

Financial institutions
Energy
Infrastructure, mining and commodities
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Banking and finance disputes review

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In this issue:

Contents

The Norton Rose Fulbright
Banking Litigation Index

Contractual estoppel and the duty to advise:
where are we now?

Valuers' negligence in structured finance transactions

Challenging governing law clauses:
New ideas in European public body litigation

Court appointed receivers

*Lehman Brothers International (Europe)
v ExxonMobil Financial Services*
[2016] EWHC 2699 (Comm)

Property Alliance Group v Royal Bank of Scotland plc
[2016] EWHC 3342 (Ch)

Taberna Europe CDO II Plc v Selskabet [2016] EWCA Civ 1262

Libya Investment Authority v Goldman Sachs International
[2016] EWHC 2530 (Ch)

Credit Suisse Asset Management LLC v Titan Europe 2006-1 PLC
[2016] EWCA Civ 1293

A quick primer on state immunity for financial institutions

Financial institutions and international arbitration

Managing litigation risk in banking investigations

Financial regulation and cyber-crime



Contents

The Norton Rose Fulbright Banking Litigation Index	03
Contractual estoppel and the duty to advise: where are we now?	08
Valuers' negligence in structured finance transactions	11
Challenging governing law clauses: New ideas in European public body litigation	15
Court appointed receivers	18
<i>Lehman Brothers International (Europe) v ExxonMobil Financial Services</i> [2016] EWHC 2699 (Comm)	21
<i>Property Alliance Group v Royal Bank of Scotland plc</i> [2016] EWHC 3342 (Ch)	23
<i>Taberna Europe CDO II Plc v Selskabet</i> [2016] EWCA Civ 1262	25
<i>Libya Investment Authority v Goldman Sachs International</i> [2016] EWHC 2530 (Ch)	27
<i>Credit Suisse Asset Management LLC v Titan Europe 2006-1 PLC</i> [2016] EWCA Civ 1293	30
A quick primer on state immunity for financial institutions	32
Financial institutions and international arbitration	34
Managing litigation risk in banking investigations	36
Financial regulation and cyber-crime	39

From the editor

English courts are in the spotlight following the vote for Brexit. In this edition of the *Banking and finance disputes review*, we discuss recent judgments relevant to banks and analyse current claims before the English courts. This gives crucial insight into future trends in English banking litigation and the effect on litigation in Europe and elsewhere.

The Norton Rose Fulbright Banking Litigation Index reveals a key tool for insight into ongoing litigation. It shows how active the English courts are in banking and finance litigation, the sort of claims they are currently considering and who is a party to litigation.

There has been a spate of recent judgments from the English courts that confirm their commercial approach. *Contractual estoppel and the duty to advise: where are we now?* and *Valuers' negligence* in structured finance transactions show how multiple judgments in very specific financial areas build up a robust and coherent body of case law. *Challenging governing law clauses: New ideas in European public body litigation* describes a recent line of cases that clarify the application of foreign laws throughout Europe. *Court appointed receivers* demystifies a powerful tool of English courts that is often effective for cross-border enforcement in Europe and elsewhere.

Apart from these review articles, we also have individual case notes for *Lehman Brothers International (Europe) v ExxonMobil Financial Services*; *Property Alliance Group v Royal Bank of Scotland*; *Taberna Europe CDO II v Selskabet*; *Libyan Investment Authority v Goldman Sachs* and *Credit Suisse Asset Management v Titan Europe 2006-1*.

Moving from the English courts to cross-border matters, *A quick primer on state immunity for financial institutions* describes a problem that leads inevitably to comparison of different courts. An alternative is arbitration, and the growth in financial institutions considering this option is described in *Financial institutions and international arbitration*.

Finally, we move from litigation to regulation and investigations. *Managing litigation risk in banking investigations* gives practical guidance at the intersection of these two topics. *Financial regulation and cyber-crime* is an introduction to another highly topical subject.



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The Norton Rose Fulbright Banking Litigation Index

The Court Intelligence Database (CID) is a ‘big data’ cloud-based database that gives novel insights into current trends in banking litigation.

Ongoing claims reveal new trends, developing practice areas, the tactics of claimants and their law firms and the activities of other banks and financial institutions. But knowledge of these claims has traditionally been accumulated by gossip, rumour and scattergun investigation, because only the tiny proportion of claims that result in decided judgments are systematically accessible, and then only years after the claim started. The Court Intelligence Database stores this information in a structured, searchable format.

In this article we introduce one specific application of the Court Intelligence Database, the creation of an index for banking litigation activity in the English courts: the Norton Rose Fulbright Banking Litigation Index (BLX).

BLX

BLX will be produced on a monthly basis starting from January 2017. It shows the overall level of current activity in the English courts for litigation relating to banking and finance. Over time, this will show whether the English courts maintain their pre-eminence in this area – a particular focus of interest in light of Brexit.

BLX also shows which firms are active in ongoing English litigation. The breakdown of the top firms gives an overall ranking that is entirely up-to-date and based on objective data. Other rankings are based on the tiny proportion of cases that proceed to judgment or rely on self-reporting from

law firms of cases finished several years in the past. BLX gives a live, accurate snapshot of who is acting in English banking and finance litigation.

BLX can also be broken down by subject matter, barrister, the stage of the claim, the identity of the parties involved, their status in the litigation and many other factors. Some of these are explored further below. In future reports, we will investigate other areas.

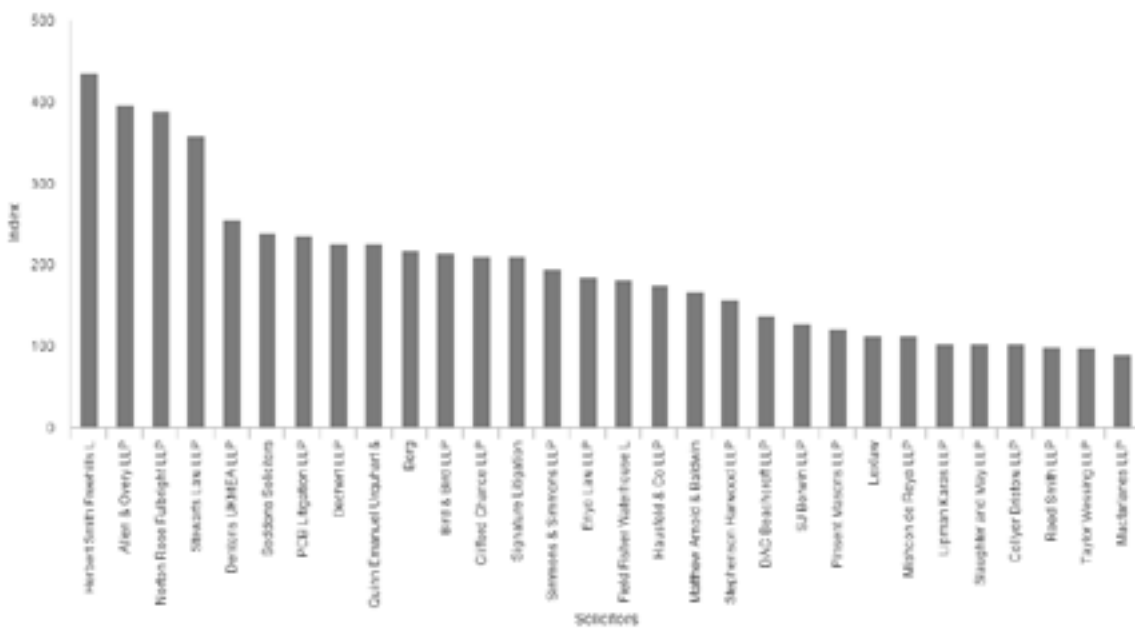
BLX is calculated using a proprietary algorithm that draws on a spectrum of information for all ongoing banking and finance litigation. A firm’s activity reflects not only the number of cases in which it is involved, but also the importance of those cases and its role in them. Furthermore, the importance of a case is not just a function of the amount at stake but also the nature of the claim. This multi-factorial approach gives an accurate portrayal of litigation activity.

BLX for January 2017

The overall BLX ranking for the English courts is based at 100 for January 2017. Future reports will show the direction of travel of overall activity. Information is presented as of January 1, 2017.

The overall ranking for law firms in January 2017 is shown below:

Norton Rose Fulbright Banking Litigation Index



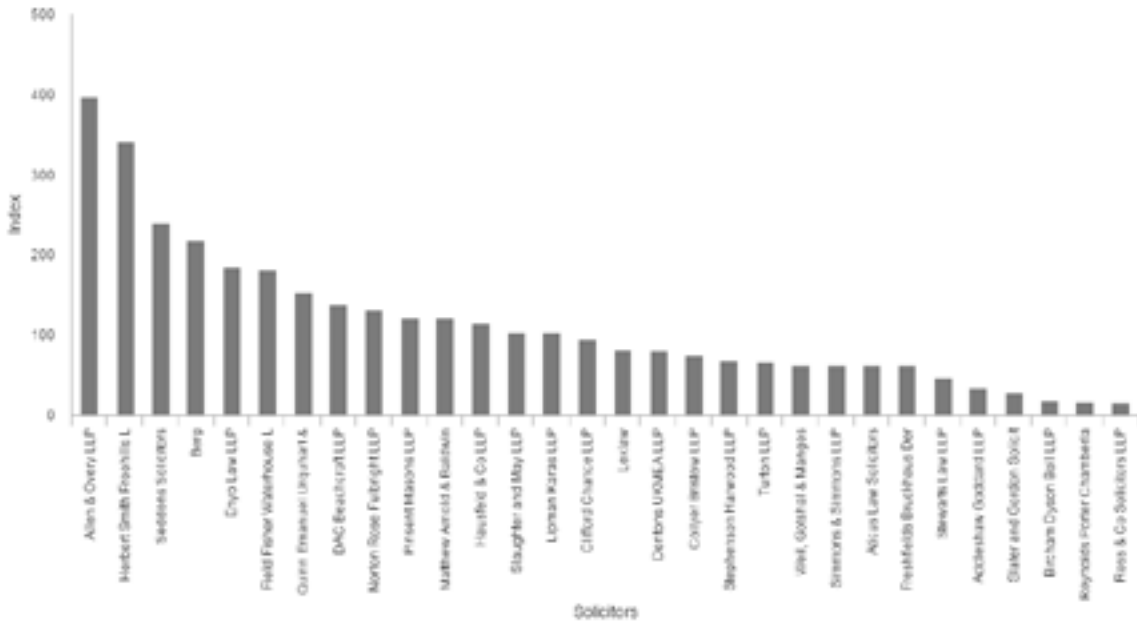
The top five for January 2017 are:

Position	Law Firm	BLX score
1st	Herbert Smith Freehills LLP	436
2nd	Allen & Overy LLP	396
3rd	Norton Rose Fulbright LLP	389
4th	Stewarts Law LLP	357
5th	Dentons UKMEA LLP	255

Perhaps the most striking aspect of this list is the growing importance of boutique law firms that are prepared to act against banks. These firms are active in certain sectors of the market.

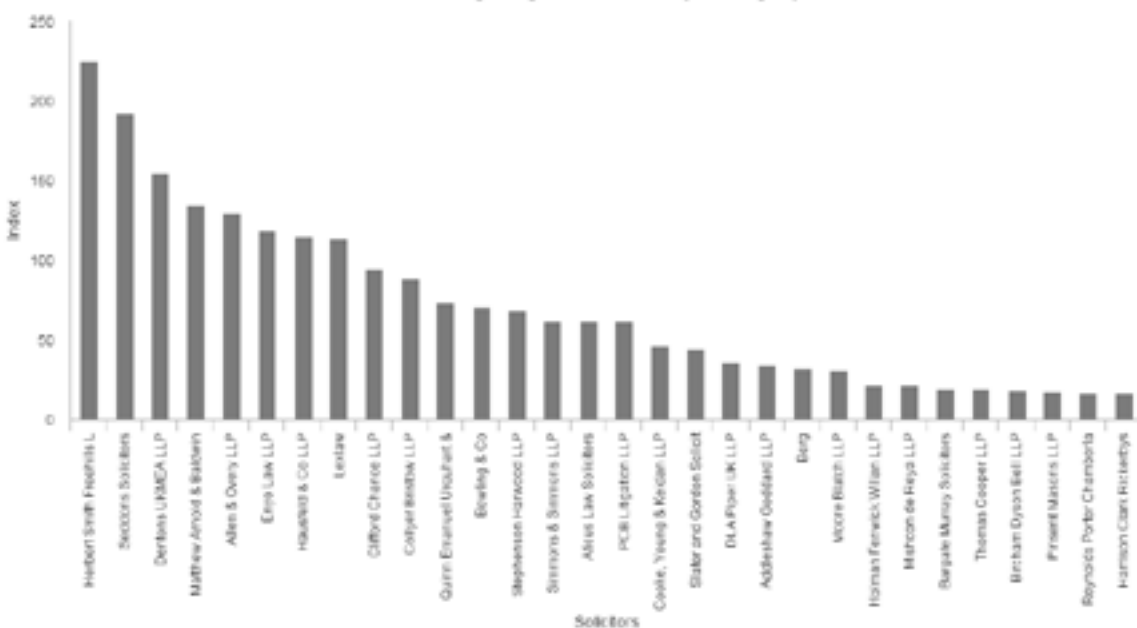
So, for instance, below is the ranking restricted to cases involving derivatives:

Norton Rose Fulbright Banking Litigation Index by category



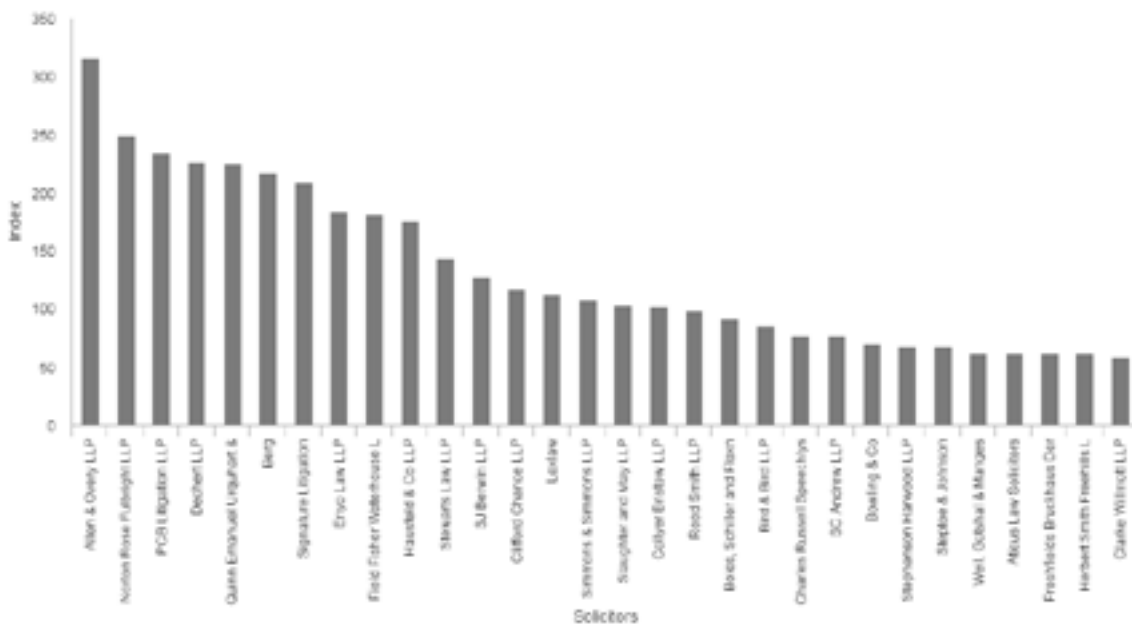
And this is the ranking for mis-selling cases.

Norton Rose Fulbright Banking Litigation Index by category



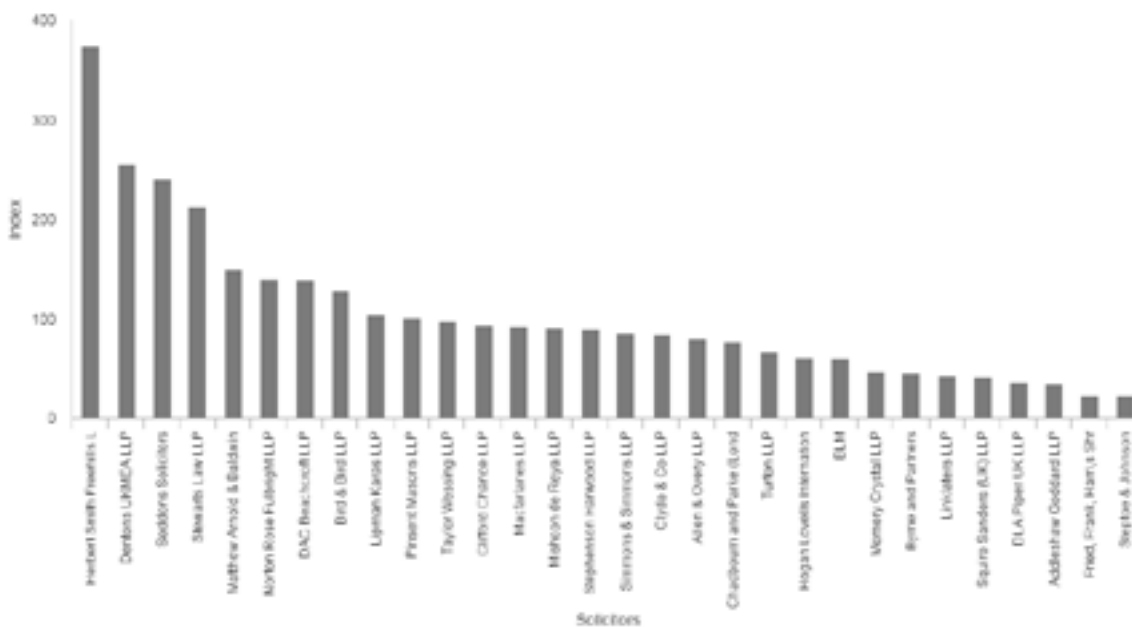
Boutique law firms figure heavily in both of these lists, although some of the traditional heavyweights are also present. And it may be thought that this bifurcation might be reflected in firms that act for claimants and firms that act for defendants. This is the BLX for defendants.

Norton Rose Fulbright Banking Litigation Index



BLX for claimants only is shown below:

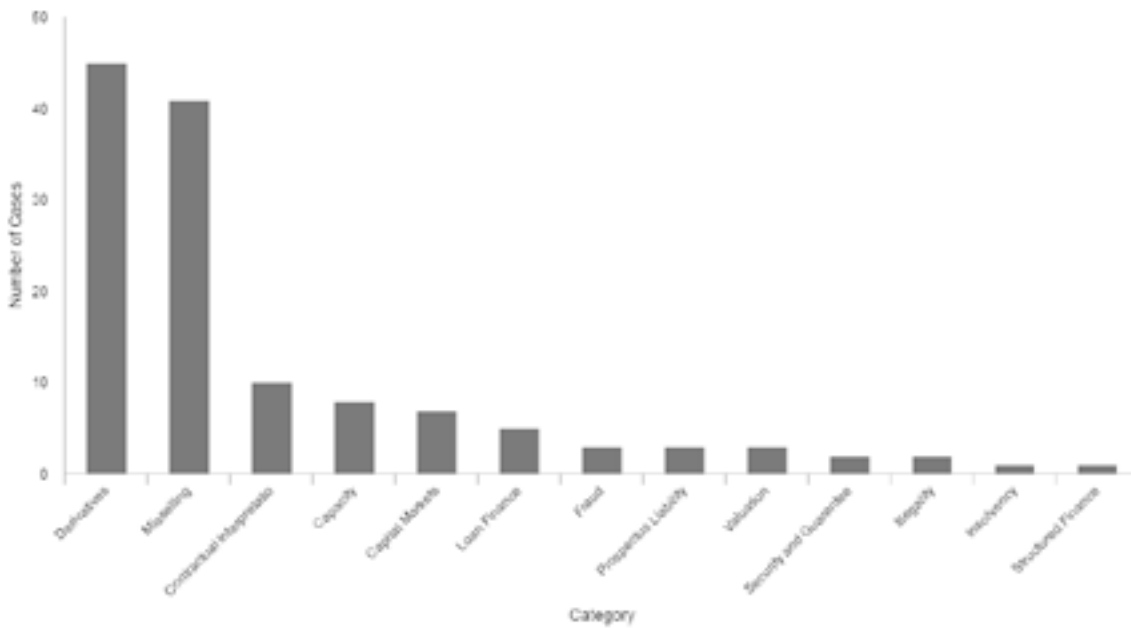
Norton Rose Fulbright Banking Litigation Index



Interestingly, the split is less marked than expected. This suggests that litigation relating to mis-selling, for instance, is not only instigated by the investor, so that the financial institution may appear as claimant or defendant.

Finally, we use BLX to break down activity in the English courts by subject-matter:

Number of cases by category



This graph, unlike the others, shows just the raw number of cases in each category. Derivatives and mis-selling claims (many of which overlap) dominate the rankings. There are many smaller, similar claims within these categories. Cases involving structured finance or prospectus liability are far fewer in number, but tend to be far more important.

Nevertheless, the English courts appear to be fairly reliant on derivatives and mis-selling claims to maintain the flow of finance litigation.

Conclusion

BLX will measure whether the vote for Brexit has any impact on use of the English courts for banking and finance litigation. The ranking of law firms by BLX shows that the traditional banking litigation heavyweights have been joined by boutique law firms acting on large numbers of mis-selling and derivatives claims. For the latest updates on these issues and to see who achieves high rankings on BLX, see forthcoming editions of the Banking and finance disputes review.

For further information about the Court Intelligence Database, including exclusive access to online trials, contact



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Contractual estoppel and the duty to advise: where are we now?

When parties conclude a binding contract acknowledging that a particular state of affairs exists, they are bound by that statement. Neither party can later assert that the opposite is true. This is the principle of contractual estoppel. It applies even if the original statement was not true.

Contractual estoppel is limited by the terms of the contract, by public policy and by statute – such as the Unfair Contract Terms Act 1977 (UCTA). However, where the statement is construed as a ‘basis clause’ – a clause setting out the basis on which the parties were dealing rather than a limitation on their liability – then even the provisions limiting the scope of exclusion clauses in UCTA may not apply. The principle of contractual estoppel has been widely used to limit the liability of banks and financial advisers in the sale of financial products.

We have previously considered the particular role of contractual estoppel in mis-selling claims, its origin and control mechanisms (see: <http://www.nortonrosefulbright.com/knowledge/publications/129033/contractual-estoppel-in-mis-selling-claims>). In this article, we briefly recap the status quo in respect of the duty to advise and then consider two recent interesting developments relating to the standard by which advice will be judged.

Contractual estoppel and the duty to advise

While contractual estoppel and its effect on the duty to advise is frequently invoked in mis-selling cases, and the list of such cases continues to grow, very few have reached trial (save for *Property Alliance Group v RBS (PAG v RBS)* – see page 23 in this edition) and so it is necessary to revisit the established common law principles.

An authoritative explanation of contractual estoppel was set out in *Peekay Intermark Ltd v Australia and New Zealand Banking Group Ltd* [2006] EWCA Civ 386 where Moore-Bick LJ stated that

“Where parties express an agreement ... in a contractual document neither can subsequently deny the existence of the facts and matters upon which they have agreed, at least so far as concerned those aspects of their relationship to which the agreement was directed. The contract itself gives rise to an estoppel”.

This was endorsed by Aikens LJ in *Springwell Navigation Corp v JP Morgan Chase Bank* [2010] EWCA Civ 1221 and has been followed in subsequent cases including *Green v Royal Bank of Scotland* [2013] EWCA Civ 1197 and *Crestsign Ltd v National Westminster Bank Plc* [2014] EWHC 3043 (Ch) (*Crestsign*), both of which have been discussed in previous issues, see: <http://www.nortonrosefulbright.com/knowledge/publications/114274/emgreen-and-rowley-v-royal-bank-of-scotland-plcem-ewca-civ-1197>.

Crestsign remains a key authority on this subject as the judge found that the defendant had given advice of such a strong nature that it constituted a recommendation and that there was a duty of care between the parties. However, despite these findings, it was held that the terms of the loan documentation could successfully exclude any liability on the part of the defendant. In other words, the claimant was estopped from relying on the defendant’s advice as a consequence of the non-reliance terms in the agreement negotiated and entered into by the parties.

Crestsign also held that there could be a so-called ‘mezzanine’ duty of care. In particular, to the extent a bank does go further to give advice or information, it is under a duty ‘to give that explanation or tender that advice fully, accurately



and properly'. The existence of the 'mezzanine' duty was considered in *PAG v RBS* and found to be a duty on the advisory spectrum that might arise depending on the specific facts.

The principles in *Crestsign* have been considered controversial by some commentators, but have been upheld in several recent cases including that of *Finch v Lloyds TSB Bank Plc* [2016] EWHC 1236 (QB). This case is of note as the claimants argued not that advice had been given, but that the defendant was under a duty to voluntarily provide advice that might be contrary to its own interest, before the defendant and the claimant had even entered into a commercial relationship. The Court's decision, in favour of the defendants, follows logically from the decision in *Crestsign* in that it would be truly exceptional for a duty to advise to arise in such circumstances, but it is interesting to consider whether if the bank had undertaken some limited

duty of care, the mezzanine duty from *Crestsign* would have applied.

In summary, the status quo remains that a contractual estoppel may arise when provisions in the contractual documentation state that no advice was being given and this is sufficient to negate any duty to advise, however artificial it may appear. In addition, if, as in *Crestsign*, the non-reliance language is deemed to be a 'basis clause' – that is, a clause setting out the basis on which the parties were contracting rather than a limitation on liability – it would not be susceptible to challenge under s13(1) of UCTA.

Standard of care in duty to advise

Bolam v Friern Barnet Hospital Management Committee [1957] 1 WLR 582 set out the test for the standard of care applied in professional negligence

claims as whether the defendants were "acting in accordance with a practice of competent respected professional opinion". This standard has ordinarily been applied to questions of the standard of advice given by financial advisers to their clients. However, in *O'Hare v Coultts* [2016] EWHC 2224, the Court held that the required extent of communication between a financial adviser and its client to ensure the latter's understanding of the advice given by the former was not governed by the *Bolam* test.

In *O'Hare v Coultts*, Kerr J upheld the applicability of the *Bolam* test to the suitability of the investments but held that it was inappropriate to determine the required level of communication between the financial adviser and the client by reference to industry standards. He instead preferred the approach of the Supreme Court in *Montgomery v Lanarkshire Health Board* [2015] AC 1430 (*Montgomery v*

Lanarkshire), in which it was the duty in a case involving medical advice to take reasonable care to ensure that the patient is aware of “any materials risks involved in any recommended treatment, and of any reasonable alternative or variant treatment”. By analogy, in the case of financial advisers, this requires the Court to ask whether “a reasonable person in the [client’s] position would be likely to attach significance to the risk, or the [adviser] is or should reasonably be aware that the particular [client] would be likely to attach significance to it”. Kerr J found support for this conclusion by reference to the Financial Conduct Authority’s Conduct of Business Sourcebook (COBS) rules, which make no reference to a responsible body of opinion, but instead advocate obligations similar to those set out in *Montgomery v Lanarkshire*. It remains to be seen how the ‘mezzanine’ duty established in *Crestsign* relates to the materiality criterion set out by Kerr J in *O’Hare v Coutts*.

While *O’Hare v Coutts* does not, therefore, represent a wholesale move away from the orthodox *Bolam* position, it does suggest a possible shift in the standard that will be applied to advice given by financial advisers.

Advisory relationship in Hong Kong

There are some warning signs from abroad that contractual estoppel may be subject to challenge. In *Chang Pui Yin v Bank of Singapore* [2016] HKEC 1721 (*Chang Pui Yin*), the Hong Kong Court of First Instance re-affirmed the doctrine of contractual estoppel in mis-selling cases; however, it also confirmed the existence of an advisory relationship between a bank and its customers, despite the inclusion of clear non-reliance provisions in the contractual documents. Furthermore,

the Court of First Instance suggests in its judgment that the doctrine could be revisited by an appellate Court in the future.

The revised paragraph 6.2(i) of the Securities and Futures Commission’s Code of Conduct (which is to be incorporated into all client agreements by June 9, 2017) may be the source of this challenge. This provision requires that all client agreements include wording to the effect that to the extent that a financial institution solicits the sale or recommendation of any financial product to a client, the financial product “must be reasonably suitable for [the customer]” and that no other provision may derogate from that clause.

The introduction of this suitability requirement, and the associated re-allocation of risk between financial institutions and their customers, may test the limits of the doctrine of contractual estoppel and prospective claimants may look to shift the focus towards the suitability of individual products as opposed to an assessment of specific non-reliance clauses.

Conclusion

The English Court will follow its now well-established view that commercial parties should safeguard their own interests and carefully consider the potential ramifications of the contractual documentation to which they become a party.

While these cases are necessarily fact-specific, a common feature of the judgments is a careful consideration of the oral testimonies of the parties to see how they align with the contemporaneous contractual documentation underlying the dispute. Accordingly, parties should remember their overarching duties to the Court and ensure that evidence is as robust as

possible. Cases such as *O’Hare v Coutts* show how the persuasiveness (or otherwise) of witness evidence can impact on the Court’s reasoning even when applying well-established principles.

For the time-being, therefore, the status quo remains that, absent an advisory relationship, a bank’s general duty is restricted to not misstating or misleading its customers. As a matter of basic principle, and as set out in *Crestsign*: “While the result may seem harsh to some, it is not the role of the common law and the Court to act as a regulator”.

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Valuers' negligence in structured finance transactions

The Courts have seen many claims by lenders against valuers for overvaluing property taken as security for loan transactions and the principles to be applied to such claims are well established. A number of recent high value claims against valuers relating to structured finance transactions, such as commercial mortgage-backed securitisations (CMBS), have required consideration of how these principles should be applied to more complicated scenarios.

Norton Rose Fulbright LLP recently acted for the claimant issuer in respect of the biggest of all such claims, *Gemini (Eclipse 2006-3) plc v CBRE Limited and Warwick Street (KS) LLP (Gemini)*, which settled on confidential terms shortly before trial. This article discusses a number of the unique and complex legal and evidential issues raised by CMBS valuation claims, including Gemini.

The Gemini claim

Gemini was a fairly typical CMBS transaction. In August 2006 the lender, Barclays, in reliance upon a draft valuation report prepared by the defendant valuers, advanced just over £1.2 billion to Propinvest (the 'Borrower'), on the security of a nationwide portfolio of 37 commercial properties including offices, shopping centres and industrial warehouses. A few months later, Gemini purchased from Barclays all of its rights and interest in the loan (including the

security over the properties), funded by the proceeds from the issue, on a non-recourse basis, of notes to investors (the 'Noteholders'). The intention was for rental income from the properties to be used to pay interest on the loan and thereby the notes.

Following the onset of the global financial crisis in 2008, the Borrower defaulted on the loan. The value of the 37 commercial properties was reassessed and considerably downgraded and the market value of the notes fell dramatically, leaving the

noteholders with substantial losses. Gemini issued proceedings against the valuers in 2012 and claimed that the valuers had negligently overvalued 35 of the 37 commercial properties, with an aggregate overvaluation of about £200 million.

The basics

For a lender to bring a successful claim against a valuer for negligently overvaluing property, it is necessary to establish negligence, causation and loss. In particular, it must establish

- That the valuer owed the claimant a duty of care.
- That, in preparing the valuation, the valuer fell below the standards to be expected of a reasonably competent valuer.
- That his valuation fell outside an acceptable margin of error or 'bracket'.
- That the lender relied upon the valuation and would have acted differently if the valuation had been more accurate.
- That as a consequence the lender has suffered a loss which falls within the scope of the valuer's duty of care (in the sense established by *South Australia Asset Management Corporation v York Montague Ltd* [1996] UKHL 10 (SAAMCO) – see

the discussion under Reliance and causation below).

There is then scope for the quantum of the claim to be reduced if the lender was itself negligent in its lending practices (contributory negligence).

Duty of care

Did the valuers owe the claimant a duty of care?

Where a lender is bringing a claim against valuers there is usually no issue in establishing a duty of care. However, where the loan is sold onto a third party, as in a CMBS, the question arises whether or not the CMBS issuer is owed a duty of care by the defendant valuers. This may depend on how the valuers' instructions were framed, the wording of the valuation report and the wording of the other securitisation documents. In *Gemini*, the definition of 'addressee' in the valuation report included not only Barclays but also 'any of its transferees, assignees or successors in title to the Facility Agreement'. It was therefore perhaps more difficult for the valuers to argue that Gemini (as assignee) was not owed a duty of care by the valuers, particularly as a securitisation was plainly envisaged before the loan was advanced. The position in other CMBS valuation cases has not been so straightforward

In addition to a direct claim against the valuers, Gemini also brought a claim as Barclays' assignee, relying upon the Loan Sale Agreement, which provided that, together with the loan, Gemini had purchased 'the benefit of all reports, valuations, opinions ... given to or held on behalf of [Barclays]'. Again, however, not all CMBS transactions provide expressly for assigned claims, and it is therefore necessary to consider the question of duty of care on a case-by-case basis with regard to the relevant transaction wording.

Who is the correct claimant?

In a straightforward property loan, it will be the lender who brings a claim against the valuer for negligent overvaluation of the security (as it is the lender who will suffer loss following default and realisation of the security for less than the outstanding loan). In a CMBS claim, it is more complicated to identify the correct claimant because the bank has sold the loan to an SPV issuer which has funded the purchase by issuing debt to the capital markets on a non-recourse basis. Arguably, in economic terms, it is noteholders rather than the issuer who suffer any loss as a result of the declining value of their notes.

The Court of Appeal considered this question in *Titan Europe 2006-3 plc v Colliers International UK plc (in liquidation)* [2015] EWCA Civ 1083 (*Titan v Colliers*). A CMBS issuer (Titan) claimed against a valuer (Colliers) for negligent overvaluation of the commercial property which secured the transaction. The Court of Appeal held that Titan was the correct claimant because, even though it had parted with the risk, it had retained the property in the loans and the securities and therefore had sufficient title to sue the valuer for negligence.

The Court of Appeal also held that Titan, as issuer, had suffered loss immediately upon the purchase of the loan for more than its true value. It was irrelevant that it had subsequently securitised the debt on a non-recourse basis, because the securitisation was an arrangement with third parties which should not benefit the defendant valuer. Titan's relationship with the noteholders was analogous to that of a company with its shareholders: per Longmore LJ "no-one suggests that, because the shareholders may be the ultimate losers in a case of this kind, the company has not suffered a loss" (paragraph 38).

The decision in *Titan v Colliers* effectively extinguished similar arguments as to the correct claimant in *Gemini*. As an alternative, the defendant valuers sought to argue that Gemini had assigned all of its interest in the loan and security and any cause of action to the Trustee (Bank of New York Mellon) under the Issuer Deed of Charge. Gemini's response was that it had assigned that interest in equity only and by way of a charge that crystallised only upon default of the notes (which had not occurred). Gemini's position accords more readily with securitisation practice, and the relative autonomy allowed to issuers in relation to their assets in the absence of a note event of default; but ultimately, of course, this question was not tested in court.

Standard of care

Negligence and the bracket

In addition to arguments about duty of care, the defendants in *Gemini* argued that they had not been negligent in that their original valuations fell within the reasonable range of values that a competent valuer could have reached, otherwise known as the 'bracket'. At first instance in *Titan*, Blair J noted that if a valuation is within the 'bracket' then it will not be negligent, even if some aspects of the valuation process fell below reasonably competent standards.

The size of the 'bracket' can vary depending on the state of the market and the type of property. If the market is particularly volatile or very flat (so that there are not many comparable sales or offers), then the bracket will be wide. Standard residential properties should be fairly straightforward to value and so may have a narrow bracket whereas commercial property and developments may be more challenging and hence may have a wider bracket. The bracket is likely to be narrower where there has been a

recent purchase of a property on the open market. Generally the margin for error for residential property valuations is +/-5 per cent, whilst for commercial properties it is likely to be between +/-10 to 15 per cent. In *Titan v Colliers* the margin was +/-15 per cent.

Titan v Colliers was unlike many other CMBS valuation disputes as it concerned the valuation of just one property. Most CMBS valuation disputes involve multiple commercial properties, as did *White Tower* (a claim by CMBS vehicle White Tower 2006-3 against valuers in respect of five commercial properties that was discontinued after trial in 2016) and *Gemini*. In *Gemini*, the defendant valuers raised an additional (and in legal terms novel) argument that a valuer's liability must be determined by looking only at the portfolio of all the properties as a whole, i.e. by considering whether the aggregate value of the portfolio fell outside the range of values that a reasonably competent valuer could have reached for the properties as a whole.

The 'portfolio' defence has some superficial attraction in that lenders and investors will frequently describe CMBS transactions in aggregate terms (e.g. 'a £1.2 billion portfolio of commercial properties'). However, it raises difficult conceptual issues because, by looking at the value at an aggregate level, a defendant valuer could be exculpated for valuing one property entirely negligently if the combined valuation of all of the properties falls within a reasonable range. In other words, the 'portfolio' approach allows a defendant valuer to offset any negligent valuations which are outside the bracket against those which it had valued within (and, conceivably, below) the applicable bracket, thus effectively reducing the

standard of a valuer's duty of care when valuing multiple properties.

The question of whether liability can (and should) be determined at a 'portfolio' level is ultimately likely to depend the facts of a particular case, in particular the nature of the properties and the terms of the valuers' instruction. In our view, the 'portfolio' defence was untenable in *Gemini* because there was no exercise of judgment at the portfolio level: the valuers were instructed to value each individual property individually and to give no portfolio premium or discount.

However, the recent decision in *Barclays Bank v Christie Owen & Davies* [2016] EWHC 2351 shows when the Court may take a portfolio-based approach to liability. This case concerned the valuation of three adjacent entertainment centres which the borrower was planning to develop as one combined complex. The court was prepared to assess liability at the portfolio level as it said the bank was looking at the security of all the properties together when deciding whether to make the loan. Here, the bank was making the loan to develop the properties into one complex. However, in a CMBS transaction, separate and diverse properties stand as security, defendant valuers are asked to value them individually and allocated loan amounts are attributed to each of them.

Reliance and causation

A claimant in a professional negligence claim against valuers must show that it relied upon the valuation and the valuation caused it loss -- possible stumbling blocks in even the most straightforward cases. In particular, a CMBS issuer bringing a valuation claim will need to show that

- Both it and the lender (where it is claiming as assignee of the lender) relied upon the valuation.
- Either it or the lender would not have proceeded with the transaction or would have proceeded with a different transaction, which would have caused less or no loss, had the valuation not been negligent.

Where the lender is not a party to the action, evidence as to reliance and causation may not be available and, unless the loan sale agreement provides the issuer with clear and wide-ranging rights to documents, it may be necessary (as it was in *Gemini*) to obtain such evidence from the lender by way of third party disclosure order.

To defeat a CMBS valuation claim on the grounds of reliance would be a challenge: it would have to be shown that the valuation played no material role in the lender's decision to advance significant amounts of money (often over £1 billion).

Causation in the context of structured lending claims presents more complicated considerations, particularly where it is alleged that the negligent act caused a lender to act in a certain way.

For instance, in *Barclays Trust Company (Jersey) Limited (and others) v Ernst & Young LLP* [2016] EWHC 869 (*Barclays Trust*), which concerned the valuation of a company rather than commercial property, the claimant borrowers sued Ernst & Young LLP (EY) for due diligence services provided in connection with the claimants' acquisition of the Esporta health and fitness business. The claimants argued that, had EY not negligently overvalued the Esporta business, then Societe Generale (SocGen), the lender, would have withdrawn its offer to finance the

transaction or alternatively would have revised the terms of its finance and that this would have caused the claimants not to proceed with the purchase (by the end of the trial, the claimants had conceded that they would not have acted differently in the absence of a change of position by SocGen). The claimants did not field any witnesses from SocGen to prove causation and instead relied upon inferences which they said were to be drawn from the contemporaneous documents. Phillips J found for EY on the basis that the claimants had not sufficiently made out their case.

By contrast with *Barclays Trust*, Gemini conceded that, had the defendant valuers correctly valued the relevant properties, Barclays would still have advanced a loan but argued that it would have been considerably smaller, so that Gemini's obligations to its noteholders would have been correspondingly smaller (i.e. an 'alternative transaction' rather than a 'no transaction' claim). This was on the basis that the original loan appeared to have been structured so that the securitised senior portion of that loan amounted to approximately 75 per cent of the aggregate value of the properties.

Yet loan to value ratios are not always determinative of causation arguments. In a 'hot market' such as the 2006 commercial property market, some lenders were willing to consider loan to value ratios of over 75 per cent for CMBS transactions, which in turn might have affected the credit ratings allocated to the notes and the coupon payable on those notes. Overall, a number of factors will have to be considered and evaluated by extrapolation from contemporaneous evidence to establish causation in a structured finance transaction.

Loss

In *SAAMCO*, the House of Lords effectively held that losses attributable to a subsequent fall in the property market fell outside the scope of duty of care owed by a valuer to a lender. Accordingly, a lender's loss is to be capped at the amount of the overvaluation (i.e. the difference between the negligent valuation and the true value of the property as at the date of valuation). In *Gemini*, the parties accepted that the claim was capped in this way (as it was in *Titan*).

Whilst the *SAAMCO* cap is applicable to most claims against valuers, where a lender's loss flows from a cause from which it has expressly sought protection (for instance in the unusual event that lender has asked the valuer to advise about likely future movements in the property market), then it might be possible to seek to recover losses flowing from a fall in the market.

Contributory negligence

The Court may reduce damages if it is satisfied that the lender's approach fell below that of a reasonably competent lender (such as applying an excessive loan to value ratio) and that its negligence contributed to the loss. In *Gemini* there were only very limited assertions of contributory negligence, perhaps because anything more overt would have at least implicitly required the valuers to concede that certain aspects of their valuation were negligent.

Conclusion

Gemini provides an interesting insight into how the well-established principles in claims by lenders against valuers apply to more complex structured finance transactions. Even if *Gemini* represents the high water mark of claims

arising out of the collapse in CMBS following the financial crisis, those principles will determine future claims arising out of different markets and different asset classes. Complex professional liability claims are likely to recur as long as professional input is required in complex structured transactions.

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Challenging governing law clauses: New ideas in European public body litigation

The Court of Appeal has recently provided guidance on when local law provisions can invalidate a contract notwithstanding an express choice of English governing law, thereby clarifying two previous inconsistent High Court decisions. The decision supports contractual certainty and makes clear that exceptions to parties' choice of law clauses will be narrowly construed.

Introduction

An express governing law clause in a contract will generally be upheld by the courts, but there are a number of exceptions. One of these prevents parties from circumventing local law rules by artificially relying on an express governing law clause in favour of a different law. Article 3(3) of the Rome I Regulation (and its predecessor the Rome Convention) provides (in summary) that where all other elements relevant to the situation at the time of the choice of law are connected with one country only, the laws of that country which cannot be derogated from by agreement shall apply despite a choice of law of a different country. Two recent Commercial Court cases considered the scope of this rule and came to different conclusions. Those differences have now been resolved by the Court of Appeal.

Banco Santander Totta SA v Companhia de Carris de Ferro de Lisboa SA [2016] EWHC 465 (Comm) and [2016] EWCA

Civ 1267 (*Santander v CCFL*) and *Dexia Crediop v Comune di Prato* [2015] EWHC 1746 (Comm) (*Dexia v Prato*) represent the latest in a long line of cases in which public bodies have sought to exit financial transactions that have become economically unfavourable. Some of the arguments raised are well-worn and include allegations that the local authorities lacked capacity. However, the attempt to use Article 3(3) of the (then) Rome Convention to rely on local 'mandatory rules' to override the governing law clause and render the transactions unenforceable is a novel alternative.

Dexia v Prato in the High Court

Dexia Crediop SpA (Dexia) and Comune di Prato (the local government for the Prato region of Tuscany, Prato) entered into six interest rate swap transactions over a number of years. Those swap transactions were all subject to an ISDA master agreement which contained an English governing law clause.

Prato was a net recipient under the swaps until June 2009 after which it became liable to make payments to Dexia under the terms of the sixth swap. Prato did not make the payments required by the sixth swap from December 2010.

Dexia sought a declaration from the English Court that sixth swap was valid and claimed for sums owing under the terms of the sixth swap. Prato argued that the swaps were either invalid or could not be enforced against it on a number of grounds. The defence that Prato ultimately succeeded on was that its obligations under the swaps were unenforceable by reason of mandatory rules of Italian law, which provided that certain rights of withdrawal available to Prato needed to be brought to Prato's attention. Those rules applied under Article 3(3) Rome Convention in spite of the English governing law clause.

Dexia argued that Article 3(3) did not allow for the application of Italian mandatory laws because not all the 'elements relevant to the situation' were connected to Italy. In particular, the ISDA agreement was a standard international form frequently used in the international capital markets and, for each swap, Dexia entered into back-to-back hedging with banks outside Italy, using ISDA form documentation.

Walker J rejected both of these arguments. He found that the form of the agreement used, even if global and

significant, was not an element truly relevant to transactions between Dexia and Prato. The back-to-back hedging equally did not amount to ‘an element relevant to the situation’ as between Prato and Dexia – such arrangements were not a relevant matter for Prato. Further, it was never envisaged that a non-Italian party would replace one of the parties to the swaps.

Prato was therefore entitled to rely on ‘mandatory rules’ of Italian law because all relevant elements of the transaction were connected to Italy. Those rules were breached by Dexia in the sales process. The mandatory rules provided that on breach the contract was null and void at the option of Prato. The rules therefore provided Prato with a defence to payment to Dexia under the sixth swap agreement.

Santander v CCFL in the High Court

Banco Santander Totta (Banco Santander) was a Portuguese subsidiary of the Spanish Santander group. The defendants were four state-owned Portuguese transport companies serving Lisbon and Porto. Between 2005 and 2007 they entered into a series of long-term interest rate swap transactions with Banco Santander. Those swaps were entered into under ISDA master agreements that were subject to English law.

The interest rate swaps were ‘snowball swaps’. They contained upper and lower boundaries and once interest rates moved outside of those barriers the fixed rate payable by the transport companies increased by a cumulative spread and became subject to further leverage. The spread was activated and the interest payable by the transport companies grew significantly. The transport companies ceased making

payments and Banco Santander claimed €270 million as owing under the swaps.

As in *Dexia v Prato*, the transport companies sought to rely on several defences to dispute the validity or enforceability of the transaction. These included a lack of capacity and that Banco Santander had breached its duties under the Portuguese Securities Code. On the facts and evidence submitted, the transport companies were unable to rely on those defences.

The final defence was that Portuguese mandatory rules applied to the swaps. It was argued that those rules meant that the swaps were (i) void for being unlawful ‘games of chance’ or (ii) were otherwise terminable because of an ‘abnormal change of circumstances’, being low interest rates for a sustained period. Those mandatory rules were said to apply despite the English governing law clause because all of the relevant elements of the swap transactions related to Portugal under Article 3(3) of the Rome Convention.

Blair J held that the swaps were valid and that the mandatory rules did not apply. Article 3(3) did not provide a route for their application in the face of the English governing law clause. The finding was significant as Blair J would have found that the mandatory rules were breached had he found that they applied under Article 3(3).

Blair J expressly declined to follow *Dexia v Prato* and adopted a different approach to the question of whether all elements relevant to the situation were connected with a particular country. Blair J held that elements which pointed to an ‘international situation’ (and not a particular alternative jurisdiction to Portugal) could be sufficient to defeat an attempt to argue that all relevant elements of the

transaction related to Portugal. Blair J found that the use of an international form document in the context of an international market was relevant as was the fact that there was a back-to-back swap with a non-Portuguese counterparty.

There were other factors relevant to the application of Article 3(3) that did not feature in *Dexia v Prato*. There was an assignment provision which contemplated the potential assignment of the transaction to a different (non-Portuguese) subsidiary of the Spanish Santander parent. The Spanish parent also approved the transactions in various committees and priced the swap transactions. Taking all of these factors into account, Blair J concluded that the swaps were not purely domestic contracts and that any other conclusion would ‘undermine legal certainty’.

Santander v CCFL in the Court of Appeal

The Court of Appeal in *Santander v CCFL* firmly supported the approach of Blair J and disapproved the approach taken in *Dexia v Prato*. However, as at the date of this article, *Dexia v Prato* is still subject to its own appeal in the Court of Appeal.

The Transport Companies’ appeal against Blair J centred on the meaning of ‘elements relevant to the situation’ set out within Article 3(3). They argued that Blair J was wrong to conclude that this included those that pointed to an ‘international situation’ rather than a particular jurisdiction. Rather, the test should be whether all other elements relevant to the situation are connected with a specific legal system in line with conflicts of laws principles. Applying that test would have resulted in Portugal being the one place where all the relevant elements pointed.

The Court of Appeal rejected this argument. Firstly, it emphasised the primacy of the parties' choice of law in private international law. The objective of the Rome Convention was to provide greater legal certainty as to the conflict of laws rules, with party autonomy to choose the applicable law a key feature. This autonomy should therefore be seen as the starting point, to which Article 3(3) is a limited exception and, as such, should be narrowly construed.

The Court of Appeal held that the wording of Article 3(3) should be interpreted in a manner consistent with its natural and ordinary meaning. As such, relevant elements for consideration should not be confined purely to factors which connect the contract to a particular country in a conflict of laws sense. In particular, the purpose underlying Article 3(3) is to ensure that the choice of foreign law in a purely domestic situation shall not enable the parties to evade application of mandatory local rules. Applying this logic, the real question would appear to be whether or not the situation is purely domestic.

All clear now?

The High Court and Court of Appeal judgment in *Santander v CCFL* has been heralded as a triumph for legal and commercial certainty. It is certainly attractive that where parties have chosen an express governing law clause, they should, so far as possible, be held to that agreement. Commercial parties cannot have much ground for complaint when they are held to a freely chosen governing law clause.

It follows from the reasoning in *Santander v CCFL* that it will be very difficult for any party to an ISDA transaction to argue that all relevant elements of the situation are connected to a particular country other than that chosen in the governing law clause.

It is worth noting two final points in respect of these judgments:

- Not all elements of local law will require the Article 3(3) gateway to be considered relevant by the Courts. In *Santander v CCFL* the parties accepted that the issue of whether the bank breached the Portuguese Securities Code in proposing the swap transactions was a matter of Portuguese law. It was not an argument that was impacted by the English governing law clause.
- The future status of the Rome I Regulation is open to question in light of the United Kingdom's decision to leave the European Union. It remains to be seen whether the Rome Regulations will be incorporated into English law or whether English law will fall back to the conflicts of law rules previously in force. Either way, we would expect that party autonomy to choose governing law will continue to be given primacy although there may, as under the Rome Regulation regime, continue to be exceptions to this principle.

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Court appointed receivers

Court appointed receivers (Receivers) have featured in a number of recent high profile cases, such as *JSC BTA Bank v Ablyazov* [2015] UKSC 64 (*Ablyazov*) and *Libyan Investment Authority v Goldman Sachs International* [2016] EWHC 2530 (Ch) (together with an ongoing claim by the Libyan Investment Authority (LIA) against Societe Generale, ‘the LIA litigation’). They appear to be an increasingly popular means both of preserving property whilst litigation is in progress and of execution after judgment has been obtained. However, despite their increasing prominence, there still seems to be some mystique as to what Receivers do and the circumstances in which they might be appointed. In this article, we aim to dispel this mystique by providing an overview as to what Receivers do in the light of recent examples, showing that they can be a powerful tool in litigation involving financial institutions.

Background

The jurisdiction of the English Court to appoint a Receiver is set out in section 37(1) Senior Courts Act 1981:

“The High Court may by order (whether interlocutory or final) grant an injunction or appoint a receiver in all cases in which it appears to the court to be just and convenient to do so.”

This jurisdiction is a discretionary one and so there are no rigid rules as to when the Court will appoint a Receiver. There is also no formal requirement as to who can act as a Receiver, although,

in practice, they are often licensed insolvency practitioners, as they have the requisite experience of investigating assets and managing a business.

A Receiver’s powers will be tailored to the specific circumstances of each case and will be set out in the Court Order appointing the Receiver. These powers can be extended by the Court on application by the Receiver if they are insufficient.

As with other types of receiver, a Receiver’s primary duty is to collect the property over which it is appointed Receiver. However, unlike

receivers appointed in respect of a fixed charge, Receivers are first and foremost independent officers of the Court. As such, they must act fairly and impartially and for the benefit of all parties interested in the assets of the company, not just for one debenture holder alone (even if the debenture holder is the person seeking appointment). As an officer of the Court, any interference with a Receiver’s powers will amount to contempt of Court.

When will a receiver be appointed?

Broadly speaking, there are two scenarios in which Receivers are usually appointed

- First, to preserve property from some danger threatening it.
- Second, to allow someone who has a right over property to obtain the benefit of that right where ordinary legal remedies are not effective – this includes enforcement by way of equitable execution.

Preservation of property

A danger to property which justifies the appointment of a Receiver can take a number of forms. A claimant in litigation may fear that a defendant intends to dissipate their assets prior to judgment or an application may arise from a dispute or deadlock as to who owns or controls an asset.



In the case of dissipation of assets, it is usual (and indeed expected) that a less invasive remedy such as a freezing order will first be sought. However, there may be circumstances where a freezing order does not provide the requisite level of protection against the dissipation of assets. This was the case in *Ablyazov* where the defendant was subject to both a freezing order and an ancillary order to provide disclosure of his assets. The claimant sought the appointment of a Receiver because (it was asserted) the defendant's disclosure of assets had been inadequate and the whereabouts of large sums of money was unexplained – hence the freezing order did not adequately protect against the risk of dissipation. Teare J was prepared to appoint a Receiver in these circumstances as the inadequate disclosure of assets by the defendant left the judge unable to trust him not to deal with his assets in breach of the freezing order.

Receivers are also typically appointed to protect assets in danger where there is a dispute or deadlock as to who owns or is in control of a business. In such circumstances, a Receiver will act as receiver and manager and will assume control of the business. Such appointments provide a pragmatic interim solution as they allow trading to continue as normal whilst the difficulties for which the appointment was sought are resolved. Examples of situations in which such appointments might be made include

- A limited liability partnership where the members are in dispute.
- Where there is deadlock amongst the board of directors as to how the company should be run.

It was in the latter scenario that the English High Court appointed a Receiver in the LIA litigation. This appointment followed an application by the solicitors acting for the LIA to come off the record in claims brought by the LIA against

Goldman Sachs and Societe Generale after they had received contradictory orders from two disputing factions within the LIA. In order that the litigation could proceed, both factions agreed to the appointment of two members of BDO LLP to act as Receivers to manage the claims.

Equitable execution

The other principal scenario in which a Receiver will typically be appointed is the enforcement of a judgment by way of equitable execution.

Equitable execution is a means of enforcing judgment debts where other methods of enforcement are not possible or have not been successful. If appointed, a Receiver can secure and liquidate equitable interests in assets that would not lend themselves to other types of legal enforcement. A good example of such assets is receipts under a trust. For instance, a judgment debtor may have no assets capable of legal attachment but maintain an extravagant lifestyle thanks to an interest in a discretionary

trust. In such circumstances, the appointment of a Receiver to collect the beneficial interest can be an invaluable enforcement tool.

Importantly, the appointment of a Receiver does not create a right against the property over which enforcement is sought; instead it creates a right against the person (i.e. the judgment debtor) who is to receive the equitable interest. Accordingly, a Receiver's appointment can be utilised as a means of enforcement outside the UK in a way that other methods of legal enforcement (such as third party debt orders) cannot. This was established by the Court of Appeal in *Masri v Consolidated Contractors (No 2)* [2008] EWCA Civ 303 in which it was held that the court could appoint a receiver by way of equitable execution in relation to foreign debts.

Cases subsequent to *Masri* have seen the Court incrementally widen its jurisdiction to appoint Receivers. Indeed, it can be said that there has been a distinct willingness of the English Court to assist with the enforcement of its judgments in this way. For example

- In *Masri*, when the judgment debtor took steps to frustrate the order (by deferring his entitlement to revenue under the project in question), the Court was willing to extend the Receiver's powers over a single revenue stream to that of 25 international construction contracts (*Masri v Consolidated Contractors International Uk Ltd* [2008] EWHC 2492).

- In *Cruz City 1 Mauritius Holdings v Unitech Ltd* [2014] EWHC 3131, the Court was willing to appoint a Receiver where the defendant's assets were located in a jurisdiction that would not recognise the order of the English Court thereby frustrating conventional enforcement. It was prepared to do so because the Receivership created a right against the judgment debtor personally in the UK and hence the sanction against the judgment debtor of contempt proceedings in this jurisdiction (should they choose to enter the jurisdiction) provided an incentive for the debtor to comply with the order.
- In *JSC VTB Bank v Pavel Skurikhin & Others* [2015] EWHC 2131 (Comm), the Court made a wide order and was prepared to appoint a Receiver over "whatever may be considered in equity as the assets of the [defendant]" if he "[had] the legal right to call for those assets to be transferred to him or to his order, or if he [had] de facto control over the trust assets".
- In *Merchant International Company Ltd v Natsionalna Aktsionerna Kompaniia Naftogaz Ukrainy* [2015] EWHC 1930 (Comm), the Court appointed a Receiver to collect certain funds in an account even though Naftogaz did not have a clear contractual right to them, merely a "sufficient expectation of [their] being paid".

Conclusion

These decisions illustrate how the Court's jurisdiction has evolved to meet the challenges faced by modern litigants. In particular, financial institutions may face defendants with complex asset-holding structures involving multiple jurisdictions and opaque trusts, especially in claims involving fraud or corruption. Although the appointment of a Receiver does not guarantee the protection of assets or the satisfaction of a judgment, it is an increasingly powerful tool for litigators and it will be interesting to see how their scope, which has already increased significantly in recent years, develops further in the future.

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Lehman Brothers International (Europe) v ExxonMobil Financial Services [2016] EWHC 2699 (Comm)

High Court delivers leading judgment on close-out valuation of repo transactions under GMRA 2000 and guidance on the meaning of ‘close of business’.

Summary

The English High Court has ruled on a number of key issues arising out of a disputed close-out under a standard form Global Master Repurchase Agreement (2000 version) (GMRA 2000), making the judgment the leading English authority on the interpretation of the close-out valuation mechanics under the GMRA 2000. It also addressed a number of issues, such as the meaning of ‘close of business’, service of notices by e-mail and the exercise of a contractual discretion regarding valuation, which are of wider relevance to finance contracts.

The outcome was that the majority of ExxonMobil Financial Services B.V.’s (EMFS) original or alternative close-out valuations were vindicated. The valuations which were argued for by Lehman Brothers International (Europe) (LBIE) were not upheld.

Facts

This was a dispute between LBIE and EMFS, a financial services arm of the ExxonMobil oil industry group, over the close-out valuation of a sale and repurchase (repo) transaction under the GMRA 2000. This followed LBIE’s default in September 2008.

A single repo transaction was outstanding at the time of LBIE’s default. Its commercial effect was in some respects similar to: (a) EMFS lending US\$250 million to LBIE; and (b) LBIE providing EMFS with collateral in the form of a large and diversified portfolio of equities and bonds.

The dispute raised questions of some complexity as to the meaning and effect of the close-out valuation and notice provisions in the GMRA 2000, some of which are of wider application.

‘Close of business’

The GMRA 2000 (at paragraph 14(b)) deems a notice or communication received after ‘close of business’ (in the place where such notice or communication is to be given) to have been given at the open of business on the following business day. However, ‘close of business’ is not defined in the GMRA 2000 and one of the issues was therefore when the ‘close of business’ was in London (that being where LBIE, the recipient of the Default Valuation Notice, was based). This issue is of wider importance as the term ‘close of business’ is of course used in many other financial contracts, such as the 2002 ISDA Master Agreement, but is

often undefined and thus far, there has been no definitive English law authority on its meaning.

Blair J ruled that the meaning of ‘close of business’ depends on the specific context. In this case, namely, repo financing extended by a major oil company to an international investment bank, he rejected LBIE’s submission that 5pm (at the latest) was the obvious answer, noting that a reasonable person might be surprised to hear that business closes at 5pm in such a context. LBIE having adduced no admissible evidence on this point and EMFS having adduced expert evidence to the contrary, this was sufficient to decide the point in favour of EMFS. EMFS’s Default Valuation Notice, which was received by LBIE at or shortly after 6:02pm London time, was therefore found to have been received prior to the close of business in London.

The term ‘close of business’ is thus context dependent and there is no one universal time that applies in all circumstances. In the context of transactions between sophisticated counterparties, which carry on business well into the night, one cannot simply assume that “close of business” occurs at around 5pm.

Service by e-mail

Another issue to be decided was whether e-mail was a valid method of service of contractual notices under the

GMRA 2000. Whilst strictly speaking obiter, Blair J gave a very clear indication that, as EMFS had argued, e-mail would be a valid method of service under the GMRA 2000, distinguishing *Greenclose Ltd v National Westminster Bank PLC* [2014] EWHC 1156 (Ch). A key point of distinction was that LBIE had included e-mail addresses in Annex 1 to the GMRA 2000 setting out addresses for notices, whereas the Schedule to the ISDA Master Agreement in *Greenclose* did not specify any email addresses for notice purposes.

Approach to valuation

One of the methods of valuing securities under the GMRA 2000 involves a 'Net Value' concept to be determined (in this particular instance) on the date falling five dealing days after the Event of Default occurred. Net Value is defined as 'the amount which, in the reasonable opinion of the non-Defaulting Party, represents their fair market value'. Where EMFS had not originally valued the securities under this method and it was decided that (principally because of other timing issues concerning the service of notices) EMFS was required to value some of the securities under this method, a question arose as to how the Court should approach the issue of valuation.

LBIE's primary case was that the relevant securities should be ascribed their objectively reasonable fair market value. EMFS's case was that they should be ascribed a fair market value in accordance with the opinion which EMFS (acting rationally) would have formed – had it conducted such a valuation exercise in accordance with the relevant terms of the GMRA 2000.

In short, Blair J accepted EMFS's case. The leading authorities on the exercise of a contractual discretion (including *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116) established that the Court ought not seek to establish an

'objectively reasonable' fair market value to the securities. Instead, it ought to apply a (Wednesbury) rationality test to the discretionary decision. The application of an objective test would largely deprive the counterparty of the benefit of the discretion which the contract gives it.

In the absence of the exercise of the discretion by EMFS at the relevant time, Blair J went on to say that the Court was engaged with a 'counterfactual' scenario of what opinion EMFS would have formed had it conducted the applicable valuation exercise acting rationally and in accordance with the relevant terms of the GMRA 2000, which was largely a question of fact.

Issues specific to the GMRA 2000

In addition to the points of wider application above, the following issues, which are more specifically confined to the GMRA 2000, were also decided

- It was sufficient that a valid Default Notice under the GMRA 2000 clearly conveyed to the recipient that an event is being treated as an Event of Default. It was not required to identify the specific event relied upon as the Event of Default.
- The fax number stated in Annex 1 to the GMRA 2000 under addresses for notices had to be used for valid service and the use of a different number was prima facie invalid. However, on the facts, Blair J found that LBIE had waived this requirement in circumstances where EMFS had used another fax number (LBIE's stipulated fax number having been busy), LBIE had in fact received the relevant notice and it had not taken issue with the point until some six-and-a-half years later in an amendment to its pleadings.

- In the context of the large and diverse portfolio of securities in issue, it would not have been permissible to determine a single 'global' Appropriate Market for the entire portfolio of securities. (Appropriate Market is a term which under the GMRA 2000 is relevant to the determination of the time by which a Default Valuation Notice is to be served and the markets in which quotes are to be obtained for the purposes of a Default Valuation Notice.)

Conclusion

While some of the specific issues of construction will be of primary interest to users of the GMRA 2000, the guidance on the meaning of 'close of business', service by email and the approach to valuation is of general importance. The High Court took a commercial view of all these issues which will be welcomed by market participants.

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Property Alliance Group v Royal Bank of Scotland plc [2016] EWHC 3342 (Ch)

Claims against RBS of derivative mis-selling, LIBOR manipulation and wrongdoing by its Global Restructuring Group failed.

Facts

Property Alliance Group Limited (PAG) was a property investment company and Royal Bank of Scotland plc (RBS) was its principal commercial banking provider. PAG claimed against RBS for mis-selling of four interest rate swaps (the 'Swaps'), for misrepresentations relating to LIBOR in connection with the Swaps and for breach of contract in relation to the transfer of PAG to RBS's Global Restructuring Group (GRG) and its subsequent management by GRG.

Decision

The High Court rejected every aspect of the claim.

It was accepted by both parties that there was no general advisory duty. PAG contended however for a duty to provide further information, including details of break costs and example scenarios, arising out of the general duty not to misstate. Asplin J held that *Crestsign* was not authority for such a duty arising whenever information was provided by a bank. It was a duty that fell on the advisory spectrum and went beyond misstatement and whether it existed in a particular case was fact-

dependent. Given the sophistication of PAG and general market practice, no such duty arose on the facts. In any case, PAG was aware of potential break costs and did not enter into the Swaps as a result of any information having been withheld.

The statement that the Swaps provided a 'hedge' was not a misrepresentation and, in any case, reliance on it was excluded by the contractual non-reliance language in the Swap and, furthermore, PAG did not enter into the Swaps in reliance on such a statement.

There was no implied term in the Swaps that RBS must act in good faith or that the Swaps would be suitable to hedge PAG's interest rate risks.

With regard to the GRG claim, there was no implied duty of good faith and the power to appoint a valuer was not a discretion subject to an implied duty not to act irrationally. There was also no implied duty that particular personnel would deal with PAG. In any case, there was no breach of the proposed duty – the transfer to GRG was not irrational or conducted in bad faith and there was no evidence of a campaign to extract value from PAG.

With regard to LIBOR, Asplin J started from the basis that there was a common assumption that the parties to contractual arrangements would behave honestly. For an implied representation, it was not sufficient for there to be an assumption by the representee – the assumption must arise "as a result of conduct viewed in context" (para. 405). So although there was an implied term that the parties would conduct themselves honestly in performing the contract, there was no conduct by RBS that would found the LIBOR representations. In any case, the particular wording of the representations argued for was so technical and complex that PAG would not have understood it and so did not rely on it.

Asplin J accepted that LIBOR was capable of giving rise to limited and less technical representations than those argued for, had there been conduct from which they could have been inferred. Asplin J also accepted the existence of an implied term that the Swaps floating rate would be calculated by reference to LIBOR as defined by the BBA, but she held that this term had not been breached.

Asplin J held that the manipulation of GBP LIBOR by RBS was not proved. It was not sufficient to show that there was manipulation of LIBOR in other currencies. One of the alleged manipulations was that RBS provided unrealistic submissions during the



financial crisis when it could not actually have borrowed money at the submitted rate, in order to paint a false picture of its ability to fund itself. This manipulation was also not proven because LIBOR submissions were a matter of judgment based on hypothetical, not actual, borrowing rates.

In any case, it was not proven that any alleged representation was made fraudulently – there was not sufficient evidence to justify an adverse inference from the fact that no senior RBS executive gave evidence.

Discussion

This was a comprehensive victory for RBS. The claims in respect of GRG and LIBOR will be closely studied as the first judicial examination of these arguments. Any finding of wrongdoing by GRG or of LIBOR manipulation with

the knowledge of senior RBS executives would have been seized upon by other claimants. To that extent, the prospects of success for future cases based on similar facts is very likely to be reduced.

However, the risk of these types of claim succeeding in the future has not entirely disappeared, particularly if the facts and evidence provide a stronger basis for addressing the particular weaknesses the Court identified in PAG's claim. For instance, the pleaded representations as to LIBOR were complex and technical, the expert evidence was found by the Court to be unconvincing and PAG was unable to take advantage of the fact that senior executives of RBS did not give evidence.

Overall, this is an encouraging victory for RBS but there remains a risk of future similar claims.

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Taberna Europe CDO II Plc v Selskabet [2016] EWCA Civ 1262

The Court of Appeal clarifies the position on liability to secondary market participants under the Misrepresentation Act 1967.

Key points

- Where a financial document is published in circumstances which actively invite investors to make use of it, those investors may be entitled to rely on its contents. Particular care should be taken when placing presentation materials on the internet.
- However, an appropriately worded disclaimer contained within the document (even if it is within a non-contractual notice) may prevent liability for a misrepresentation.
- Liability under section 2(1) of the Misrepresentation Act 1967 (the ‘Act’) is limited to circumstances where there is a direct contract between the representor and representee.

Facts

Roskilde Bank A/S (Roskilde), a Danish regional bank, issued subordinated loan notes (the ‘Notes’) in 2006, some of which were acquired by Deutsche Bank. In 2008, Deutsche Bank sold these to Taberna Europe CDO II Plc (Taberna), an Irish investment vehicle, on the secondary market. The following

year, Roskilde was declared insolvent. Prior to this, however, the majority of its assets and liabilities (with the exception of the Notes) had been transferred to a new bank.

Taberna considered that its best option for recovery was to argue that liability for misrepresentation had passed to the new, solvent bank. Accordingly, rather than prove for the Notes in Roskilde’s bankruptcy, it claimed damages for misrepresentation under s2(1) of the Act against the new bank.

Taberna asserted that it had been induced to buy the Notes by an “Investor Presentation” published by Roskilde on its website which significantly misstated the amount of its non-performing loans (NPLs). The Presentation was widely available and was accessible to potential purchasers of the Notes on the secondary market. However, the Investor Presentation contained a series of disclaimers as to the accuracy of the information contained therein. The loss claimed was the purchase price paid to Deutsche Bank to buy the Notes. No allegation of misrepresentation was made against Deutsche Bank.

At first instance, Eder J found in favour of Taberna. He held that: (1) the Investor Presentation had misrepresented Roskilde’s NPLs and that Taberna had been entitled to rely on this; (2) the disclaimer language did not have contractual effect and was therefore invalid (although, if valid, it would have passed the reasonableness test required by the Unfair Contract Terms Act 1977); and (3) s2(1) of the Act applied despite the misrepresentation having been made by a third party (Roskilde) to the contract (between Deutsche Bank and Taberna) it induced.

The decision

The Court of Appeal reversed the decision, holding that Taberna was not entitled to damages under the Act. It considered three key questions.

Was there a misrepresentation to Taberna?

The Investor Presentation was originally directed to those who attended various investor roadshows – as the disclaimer made clear. However, not only had the Investor Presentation been put on Roskilde’s website, but Roskilde had actively encouraged potential investors to view it there. The Court of Appeal found that where a company actively invites potential investors to make use of information, it can hardly complain if the investor

does then use that information. Roskilde intended Taberna to rely on the Investor Presentation and the representations in it were made by Roskilde to Taberna.

Was the disclaimer valid?

The Investor Presentation contained disclaimers relating to its content and use. These included disclaimers restricting liability for errors (liability disclaimers) and disclaimers stating that no representations were made (duty disclaimers). As there was no direct contract between Roskilde and Taberna, the disclaimers did not have contractual effect.

The Court of Appeal held that the disclaimer could take effect as a non-contractual notice that limited the scope of the duty. Where a prior representation induces a contract, only a contractual estoppel arising from an agreement in the contract could negate liability. Here, although there was no contract, the limitation was contained in the same document as the misrepresentation and it could affect the scope of the representations. Generally, parties to commercial contracts are entitled to determine for themselves the terms on which they will do business. Taberna was an experienced investor and can be expected to have read and taken account of all the disclaimers. So long as the position is made clear, there is no reason in principle why a party cannot publish material on the basis that it does not take responsibility for its content.

Did section 2(1) of the Act apply where the representor was not a party to the contract?

The Court of Appeal held that s2(1) only permitted a claim for damages when the misrepresentation that

induced the contract was made by the other party to the contract. This reversal of the first instance decision has significant wider implications for the secondary markets.

A complicating factor was that, as a result of purchasing the Notes, Taberna and Roskilde were brought into contractual relations, so Taberna could argue that it had entered into a contract within the meaning of s2(1) in reliance on the misrepresentation. This argument would have been unavailable had Taberna acquired from Deutsche Bank property other than an obligation of a contractual nature.

Moore-Bick LJ, in delivering the main judgment, stated that: “section 2(1) is concerned only with the contract which the representee has been induced to enter into directly with the representor (and in respect of which a right of rescission would arise)... although the notes in the present case represented obligations of a contractual nature they are better regarded for these purposes as a species of property, which Taberna acquired pursuant to a contract with Deutsche Bank... The contract that came into being between Taberna and Roskilde as a result of the purchase of the notes was a consequence of the contract with Deutsche Bank, not the cause of it”.

In short, it was the loss under the contract between Taberna and Deutsche Bank which Taberna was looking to claim against – not the loss arising from any contract between Taberna and Roskilde. As such, Taberna could only have recovered its loss (being the price it paid for the notes) under s2(1) of the Act had it been a misrepresentation by Deutsche Bank which had induced them to buy the notes.

Discussion

Securities issuers will take comfort from the fact that the application of s2(1) of the Act to secondary market purchases of notes has now been clarified. The first instance decision exposed issuers of tradeable securities to liability to a potentially wide class of investors and the Court of Appeal’s decision closes those floodgates.

This case highlights the risks associated with making investor materials publicly available. Issuers should recognise that these materials may be relied on by investors. While disclaimers may be effective, they do not fall within the wide doctrine of contractual estoppel and are subject to a reasonableness test.

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Libya Investment Authority v Goldman Sachs International [2016] EWHC 2530 (Ch)

The High Court rejected the Libyan Investment Authority's (LIA) claims that Goldman Sachs had exercised undue influence to procure the LIA to enter into a series of derivatives transactions or that the trades otherwise amounted to an unconscionable bargain.

Summary

Bank counterparties face increasingly high barriers to success in claims to exit financial transactions. Contractual estoppel is often an insuperable obstacle – a pleading of fraud may circumvent contractual estoppel, but will rarely be supported by the facts.

In this case, the claimant employed a new argument, based on equitable wrongs. LIA argued that Goldman Sachs had unduly influenced it to enter into the transactions (the 'Disputed Trades') and that the Disputed Trades amounted to unconscionable bargains.

While largely depending on its facts, the case gives useful guidance as to how far a bank counterparty can rely on undue influence and unconscionable bargain claims to set aside their contracts.

Facts

Economic sanctions were lifted against Libya between 2003 and September 2004. The Libyan government had

accrued oil revenues of many billions of dollars and following the sanctions set up the LIA as a fund to invest its assets for the benefit of the citizens of Libya.

Many investment banks pitched investment proposals to the LIA. One of these was Goldman Sachs. As a result, Goldman Sachs entered into the Disputed Trades with the LIA between September 2007 and April 2008.

The Disputed Trades were designed to give the LIA exposure to different equities (including those of Citigroup, EdF, Allianz, Banco Santander, ENI and Unicredit). Under the structure of the Disputed Trades, LIA did not invest in the shares directly. All the Disputed Trades were synthetic derivatives comprising a put option and a forward. The LIA paid a premium to Goldman Sachs in return for exposure to the equities. If the share price rose by the maturity date of the Disputed Trades, Goldman Sachs would pay the LIA the amount of the increase multiplied by the total notional number of shares. Otherwise, Goldman Sachs kept the premium and the LIA received nothing.

The total premium paid by the LIA was US\$1.2 billion.

The LIA argued that

- It was naïve and unsophisticated with a limited understanding of the products invested in. The LIA believed that it acquired actual shares, not merely exposure to them via synthetic derivatives. The LIA did not realise it could lose all of the premiums paid to Goldman Sachs.
- A relationship of trust and confidence had grown by the time the Disputed Trades were concluded and Goldman Sachs became the LIA's adviser (and, it was argued, 'virtually the LIA's in-house bank'). As a consequence, the LIA expected that Goldman Sachs would act in the LIA's best interests.
- That relationship was different from that between the LIA and other banks because of the provision of a Goldman Sachs employee to the LIA as a secondee, training, informal advice and extensive corporate hospitality.
- The offering of an internship within Goldman Sachs to the brother of the Deputy Chairman of the LIA was said to have improperly influenced the LIA to enter into the Disputed Trades.
- The Disputed Trades themselves were priced unfairly, led to excessive profits for Goldman Sachs and were otherwise unsuitable for the LIA.

The LIA asserted that the above factors gave rise to two causes of action

- Undue influence including (i) actual undue influence and (ii) presumed undue influence.

The Court considered two forms of actual undue influence. First, actual undue influence where there has been an improper threat or, as the LIA argued, an improper inducement. No prior relationship is required for this type of undue influence. Second, where a 'protected relationship' arises which places a duty on the stronger party to behave with candour and fairness to the weaker party and that duty is breached. The LIA contested that such a 'protected relationship' existed with Goldman Sachs.

Presumed undue influence may arise where trust and confidence is placed in another party and a transaction is then entered into which 'calls for explanation'. In the absence of a satisfactory explanation, the Court will infer that the transaction was procured by undue influence.

- Unconscionable bargain. The LIA needed to establish that it was seriously disadvantaged compared to Goldman Sachs and that it was exploited by Goldman Sachs in a morally culpable way with the result that the Disputed Trades were overreaching and oppressive.

Decision

Issue 1: Was there a 'protected relationship'?

Rose J held that the actions of Goldman Sachs in building the relationship with LIA did not cross the line into a special

or advisory relationship. Goldman Sachs did what they could to win the work and build the relationship. This did not place them into a different category from the other banks that the LIA were trading with.

Issue 2: Did the Goldman Sachs internship amount to actual undue influence on the LIA to enter into the Disputed Trades?

Rose J held that the offer of the internship did not lead to undue influence. Goldman Sachs's motivation in offering the internship was the chance to form a strong link with someone who might be leading the LIA London office in the future. It was also unrealistic to expect that the Deputy Chairman of the LIA would be influenced to commit the LIA investing over a billion dollars on the basis of a few months' internship for his brother. All the internship did was to create a friendly atmosphere between Goldman Sachs and the LIA.

Issue 3: Should there be a presumption of undue influence?

Although there was no 'protected relationship' necessary for a finding of presumed undue influence, in any event there was no feature of the Disputed Trades that would call out for explanation and therefore lead to a presumption of undue influence. The level of Goldman Sachs profits were commensurate with the nature of the trades and the work that had gone into winning them. Even if the Disputed Trades were unsuitable, the LIA entered into similar trades with other counterparties and it was found that the LIA had its own reasons for entering into the Disputed Trades. Accordingly, the claim for unconscionable bargain also failed.

Discussion

Although the case was not argued as a misrepresentation claim, many of the classic elements of such a claim feature in the attempt to frame the Disputed Trades as having been entered into as a result of undue influence. These include allegations that Goldman Sachs assumed an advisory relationship, that the products were not suitable, that the profits that Goldman Sachs were making were excessive and that the LIA was naïve and unsophisticated.

On the face of it, an undue influence claim appears no more fruitful a way of using these types of argument to assert that a contract should be set aside than a claim in misrepresentation. The courts will still be mindful not to let a contractual party escape a bad bargain and will be likely to consider matters from that viewpoint.

However, there were other features of the case which would not ordinarily arise in a typical misrepresentation claim. The secondment of a Goldman Sachs employee to the LIA, training, informal advice and corporate hospitality were all relied on by the LIA to assert that the relationship had become something more than one merely that between a bank and counterparty. The court rejected these arguments firmly and this will provide comfort for banks marketing to sovereign wealth funds in the emerging markets.

Finally, it is worth noting that although Goldman Sachs won the case, there are risk factors for banks to be mindful of in these situations

- Although the internship offered to the brother of the LIA Deputy Chairman or the corporate



hospitality provided did not result in a ‘protected’ relationship, internal policies on internships or corporate hospitality should be adhered to and any compliance issues considered carefully.

- A Court will need some degree of persuasion to find that a bank-customer relationship has become a trusted advisor relationship. In *LIA v Goldman Sachs*, the court accepted that banks need to market their services and that will involve a process of relationship building. It did not give excessive weight to marketing material that used wording such as ‘unique relationship’ or ‘strategic partnership’ as the substance of the relationship was that of a typical bank customer.
- Care should be taken when engaging in general market discussions with a counterparty which include comments on the state of the market and investment potential, even though the courts will probably provide a degree of protection in these circumstances. The conversations between Goldman Sachs and LIA employees did not stretch beyond general and informal discussions about the market and so a ‘protected relationship’ did not arise. However, these types of discussion should be undertaken with caution.
- Evidence of a counterparty’s dealings with other banks can be useful. If a counterparty is dealing with other banks on similar terms on similar transactions, it is less likely that a ‘protected’ relationship will be found to have arisen between the counterparty and a particular bank.

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Credit Suisse Asset Management LLC v Titan Europe 2006-1 PLC [2016] EWCA Civ 1293

Court of Appeal gives guidance on construction of notes and offering circular in context of a commercial mortgage-backed securitisation

Facts

A tranche of notes issued as part of a commercial mortgage-backed securitisation (the ‘Class X Notes’) were entitled to interest calculated on the basis of the difference between amounts received by the securitisation vehicle and amounts owing to other noteholders – effectively, a measure of the profit or the excess spread retained in the structure.

A dispute arose as to the correct calculation of the interest following a default in the underlying structure that led to the payment of additional default interest. The Class X noteholders claimed that the correct construction of the terms and conditions of the Class X Notes was to include this entitlement; other noteholders argued that it should not.

Decision

The Court of Appeal held, Briggs LJ dissenting, that the Class X interest calculation did not include default interest. The majority held that use of the phrase ‘per annum’ meant that the natural construction excluded default interest. Briggs LJ put less weight on this phrase and came to the opposite view.

All members of the Court of Appeal agreed on the correct approach to construction. First, it was necessary to determine the meaning of the words in their context. The importance of respecting the bargain made by the parties even when it was imprudent was stressed both in the leading judgment of Arden LJ and the dissent of Briggs LJ.

The Offering Circular was not merely part of the surrounding circumstances: the Class X Notes were issued on the basis of it, it would have been available to subsequent noteholders and the issuer expressly accepted responsibility for the information in it. Although the Offering Circular states that the information in it is qualified by the transaction documents, and so cannot prevail in the case of a conflict, it is nevertheless ‘an aid to construction’ (per Arden LJ).

Both Arden LJ and Briggs LJ started by considering the natural meaning of the words in context and then cross-referenced this against the commercial common sense of the provision. Although they came to opposite views on the meaning, they both decided that commercial common sense did not require any change

of view. Both interpretations had commercial flaws: excluding default interest meant that some funds might flow through the waterfall and end up being paid out to charity; including default interest meant that the Class X noteholders arguably received a windfall at the expense of more junior noteholders. But these flaws were not serious enough to displace the natural construction. Briggs LJ, in particular, stressed the difficulty of displacing construction by appeal to commercial common sense:

“The detection of ambiguity does not entitle the Court to resolve it simply by reference to a balance of commercial considerations. Sometimes the words used, even if admitting some ambiguity, still point firmly towards a different answer to that which is to be derived from a balancing of commercial considerations” (para. 82).

Discussion

Construction is fraught with difficulty: even though all members of the Court of Appeal agreed on the general approach, they disagreed on the plain meaning of a single phrase. As Briggs LJ put it:

“English law assumes that every question of construction has a right and a wrong answer. In reality there can often be as much scope for reasonable differences of view as there

is in many questions about the exercise of a discretion” (para. 59).

Nevertheless, it is clear that commercial common sense will rarely be able to impose a particular construction. The Court of Appeal has followed the new orthodoxy of *Arnold v Britton* [2015] UKSC 36 – even perhaps expanding it in making clear that a little ambiguity will still not allow recourse to commercial common sense.

The rule against penalties featured at first instance in similar cases dealing with Class X interest – as the interest

on the Class X Notes is out of all proportion to the nominal principal, to the extent it is payable on default, it is arguably a penalty. It is unfortunate that this issue did not arise for consideration before the Court of Appeal.

Finally, the comments as to Offering Circulars may be relevant for future questions of construction in the capital markets. The Offering Circular has a special status, it is not just another background document. Although it cannot displace a transaction document, it may be used as an aid to construction.

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A quick primer on state immunity for financial institutions

When can a state claim immunity from legal proceedings and enforcement of a judgment in courts that are not its own? Most legal systems recognize that, at least in some circumstances, the courts are not the appropriate forum for resolving disputes involving states. In the worst case scenario, this can leave a creditor without a remedy against a defaulting state.

Norton Rose Fulbright has recently released a guide to the nature and extent of state immunity setting out the essential information needed by financial institutions lending to sovereign entities. It contains answers to the key questions presented country by country and in a comparative format. For more information, see <http://www.nortonrosefulbright.com/knowledge/publications/146469/state-immunity>.

Which rules apply?

First, it is necessary to clear up a misconception. State immunity may prevent a court from acting against a foreign state. It does not concern the power of a court to consider proceedings involving its own state. That is a matter of its domestic law. So, for instance, in England there are rules concerning actions against the crown by private individuals. There are similar rules in other countries and, in many cases, it is difficult or impossible to obtain judgment against a state in its own courts.

If it is not possible to enforce against a state in its own courts, a counterparty may look to take action or enforce against assets in the courts of other jurisdictions. This is where state immunity is relevant. State immunity concerns the power of a court to entertain proceedings or enforce judgments against foreign states. When considering whether a court can take action against a state, it is the state immunity rules of the court's jurisdiction that are relevant, not those of the foreign state or of any agreement involving the foreign state. So where a financial institution is considering recourse against a sovereign borrower, it is the rules of all the jurisdictions where that borrower has significant assets or where courts may have jurisdiction over it that are relevant.

Are the rules absolute or restrictive?

Broadly speaking, there are two different approaches to state immunity. The absolute approach provides that states are immune from proceedings in

foreign countries. This has gradually been displaced by the restrictive approach, which is more commercial. The restrictive approach differentiates a state acting in a sovereign capacity – when it is immune – from a state acting in a commercial capacity – when it may not be immune.

The first question to decide is whether a jurisdiction's state immunity rules are absolute or restrictive. For example, China takes an absolute approach to state immunity; England takes a restrictive approach. When enumerating jurisdictions relevant to a sovereign borrower, the first task is to divide them according to whether they take an absolute or restrictive approach.

Adjudication and enforcement

It is also necessary to distinguish two types of immunity: immunity from suit and immunity from enforcement. Immunity from suit concerns whether the court or arbitral tribunal has the power to adjudicate the dispute. (A related concept is 'justiciability' – whether the act that is complained of is of a type that should be resolved between states and not by the intervention of the courts. Acts of state, such as exercises of foreign policy, are generally not justiciable.) Immunity from enforcement concerns whether the court has power to enforce a judgment or arbitral award and to execute against certain assets of the state.



The two types of state immunity are dealt with differently by courts and, typically, a waiver of one will not necessarily imply a waiver of the other. When drafting loan agreements, for instance, it is necessary to ensure that there are appropriate waivers of execution that would be given effect by the courts of the jurisdiction where assets are located.

What is a state and what are state assets?

States may act through agencies, sub-divisions or incorporated entities. Many jurisdictions, including England, contain rules to distinguish whether state immunity is triggered dependent on the nature of the entity. Similarly, whether immunity from enforcement is triggered may depend both on the nature of the entity that owns the assets and the nature of the assets themselves, particularly whether they are put to commercial use.

When lending to a sovereign entity, if there is any doubt as to whether it is actually a state or whether it is acting in a commercial capacity, this should be resolved by analysis according to the state immunity rules of the jurisdiction in which proceedings will take place. Similarly, when gauging whether assets of a possible state entity are actually available to satisfy a state liability, it is necessary to analyse the issue according to the rules of the jurisdiction where the assets are located.

English rules of State Immunity

The State Immunity Act 1978 sets out the English rules as to state immunity. The Act differentiates between immunity from suit and immunity from enforcement. It sets out when waivers may be given – including the waiver effect of an agreement to arbitrate – and the scope of commercial exceptions to immunity. The Act also contains separate rules for central banks, limiting the availability of their assets to satisfy judgments.

A series of English court judgments clarify when a separate entity will be able to take advantage of state immunity and the exact scope of the exception to immunity from enforcement for assets being used for commercial purposes. The English approach relies closely on the development of international law towards the restrictive model of state immunity. Accordingly, it is a good point of comparison for financial institutions when considering action against state borrowers in different jurisdictions.

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Financial institutions and international arbitration

Financial institutions, which traditionally prefer litigation in certain select jurisdictions such as London, New York, Hong Kong and Frankfurt, are increasingly open to the use of international arbitration for cross-border banking and financial disputes, according to a report published in December 2016 by the ICC Commission Task Force on Financial Institutions and International Arbitration (the ‘Report’).

The Report’s findings tally with those in a 2013 survey by the QMUL School of International Arbitration and PwC. That survey found that a significant proportion of the banking and finance sector (69 per cent) indicated strong support for arbitration, although less than a quarter of general counsel listed arbitration as their most preferred option.

The Report found that financial institutions tend to favour arbitration where

- The transaction is significant or particularly complex.
- Confidentiality is a concern.
- The counterparty is a state-owned entity.
- The counterparty is in a jurisdiction where recognition of foreign court judgments is problematic or where enforcement of an arbitral award may be easier.

A majority prefer using institutional arbitration owing to the settled procedural rules and proven ability to handle complex and high-value disputes. The arbitral institution rules most frequently chosen are LCIA, ICC, HKIAC and SIAC, and the most popular seats are London, Paris, Geneva, New York, Hong Kong and Singapore.

Financial institutions are increasingly open to arbitration because of the changing (and often increasingly strict) regulatory environment and the fall-out faced by banking and financial institutions after the global financial crisis which brought “an unprecedented wave of claims by and against financial institutions, as well as among them”. The ability to deal with such disputes in private and confidential arbitral proceedings offers a welcome respite from playing them out in public. Financial institutions, like most business, also prefer to avoid jury trials where possible.

Another point in favour of arbitration is the growth in emerging market transactions where local courts are regarded as inexperienced or unreliable, particularly where the state is a counterparty. Arbitration offers neutrality and party-autonomy. Financial institutions are also more alive to the fact that if their foreign investment is structured appropriately and the financial instrument is a qualifying investment, they may benefit from protections under investment treaties. These afford investors a direct right of action against the host state for any internationally wrongful act, generally by bringing arbitral proceedings in a neutral seat.

Parties’ ability to select specialist arbitrators with industry expertise and experience was also cited by financial institutions as a key benefit of arbitration; financial transactions are increasingly complex and financial services disputes are often highly technical. Specialist arbitrators, arbitral institutions and rules tailored to resolving complex financial disputes have all emerged in recent years.

Crucially, arbitral awards can be enforced internationally, often more readily than foreign court judgments, under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. There are currently 156 state parties to that



convention with no equivalent, in terms of both scope and ease of enforcement, for court judgments.

The Report suggests that arbitration is not used consistently or on a large scale and nor is it used to its full potential in many areas (Islamic finance disputes were identified in particular as a potential growth area). Most financial institutions interviewed stated that they do not have substantial experience of arbitration but the use of and expectations about arbitration is evolving. Financial institutions remain cautious about arbitration because of a lack of awareness about the potential benefits and misconceptions about

the arbitral process. The report offers detailed recommendations for tailoring arbitration to the needs of the banking and finance sector.

The Task Force compiled its findings from interviews of some 50 financial institutions and banking counsel from across the globe, as well as other sources including internal policies, publications, arbitral awards and data from thirteen arbitral institutions. It examined a wide range of banking and financial activities including those undertaken by licenced banks and funds (equity, investment or sovereign wealth). The Report can be found on the ICC's website.

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Managing litigation risk in banking investigations

Introduction

The conclusion of a banking investigation is increasingly unlikely to mark the end of the matter. Financial institutions face ‘follow-on’ actions brought by customers, third party suppliers and ex-personnel. The growth in claims management companies and shareholder action groups, combined with uncertainties in economic outlook serves only to fuel this litigious activity.

The steps taken throughout an investigation can have a significant impact upon subsequent litigation. As such, it is essential that litigation risk is effectively managed throughout all stages of the investigatory process.

In this article we address issues in follow-on litigation. We provide a high-level checklist of different litigation risks specific to follow-on claims. Then we provide some practical guidance when preparing for investigations that addresses those risks, including in relation to efficient data management, reputational risk and privilege.

What are the litigation risks?

Banks face a number of challenges in defending follow-on litigation claims. A brief overview of the principal risks is as follows.

Regulatory notices

The publication of regulatory notices online provides a gateway for prospective litigants. Pursuant to s138D of the Financial Services and Markets Act 2000 (FSMA), private persons who have suffered a loss as a result of the breach of Financial Conduct Authority (FCA) or Prudential Regulation Authority (PRA) rules (such as the FCA’s Conduct of Business Sourcebook (COBS)), can bring an action for damages. Despite the regulator producing its findings on the basis of relatively limited access to documentation, claimants may present the content of these notices as established facts. For example, in the recent interest rate hedging product (IRHP) mis-selling case, *Hockin v The Royal Bank of Scotland* [2016] EWHC 925 (Ch), the Court permitted the claimant to amend their claim to incorporate LIBOR misrepresentation allegations supported by inferences drawn from the conclusions of regulatory authorities, following the position established in *Graiseley Properties Ltd v Barclays Bank plc* [2012] EWHC 3093 (Comm).

In addition, pursuant to the Civil Procedure Rules (CPR17.4(2)), claimants can add new claims even after the expiry of the limitation period, providing the new claim arises out of the same or ‘substantially similar’ facts as the existing claim, as per *Mercer Ltd v Ballinger* [2014] EWCA Civ 996. The

publication of regulatory notices can trigger such amendments.

Unless the claimant has entered into a tightly worded ‘full and final’ settlement agreement, it may seek to use regulatory notices to raise new causes of action and unpick the former settlement, exposing the financial institution to further liability. In *WW Property Investments Ltd v National Westminster Bank Plc* [2016] EWCA Civ 1142, another IRHP mis-selling case, the Court held that settlement agreements were binding in relation to collar products but not in relation to the overarching swap agreement. This highlights the need for clarity in drafting settlement agreements.

Witnesses

The unavailability of key witnesses (such as relationship managers and salespeople) can prove challenging. Often, given the passage of time, key individuals may have moved on to work at another institution or even left the industry. Former senior stakeholders may have since retired and have little incentive to engage with their former employer. Alternatively, individuals may themselves be subject to investigation which may discourage them from assisting with an investigation.

Documents

Banks will often not receive notification of follow on litigation until a considerable time after the

relevant events. This can exacerbate the difficulties in promptly sourcing relevant documentation, retrieving emails and hard copy files. For historic claims, this may require time-consuming searches of back up tapes.

A bank's customers may attempt to obtain documents outside of the formal disclosure process via a Data Subject Access Request (DSAR). This approach was challenged in *Dawson-Damer v Taylor Wessing LLP* [2015] EWHC 2366 (Ch) which indicated that the English courts will be disinclined to enforce DSARs made for the purpose of advancing litigation (although this case is being appealed).

Privilege

Banks may seek to rely upon privilege to protect legal advice between lawyers and their clients. The recent decision in *PAG v RBS* [2015] EWHC 1557 (Ch) provides some reassurance to institutions undergoing regulatory investigations, demonstrating that it is not necessary to distinguish between legal advice and factual communications provided the latter forms part of a "continuum of communications and meetings between solicitor and client." The ruling appears to confirm that legal advice privilege can be protected within an advisory committee provided that the participating lawyers convey information and provide legal advice in respect of the regulatory investigation. However, the scope of those covered by privilege looks set to be narrowed, further to *The RBS Rights Issue Litigation* [2016] EWHC 3161 (Ch). In that case, the High Court found that interviews conducted by a bank's solicitors with its employees were not covered by legal advice privilege, as the employees were not the lawyers' "clients." This decision may lead to a re-examination of the seminal case of *Three Rivers District Council v The*

Governor & Company of the Bank of England Rev 1 [2003] EWCA Civ 474 and as such its appeal has been leapfrogged up to the Supreme Court, due to be heard in early 2017.

Documents primarily concerning business advice or administration will not attract legal privilege. In addition, privilege can be harder to maintain in an international investigation. While common law jurisdictions such as the UK, US and Australia recognise legal privilege, civil law jurisdictions such as the People's Republic of China do not.

Litigation privilege may protect confidential communications between parties if the dominant purpose of such communications is in relation to adversarial proceedings either pending, reasonably contemplated or in existence. In practise, litigation privilege can prove difficult to assert and requires specialist advice to determine its precise coverage. Purely internal investigations or investigations conducted to assist with early stage regulatory investigations may not attract litigation privilege, as the dominant purpose of such work is unlikely to be in anticipation of future litigation.

Reputational risk

Although an investigation may commence in relative privacy, as the process continues the risk increases of reputational damage from breaches in confidentiality, such as via information leaks or whistleblowers. Reputational risks will increase further once follow-on litigation commences.

How to tackle litigation risk

It is important to identify any actual and potential litigation risk areas at the outset of an investigation and to monitor these throughout the investigatory process. It may be appropriate to diarise a regular legal team meeting to discuss

these risk areas and to maintain a risks log, rating each item against a scale. The risks log should recognise that investigations based in one jurisdiction may prompt follow-on litigation in another. The creation of an action plan can help to communicate these risks to the business. An assessment of the conduct of the individuals involved in the investigation (including former employees) is necessary to consider whether any may require separate legal advisors.

Document management policies should identify the bank's operations, functions and jurisdictions affected by the scope of the investigation and include the location details of the relevant data servers and systems. The unnecessary transfer of data to other jurisdictions should be prevented. It is prudent to check whether document retention policies have been adhered to and, pursuant to CPR Practice Direction 31B, that a 'litigation hold' is put in place in co-ordination with the IT department. Any routine systematic destruction of documents relevant to the dispute should be suspended.

Careful consideration should be given to how to maintain privilege throughout the investigation, including over records of meetings and interviews, along with communications with regulators. A privilege protocol should be created which is tailored to the intricacies of the investigation and covers all in-scope jurisdictions. Although the label 'Privileged and Confidential' will not create privilege over a document, it is helpful to label such documents accordingly. It is important to consider whether lawyers can attend meetings to create a privileged record and to consult with the business to determine whether privilege can be waived over any particular documents. Care should be taken to limit the number of people involved in the investigation to reduce

the risk of information leaks. Interviewees should be informed that all matters addressed in interviews are confidential and should not be discussed.

The need to communicate with regulators should be carefully balanced against the risks of creating additional documents which may be disclosable during litigation. Members of the investigation team should therefore refrain from creating new documents which summarise legal advice received.

Conclusion

Litigation risk is something to be considered and managed throughout the life cycle of an investigation, particularly in light of the likely costly implications and potential reputational damage arising from defending claims. Dedicating time to the careful planning of an investigation will prove worthwhile in effectively managing litigation risk.

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Managing litigation risk: practical guidance

Engage with regulators at the outset of the investigation and seek to establish a communications protocol to help maintain privilege over interparty correspondence.

Establish a privilege policy tailored to the jurisdictions involved to ensure that privilege is not inadvertently waived.

Develop an understanding of how your organisation responds to data subject access requests (DSARs), including the teams involved and usual response timescales. Seek to be notified of any DSARs brought by litigious customers.

Ensure that complaints are managed efficiently to reduce matters being escalated to the Financial Ombudsman or comprising the basis for litigation.

Develop a PR response plan, including templates for briefing key internal stakeholders and the press. Consider how best to manage issues arising from social media. Ensure the bank's PR team is kept aware of legal deadlines and key dates within the litigation process so they can plan communications to minimise or maximise their impact as required.

Financial regulation and cyber-crime

As the number and profile of cyber-attacks increases, so the financial regulators focus their attention on the risks posed to authorised firms and how these should be managed. The number of cyber-attack reports by firms to the Financial Conduct Authority (FCA) has risen from just five in 2014 to over 75 in the nine months from January to September 2016 alone and these include high profile incidents which have left customers temporarily unable to access bank services and allowed hackers to access funds in customer accounts.

Against this background, cyber risk is firmly on the agendas of both the FCA and the Prudential Regulation Authority (PRA) in the coming year. This article provides an outline of some regulatory expectations in relation to cyber-crime and considers the potential for adverse regulatory consequences for those who fail to meet these expectations.

Regulatory expectations

The FCA's Business Plan for 2016/2017 (the 'Business Plan') identifies cyber-crime as one of the key risks posed by technological innovation and one which requires continuing vigilance. The following areas have been particularly highlighted as posing the greatest cyber security risks.

- The use of ransomware.
- Data outsourcing by firms.

- A skills gap caused by firms failing to recruit skilled staff to analyse data and respond to threats.

It is clear from the Business Plan and a speech given in September 2016 by the Director of Specialist Supervision at the FCA, that the regulator expects firms to take action to ensure that they are managing cyber risk effectively. Tackling this is seen as a cultural and holistic issue, extending beyond IT and systems and controls to people and governance. In particular, the FCA has indicated that it expects firms to develop

- Strong defensive capabilities which protect the firm against cyber-attacks. Such capabilities will depend not only on technology, but also on other mechanisms such as training staff (for example, to recognise phishing emails) and effective staff security screening

- Adequate detection and recovery capabilities which enable the firm to identify when it has been attacked, to carry on in the event of unforeseen interruptions and recover from the attack, preserving essential data
- A 'security culture', including 'good governance' around cyber security, evidenced by engagement from the Board and senior management and effective challenge at the Board.

Whilst the FCA's resource will be focused on 'the firms and markets with the greatest risks', all firms are expected to take action to manage their cyber risk, regardless of size. Given that the smallest of firms can hold 'large quantities of data ... which if compromised could then have a ripple effect to other areas of the financial sector', the FCA has noted that cyber risk 'does not really depend on the size of the firm'.

In addition, the PRA is consulting on cyber insurance underwriting risk and, in particular, proposals requiring firms to monitor, manage and mitigate the underwriting risks emanating from cyber insurance policies and from implicit or 'silent' cyber exposure within more general insurance policies that do not specifically exclude cyber risk. The PRA expects firms to have in place clear strategies and risk appetites for managing cyber risk, which should be owned by the Board.



Potential repercussions

Regardless of whether any damage is sustained to a firm or its customers, a cyber-attack may require a prompt regulatory notification to the FCA and/or the PRA and may also give rise to concerns regarding potential weaknesses in a firm's systems and controls. An investigation may be needed in order to identify root causes, any wider implications and remediation requirements.

One key consideration will be whether there has been a potential failure to comply with Principle 3, which requires that firms take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems, and related rules set out under the Senior Management Arrangements, Systems and Controls (SYSC) section of the FCA Handbook. These rules include requirements relating to arrangements for and supervision and management of the outsourcing to a service provider

of critical or important operational functions and the protection of confidential information relating to the firm and its clients .

Whilst no enforcement action has yet been brought for failures relating to cyber security, there is clearly scope for regulatory sanctions, including the imposition of considerable fines. The FCA has already fined a number of firms in relation to data and information technology-related failures

- In November 2014, following a joint investigation, the FCA and PRA imposed fines totalling £56 million for a breach of Principle 3 arising from an IT failure which led to certain bank customers variously being unable to withdraw cash from ATMs, drawdown loans or make transfer payments. The regulators found, amongst other things, that the incident had been caused by a failure to check the effectiveness of a software upgrade and a failure to implement effective systems

and controls for testing software or identifying, analysing and resolving IT incidents.

- In September 2010, the FSA imposed a fine of over £2 million on an insurance company for a breach of Principle 3 arising from a failure to have adequate systems and controls in place to prevent the loss of confidential customer information. The fine related to the outsourcing of security over customer data storage to a foreign subsidiary and on to a sub-contractor and the loss of back-up tape by that sub-contractor. Although there was no evidence that the lost data was compromised or misused, there was a risk that customers could have suffered serious financial detriment. The insurance company did not carry out ongoing assessment of the risks connected with the outsourcing arrangement, conduct adequate due diligence on the sub-contractor's data security procedures or obtain

sufficient management information to enable it to manage and control data security and financial crime risks. It also failed to put in place proper reporting lines between the subsidiary and the UK business (resulting in the data loss incident not being reported to the UK business for twelve months); and there was a lack of clarity over who had responsibility for providing assurance to management that data security issues were being appropriately identified and managed.

- In July 2009, the FSA imposed fines totalling over £3 million in connection with breaches of Principle 3 due to inadequate systems and controls to protect confidential customer data from being lost or stolen. In particular, the FSA found that the relevant firms had variously failed to put in place adequate and effective procedures, guidance and resources to ensure that, among other things, customer data sent to third parties on portable electronic media was secure in the event that it was lost or intercepted, customer data that was sent to third parties in hard copy form was sent securely, customer data kept in their offices was at all times secure from the risk of internal fraud or theft and an appropriate due diligence process was followed prior to contracting services to third parties such as waste disposal firms.

Further, the FCA has issued a number of fines against firms for systems and controls failures relating to a range of other issues, including outsourcing and financial crime, which could equally apply in circumstances involving a cyber security breach. In the context of cyber risk, this consideration will be particularly relevant for firms storing data through third party 'cloud' service providers.

Since the calculation of a fine may be based on the revenue derived by the firm during the period of the breach from the relevant business areas, there is clearly potential for significant sums to be levied. Fines can also be imposed or increased in respect of any notification failure including where information provided to the regulator regarding processes in place is found later to be inaccurate.

Senior management

Cyber-crime also poses a potential regulatory risk for senior management. As set out above, both the FCA and PRA have stressed the importance of understanding and effective challenge at Board and senior management level in relation to cyber risk. Any individuals holding relevant responsibilities under either the approved persons or the senior managers and certification regimes may face scrutiny in the event of a cyber-attack in terms of potential breaches of the Code of Conduct or Statements of Principle and Code of Practice for Approved Persons.

Protective measures

In light of the potential exposures described above, firms may wish to consider carrying out a review of

- IT systems and controls, to establish whether they provide sufficient protection against and adequate detection of cyber-attacks. The FCA has also suggested that firms should consider regular testing of their IT systems and controls to determine how they would function in a cyber-attack, and the Bank of England has noted that assurance control sampling is often not sufficient in this area.

- Business continuity arrangements and plans, to ensure that they deal with the eventuality of a cyber-attack and will enable the firm to recover from such an attack.
- Existing governance arrangements, to check that the risk of cyber-crime is adequately dealt with and reported on, for example in risk committees.
- Existing training for staff, to ensure that they are informed of cyber risks, such as phishing emails, and how to recognise potential attacks.
- Allocations of responsibility among Senior Managers, to establish who has or should have responsibility for cyber risk and ensure that they are fully informed and receive relevant Management Information.
- Existing insurance arrangements, to establish whether these policies adequately cover cyber risk and the extent to which the firm may require separate specialist cover.

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