumulate all the borrower's income and which must be used as the source to repay its loan.

Article 9(3) does not link the place of performance with the obligation that is unlawful. The first half of the clause refers to 'the obligations arising out of the contract' but the second half refers to 'the performance of the contract'. There is no link in the Article between obligations that have to be performed in a certain place and the obligations that are rendered unlawful. A connection between those obligations might be implied by the process of statutory interpretation, if the courts took the view that the purpose of the Article was to restrict unlawfulness only to obligations that had to be performed in the relevant jurisdiction. However, in the absence of any authority, it is uncertain whether this purposive interpretation would be adopted.

The implication of this for financial institutions is that they must enumerate all the jurisdictions where performance of any part of a contract is required and determine whether any overriding mandatory obligations affects any obligations of the contract. At least until this is clarified by the courts, this ambiguity adds extra due diligence overhead.

Meaning of unlawful

Article 9(3) refers to the contract being rendered 'unlawful'. This is to be interpreted not in accordance with the law of any particular jurisdiction but in a supra-national sense. Accordingly, for each local jurisdiction, it is necessary to determine exactly which doctrines of local law correspond to unlawfulness within Article 9(3).

It is easy to overlook this issue when restricted to an English law perspective. There is an English law doctrine of illegality and it appears to coincide with unlawfulness, as set out in Article 9. However, other jurisdictions may have a less well-developed doctrine of illegality, or it may overlap with related doctrines.

Take our continuing case study: a payment is required to be made from a particular bank account; a law is passed which makes it illegal for the bank to effect this payment but does not directly address the position of the payor. Assume that, as a matter of statutory construction, it is not then illegal for the payor to make the payment, but it will be impossible for it to do so because it is illegal for the bank to transfer the funds. It is clear, as a matter of English law, that the payor's obligation is not illegal, although it is impossible. Depending on the terms of the contract, similar consequences might follow – the contract may be terminated by frustration, for instance. But this is still distinct from the consequences of illegality.

Yet it is quite plausible that another legal system might treat this fact-situation as an example of illegality, rather than some other doctrine. In that case, the question arises whether the local law definition of illegality prevails over any floating European concept. If it does, the scope of Article 9 might be substantially expanded.

Unlawful for whom?

A related ambiguity is that Article 9(3) states that performance of the contract must be unlawful, but it does not say by whom. Not only does Article 9 not make any explicit connection between the obligation that is to be performed and the obligation that is unlawful, but it does not link the person for whom performance is illegal with the parties to the contract.

In most cases, this will not cause a problem: it will clearly be a party to the contract who must perform the obligations under the contract and any illegality will be in respect of that party. But the case study illustrates a common situation where that is not the case. The contract states that a payment must be made from a bank account – although the bank is not a party to the contract, this is an action that only it can undertake. That is, the obligation on the party to the contract is to procure that the bank transfer funds from its account with the bank to another account.

It is not uncommon for a contract to contain such a provision: an obligation on a party to procure that something be done, or that a third party do something. At present, it is unclear whether Article 9 will be engaged when that act is illegal for the person who, as set out in the contract, is required to do it, if they are not a party to the contract.

Effect on default provisions

Many contracts contain an event of default or other termination provision that refers to illegality of the contract. They may either refer to illegality according to relevant local laws or illegality according to the governing law of the contract.

If the event of default extends to illegality according to the local law of any relevant jurisdiction, there has to be some limit to which jurisdictions are considered relevant. One option is to include all jurisdictions where an obligation under the contract is to be performed. As discussed above, this may itself be a complex question. It avoids all the subsequent questions about the operation of Article 9 although, of course, this is at the cost of including a much wider range of illegality than Article 9, depending on how the various ambiguities noted above are resolved.

If a clause is restricted to illegality under the governing law of the contract, that effectively refers back to Article 9. That is, there will be illegality under the governing law of the contract if there is illegality under a relevant local law and Article 9 applies. Accordingly, the various ambiguities noted above are still relevant. But there is another problem. Article 9 renders a contract illegal on a discretionary basis – so even if all the preconditions are satisfied, it is not possible to say with certainty that a contract is illegal until a court has exercised its discretion accordingly. This makes it inherently risky to rely on a governing law illegality clause based on a local law illegality translated to the governing law by Article 9.

Conclusion

The ability of a court under Article 9 to declare a contract illegal under its governing law based on non-compliance with local law obligations adds to the local law risks faced by a bank in its cross-border transactions. The various ambiguities of Article 9, many of which have only recently become apparent, increase the scope of this risk. Banks will meet this risk by careful drafting and further due diligence. However, this can only be of limited help where political or economic crises cause drastic changes to local laws in the future.

For more information contact:

Adam Sanitt
Head of disputes knowledge
Tel +44 20 7444 2269
adam.sanitt@nortonrosefulbright.com

Insolvency update: the recast insolvency regulation

The European Insolvency Regulation (Regulation (EC) No. 1346/2000) (the 'Regulation') has reduced the risk to banks and financial institutions of enforcement against insolvent companies in EU Member States by enabling cross-border cooperation and increasing certainty in the law applicable on insolvency. New European legislation addresses some deficiencies of the Regulation and introduces a new framework for group insolvencies. Banks lending to groups of companies will take note in particular of the increased scope for coordination between different jurisdictions in complex cross-border group insolvencies.

The recast Regulation

The Regulation originally came into force on May 31, 2002. Its purpose was to provide rules to determine the proper jurisdiction for a debtor's insolvency proceedings and the applicable law to be used in those proceedings and to require mandatory recognition of those proceedings in other EU member states. The Insolvency Regulation provided for a review of its operation after ten years and in December 2012 the European Commission made proposals for it to be updated. Following extensive trialogue discussions between the European Commission, European Parliament and Council, the final text of the recast Insolvency Regulation was approved by the European Parliament on May 20, 2015, and the recast Insolvency Regulation (Regulation (EU) No. 2015/848) (the 'recast Regulation') entered into force on June 26, 2015, applying to insolvency proceedings from June 26, 2017.

Key changes

The recast Regulation contains a codification of the method of determination of centre of main interests (COMI). COMI is a central concept that determines whether the recast Regulation applies to a debtor and the jurisdiction for opening of main insolvency proceedings. COMI will be presumed to be at the registered office, but the presumption is rebuttable if the central administration is located in another Member State and a comprehensive assessment of all the relevant factors establishes, in a manner that is ascertainable by third parties, that the company's actual centre of management and supervision and of the management of its interests is located in that other Member State. The registered office presumption will not apply if there has been a move of the registered office during the three months prior to the opening of proceedings. Although essentially stating what has been developed by case law since the Regulation, these new rules provide welcome clarity.

The recast Regulation is extended in scope to new categories of proceedings. It covers hybrid and pre-insolvency proceedings and secondary proceedings will no longer be limited to liquidation proceedings where a company has an establishment. The definition of 'establishment' is amended to 'any place of operations where the debtor carries out a non-transitory economic activity with human means and assets' (using a reference to 'assets' rather than 'goods') and the relevant time for assessing an establishment will be either the time of the opening of the secondary proceedings or, alternatively, the three month period prior to that, so that secondary proceedings may still be possible even if an establishment has recently closed. In addition, the insolvency practitioner in the main proceedings is now expressly permitted to provide undertakings to treat local creditors as they would be treated under secondary proceedings.

Under the recast Regulation, the courts of the member state where main insolvency proceedings are opened will also have jurisdiction to hear actions derived directly from the insolvency proceedings that are closely linked, such as avoidance actions, to avoid the risk of irreconcilable judgments resulting from separate proceedings.

There will be new linked registers of insolvency proceedings. The recast Regulation calls for both national electronically-searchable databases in each member state, and for these to then be linked via a central European e-justice portal. On July 7, 2014, the Commission announced a pilot scheme to connect insolvency registers in the Czech Republic, Germany, Estonia, Netherlands, Austria, Romania and Slovenia through the e-justice portal.

Group companies

The recast Regulation introduces a framework for group insolvency proceedings. The aim is to improve the efficiency of insolvency proceedings concerning different members of a group of companies, which may encourage cooperation across the group and rescue of the group as a whole. Currently, each insolvent debtor company is subject to separate insolvency proceedings in the place of its COMI. Where two or more members of a group of companies are subject to insolvency proceedings, an insolvency practitioner appointed to any group company, together with any courts involved, will be obliged to cooperate (for example by agreement or protocol) to facilitate the effective administration of those proceedings, to the extent it is not incompatible with the rules of such proceedings and there is no conflict of interest in doing so.

Group coordination proceedings may be requested before any court having jurisdiction over the insolvency proceedings of a group member by the insolvency practitioner appointed there. The purpose of these proceedings is to propose a group coordination plan recommending a comprehensive set of measures appropriate to an integrated approach to the resolution of the group members' insolvencies. Insolvency practitioners in other members states may choose not to participate in proposed group coordination proceedings, so they will only be effective where they are consensual. It is already open to insolvency practitioners in some European jurisdictions to form agreements with insolvency practitioners in other jurisdictions and give appropriate undertakings to creditors in order to effect a form of group coordination plan, and given the new provisions in the recast Regulation, we may see increased group coordination in advance of the new provisions applying.

Timing of the recast Regulation

The recast Regulation has direct effect in each member state (apart from Denmark, which has opted-out) without the need for separate enactment at a national level. The majority of the provisions apply from June 26, 2017 and the original Regulation will continue to apply to proceedings opened before this date. The establishment of national insolvency registers will not come into force until June 26, 2018, with the requirement for an EU interconnected register by June 26, 2019.

Conclusion

Banks and financial institutions will hope to take advantage of the recast Regulation. The amendments to COMI and extension to all secondary proceedings should discourage forum shopping. The insolvency register and group coordination proceedings will facilitate complex cross-border insolvencies. Even before the recast Regulation comes into effect, there may be a push towards increased cooperation in group insolvencies.

For more information contact:

Hamish Anderson
Partner
Tel +44 20 7444 3424
hamish.anderson@nortonrosefulbright.com

Rebecca Oliver
Knowledge of counsel
Tel +44 20 7444 3885
rebecca.oliver@nortonrosefulbright.com

Damages for late payment of insurance claims

In *The Insurance Act 2015: a banking case study*, published in the previous edition of the *Banking and finance disputes review*, we commented on the absence of a provision in the Insurance Act 2015 entitling a bank insured to contractual remedies (including damages) in the event of late payment or an unreasonable refusal by insurers to pay insurance claims. While the government had omitted such a clause from the Act given the opposing views of a number of stakeholders, it promised to introduce such a clause in legislation once a solution had been agreed.

It has now done so. Part 5 of the Enterprise Bill (the Bill), introduced in the House of Lords on September 16, 2015, provides for the insertion into the Act of clause 13A which largely mirrors the wording proposed by the Law Commissions of England and Wales and of Scotland (the Commissions). If this amendment to the Act is successful, it will come into force a year later – that will be some time after August 2016 (when the Act as originally passed comes into force).

As discussed in our previous article, claims by banks may involve complex issues of compliance, knowledge and disclosure, that lead to lengthy investigations by insurers. These are exactly the circumstances where this amendment should rebalance the position between insurers and bank insureds.

In this article, we first provide a brief overview of the current legal position in relation to the late payment of insurance proceeds and the reasoning behind reform in this area of insurance law, before providing a summary of clause 13A, addressing the likely areas of dispute that may arise out its current drafting.

The current position and reasons for reform

The normal position is that where one party suffers loss because the other party has failed to meet its contractual obligations, the innocent party may claim damages for the loss suffered (*Hadley v Baxendale* (1854) EWHC J70). The English courts have, however, held that insurance contracts fall outside this rule. In English law, an insurer is not liable for any loss caused by its delay or failure to pay a valid claim. This is based on the legal fiction that the insurer's contractual obligation is to prevent the loss occurring (or to 'hold the insured harmless') rather than to pay out a claim. As a result, claims payments are considered to be damages. Where payment is late, there can be no remedy (other than interest on the amount outstanding) as English law does not allow damages for late payment of damages (*The President of India v Lips Maritime Corporation (The Lips)* [1988] AC 395).

The operation of the 'hold harmless' principle is clearly illustrated in *Sprung v Royal Insurance (UK) Limited* [1999] 1 Lloyd's Rep 111. In that case, the insured was unable to finance the repairs to his factory after his insurer denied liability for the damage caused during a break-in. As a result, after a few months, the insured was forced to wind up his business. He brought proceedings against his insurer and managed to recover the amount of his claim under the policy together with interest, but the court held that he could not recover a further loss representing the amount for which he could have sold his business had the delayed payment by the insurer been made in good time and the business been kept open.

The Commissions' report on insurance law reform in July 2014 set out a number of reasons for changing the

unfairness illustrated by *Sprung*, including the following:

- The notion that an insurer's primary obligation under a contract of indemnity is to prevent the insured loss from occurring does not reflect commercial reality. Insureds expect to have a contractual right to a payment in the event of a loss.
- The current position unfairly favours the interests of insurers and their failure to make a timely payment risks prejudicing the very purpose for which insurance is purchased.
- The English law position is inconsistent with that of a number of other jurisdictions, and less protective of insureds. This, among other things, poses risks to the competitiveness of the UK insurance market.

The Government believes that this change in the law will incentivise insurers to pay claims promptly and allow for damages to be paid to policyholders who have suffered loss as a result of late payment. However, the introduction of the Commissions' proposal in the Bill has come as a surprise to the insurance industry which opposed the introduction of such a remedy as drafted in clause 13A. The industry was against the inclusion of such a requirement on the basis that it would impair insurers' ability to investigate claims thoroughly before taking a decision on liability and make it almost impossible to calculate future liabilities.

The Bill

Clause 13A makes it an implied term of every contract of insurance that, following a claim, the insurer must pay sums due under an insurance policy 'within a reasonable time'. Failure by the insurer to do so will entitle the insured to pursue the remedies available under contract law, including damages, and those remedies shall be separate to the insured's existing rights to recover the sums due under the policy together with interest on those sums.

It is a defence to a claim for breach of the implied term if an insurer can show that there were reasonable grounds for disputing a claim or its quantum. The insurer will not be held to have breached the implied term merely due to non-payment while a dispute is ongoing. However, a court may take into account the conduct of an insurer in handling the claim when deciding whether a breach has nonetheless occurred.

While contracting out of the remedies available for breach of the implied term is prohibited for consumer insurance contracts, it will be possible to contract out for non-consumer contracts, although any attempt to do so will be invalid if the insurer has committed a deliberate or reckless breach of the implied term. Any attempt to contract out is subject to compliance with the transparency requirements contained in the Act (see further below).

Likely areas of dispute

What is a 'reasonable time'?

This was one of the key areas of concern for stakeholders during the consultation process, given the difficulty of specifying a single standard for a 'reasonable time' within which to pay a claim. Clause 13A simply provides that it includes 'reasonable time to investigate and assess a claim', and states that what is 'reasonable' will depend on all the relevant circumstances, including the following:

- the type of insurance involved
- the size and complexity of the claim
- compliance with any relevant statutory or regulatory rules or guidance
- factors outside the insurer's control.

The explanatory notes to the Bill explain that some types of insurance, such as business interruption, are likely to take longer to assess than simple claims for property damage. Factors beyond the insurer's control might include delays to an investigation due to the failure of a third party to supply relevant information or where a market follower in a subscription market is dependent upon a decision or action of the lead insurer.

It is inevitable that the scope of this wording, if incorporated into the Act in its current form, will be the subject of dispute. Its interpretation will also be of fundamental importance for determining when the breach of contract occurs, for the purposes of limitation of actions. The courts, aided by expert evidence, are likely to expand on the above factors and add additional ones, and for a market as diverse as the insurance industry, a range of standards is likely to emerge.

The insurer's defence

Establishing coverage under an insurance policy often turns on subtle arguments relating to the interpretation of policy wordings and/or the results of a careful investigation into the circumstances of a loss. It therefore seems reasonable that an insurer should be afforded an appropriate amount of time to be able properly to investigate the claim (including its quantum) and that it should not be penalised for withholding payment until the claim is determined or agreed to be valid and its amount established.

Again, the courts will have to determine what should constitute reasonable grounds for disputing a claim, as well

as the types of conduct by the insurer and any other factors which could negate the defence.

Has an insurer successfully contracted out?

Another area of uncertainty, and therefore one which is likely to end up being the subject of dispute, is whether the parties to an insurance contract have effectively contracted out of the remedies available under clause 13A. Pursuant to clause 16A (also introduced by the Bill) and clause 17 of the Act, an insurer attempting to include a term in a policy which puts an insured in a worse position than the default position set out in clause 13A must comply with the following transparency requirements:

- It must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into.
- The term must be clear and unambiguous as to its effect.

A court must take into account the characteristics of the type of insured involved, and the circumstances of the transaction in determining whether these requirements have been met. For example, in the case of a small business purchasing insurance, the insurer might be expected to be more proactive and take more steps to bring the term in question to the insured's attention than it would have to if the insured is a large business and a sophisticated buyer of insurance.

The drafting of any term in an insurance policy purporting to contract out of the remedies in clause 13A will no doubt be carefully scrutinised in the event of a dispute. Further, while a policy may contain a term which purports to allow the insurer to contract out, if that insurer deliberately or recklessly breaches clause 13A then its attempt to contract out will be ineffective.

Conclusion

Financial institutions will welcome the reform allowing damages for late payment of insurance claims. Complex insurance claims under a bank's D&O liability, for instance, are susceptible to delay in payment while the insurer investigates and difficult arguments of construction of the policy are resolved. The old rule was becoming increasingly anomalous as the Financial Ombudsman Service will frequently compensate consumers for distress and inconvenience caused by late payment and Financial Conduct Authority rules (Insurance Conduct of Business Sourcebook (ICOBS) 8.1.1.R) require insurers to handle claims promptly and fairly.

Any fundamental reform of a relatively settled area of law will throw up a number of issues and uncertainties. As discussed above, the introduction of an obligation on insurers to pay sums due under insurance policies within a reasonable time (within the context of the wider reforms introduced by the Act) is no different. These issues and uncertainties will have to be addressed over time by the courts, legal practitioners and the market, and while the precise mechanism of the obligation may yet change during its passage through the legislature, financial institutions should obviously monitor any consequential changes to the wordings of policies they purchase.

For more information contact:

Susan Dingwall
Partner
Tel +44 20 7444 2349
susan.dingwall@nortonrosefulbright.com

Martin Schneider
Associate
Tel +44 20 7444 5226
martin.schneider@nortonrosefulbright.com

SwissMarine Corporation Ltd v O.W. Supply & Trading A/S [2015] EWHC 1571 (Comm)

A submission to English jurisdiction in the 2002 ISDA Master Agreement was not inconsistent with Danish insolvency proceedings that overrode the suspensory effect of s2(a)(iii) of the Agreement.

Facts

O.W. Supply & Trading ('OWSupply') and SwissMarine Corporation Ltd ('SwissMarine') entered into a 2002 ISDA Master Agreement (the 'ISDA Agreement'). OWSupply filed for bankruptcy in Denmark. SwissMarine did not designate an Early Termination Date. OWSupply brought proceedings in Denmark for close-out netting of the ISDA Agreement, on the basis that Danish insolvency law disapplied the suspensory provisions of s2(a)(iii) of the ISDA Agreement (under which no payments are made from the non-defaulting party to the defaulting party following an event of default and before any Early Termination Date is designated – that is, the non-defaulting party can effectively hold the contract 'in suspense', see *Lomas v JRF Firth Rixson* [2012] EWCA Civ 419 for more details). SwissMarine sought an anti-suit injunction to restrain the Danish proceedings.

Decision

Andrew Smith J held that the proceedings in Denmark were not incompatible with the jurisdiction clause in the ISDA Agreement and refused to grant the anti-suit injunction.

The jurisdiction clause in section 13 of the ISDA Agreement stated 'with respect to any suit, action or proceedings relating to any disputes arising out of or in connection with this Agreement ('Proceedings'), each party irrevocably ... submits ... to (A) the non-exclusive jurisdiction of the English courts if the Proceedings do not involve a Convention Court and (B) the exclusive jurisdiction of the English courts if the Proceedings do involve a Convention Court ... '

Andrew Smith J held that the 2002 wording was similar in effect to the 1992 wording, previously considered in *AWB (Geneva) v North America SS Ltd* [2007] EWCA Civ 739. The Danish proceedings were not about what rights and obligations the parties have under the contract but how the Danish insolvency regime operates on those rights and obligations. Therefore, it was outside the scope of the jurisdiction clause.

Andrew Smith J also rejected the argument that 'Convention Courts' meant any court covered by the Brussels Regulation, so that the jurisdiction was in any case non-exclusive.

Discussion

As Denmark is not party to the Insolvency Regulation (Regulation (EC) No 1346/2000), a discharge of the ISDA Agreement under the Danish insolvency regime will not be a discharge of the ISDA Agreement under English law. English courts will not recognise the modification of an English law governed contract by foreign courts. Accordingly, the Danish proceedings may lead to a judgment for a debt owing from SwissMarine to OWSupply under the ISDA Agreement and the English proceedings may lead to a judgment for a different sum under the ISDA Agreement, or a declaration that

no sum is owing. Both incompatible judgments would theoretically be enforceable in other Member States, with unpredictable results.

There is some suggestion in the judgment that the Danish proceedings were embarked on specifically to circumvent the suspensory effect of s2(a)(iii). This then becomes another factor when considering whether to defer the designation of an Early Termination Date.

The analysis of the jurisdiction clause will also be of interest to derivatives practitioners. The curious split between exclusive and non-exclusive jurisdiction is due to an historic concern that non-exclusive jurisdiction clauses were not enforceable in certain jurisdictions.

For more information contact:

Adam Sanitt
Head of disputes knowledge
Tel +44 20 7444 2269
adam.sanitt@nortonrosefulbright.com

Fondazione Enasarco v Lehman Brothers Finance SA [2015] EWHC 1307 (Ch)

The High Court confirmed a Wednesbury unreasonableness test applies to whether a party has reasonably determined its Loss under a 1992 ISDA Master Agreement.

Facts

The claimant, an Italian pension fund, claimed losses arising from the automatic early termination of a put option under a 1992 ISDA Master Agreement, triggered by the collapse of Lehman Brothers in September 2008. The claimant had invested in a structured product devised by Lehman – specifically in notes issued by ARIC, an SPV, the proceeds of which were indirectly invested in various hedge funds. The claimant also secured capital protection for the investment via the put option granted by Lehman.

Following the collapse of Lehman, the claimant sought to obtain substitute capital protection, which it eventually secured from Credit Suisse in May 2009, albeit on terms which were different in a number of respects.

The Agreement provided that upon early automatic termination, the non-defaulting party's (i.e. ARIC's) Loss would be payable – 'Loss' was defined as the 'amount that party reasonably determines in good faith to be its total losses and costs'. Further, the Agreement provided that the party 'will determine its Loss as of the relevant Early Termination Date or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets.'

ARIC calculated its Loss as a result of the early termination by reference to the cost of the replacement transaction obtained by the claimant, serving its calculation statement in September 2009. It subsequently assigned the claim to the claimant.

The question for the court was as to the correct calculation of Loss as a result of the early termination. The claimant's claim was calculated at in excess of $61 million, whereas Lehman contended that it was owed over $42 million.

Lehman argued that the claimant's alleged loss had not been calculated in accordance with the terms of the agreement on various grounds including: that May 2009 was not the earliest reasonably practicable date at which loss could have been determined; the Credit Suisse option was wholly different to the original put option such that its price should not be used to ascertain the loss of bargain; the date of the calculation statement of September 16, 2009 was not 'as soon as reasonably practicable following the occurrence of the 'early termination date'.

Decision

David Richards J concluded that the claimant's loss had been validly calculated in accordance with the terms of the ISDA Master Agreement and that accordingly, the claimant was entitled to judgment on its claim. Although the calculation statement ought to have been provided earlier than September 2009, this did not affect the validity of the calculation of loss.

The Judge confirmed that in assessing whether a non-defaulting party has 'reasonably determined' its loss, that party is not required to comply with an objective standard of care as in a negligence claim, but rather, 'must not arrive at a determination which no reasonable non-defaulting party could come to'. In other words, this is essentially a 'Wednesbury unreasonableness' test, which will be determined on the facts of the case.

In addition, he found that ARIC was entitled to calculate its loss by reference to the cost of the replacement put option granted to the claimant by Credit Suisse. Moreover, the Judge took the view that loss of bargain was better ascertained by references to quotations from the market than by financial

models, notwithstanding that the quotations were on different terms to the original transaction.

Finally, the Judge rejected the assertion that the quotation had not been obtained at the earliest 'reasonably practicable' date. David Richards J drew a distinction between 'reasonably practicable' and 'possible', and that to ascertain the former requires consideration of all the circumstances including those which are particular to the person who is required to act (although he doubted that the distinction would have made much difference in this case). Given the extensive effects of the collapse of Lehman, it had not been reasonably practicable for a replacement transaction to have been entered into prior to the end of 2008 – and even if it had been practical to obtain quotations prior to May 2009 it would have made no difference to the price of a replacement transaction.

Discussion

The decision is of interest in relation to the question of calculation of losses under a 1992 ISDA Master Agreement in a numbers of respects – in particular, the confirmation of a Wednesbury test to determine whether Loss has been reasonably determined.

Also of note is the Judge's conclusion that where the parties contract on the basis that payment is measured by reference to the definition of 'Market Quotation' rather than 'Loss' (it was agreed that the two are intended to arrive at broadly the same result), the basis of calculation was not as Lehman contended. The 'Market Quotations' definition requires the replacement transaction to preserve the 'economic equivalent of any payment or delivery', not the 'economic equivalent of the covenant under the terminated transaction to make payment or delivery'. In other words, the focus was on the payment to be made under the terminated transaction, not on the prospects of performance by the counter-party.

For more information contact:

Andrew Sheftel
Senior knowledge lawyer
Tel +44 20 7444 5682
andrew.sheftel@nortonrosefulbright.com

Titan Europe 2006-3 plc v Colliers International UK plc [2015] EWCA Civ 1083

A securitisation issuer was able to sue a valuer for negligent valuation of property forming part of the securitised assets.

Facts

A special purpose vehicle (SPV) issuer of notes in a commercial mortgage backed securitisation (CMBS) claimed that a property valuer gave a negligent valuation. The property was part of the portfolio of assets that were transferred to the SPV as part of the securitisation. The valuer claimed that the SPV had suffered no loss, because the claims of noteholders against it were reduced by the extent of any shortfall in the value of the property. Any loss had been suffered by the noteholders and it was they or the note trustee who should bring the action.

Decision

The Court of Appeal held that the valuation was not outside the margin of error of 15 per cent so that the claim of negligence did not succeed.

Although it was thus not strictly relevant, the Court of Appeal went on to consider the question of who was the correct claimant, as it was important to the securitisation industry and had been fully argued. The court held that the SPV was legal and beneficial owner of the property, even if it had transferred the commercial risk in the property, and so it had the title to sue. It was not relevant that any recovery might be passed straight on to noteholders in accordance with the securitisation documentation.

The court also accepted the argument that the entry of the SPV into the securitisation did not reduce the damage caused by the negligent valuation. It was an act that occurred after the loss had been suffered and it was not a consequence of the negligent valuation. Therefore, it was not to be taken into account in determining the SPV's loss.

The case was analogous to a company and its shareholders – just because shareholders might be the ultimate losers, this did not deprive a company of the right to sue in respect of its property.

Discussion

The Court of Appeal took an admirably straightforward approach to the situation: a negligent valuation caused loss to the SPV when it acquired property that was worth less than expected. What happened afterwards – including an alienation of the risk in the property by the SPV – was not relevant.

This locates the title to sue in respect of securitised assets with the SPV. This is usually the right place. What this judgment sacrifices, in order to preserve simplicity, is the option to modify this conclusion if the securitisation documents require it. It follows that those drafting securitisation transactions should take account of receivables that accrue to the SPV as a result of litigation in respect of its assets.

For more information contact:

Adam Sanitt
Head of disputes knowledge
Tel +44 20 7444 2269
adam.sanitt@nortonrosefulbright.com

Contact

If you would like further information please contact:

Adam Sanitt
Head of disputes knowledge, London
Tel +44 20 7444 2269
adam.sanitt@nortonrosefulbright.com

NORTON ROSE FULBRIGHT

Norton Rose Fulbright

Norton Rose Fulbright is a global law firm. We provide the world's preeminent corporations and financial institutions with a full business law service. We have more than 3800 lawyers and other legal staff based in more than 50 cities across Europe, the United States, Canada, Latin America, Asia, Australia, Africa, the Middle East and Central Asia.

Recognized for our industry focus, we are strong across all the key industry sectors: financial institutions; energy; infrastructure, mining and commodities; transport; technology and innovation; and life sciences and healthcare.

Wherever we are, we operate in accordance with our global business principles of quality, unity and integrity. We aim to provide the highest possible standard of legal service in each of our offices and to maintain that level of quality at every point of contact.

Norton Rose Fulbright US LLP, Norton Rose Fulbright LLP, Norton Rose Fulbright Australia, Norton Rose Fulbright Canada LLP and Norton Rose Fulbright South Africa Inc are separate legal entities and all of them are members of Norton Rose Fulbright Verein, a Swiss verein. Norton Rose Fulbright Verein helps coordinate the activities of the members but does not itself provide legal services to clients.