ThoughtLeaders4 Disputes • September 2022

Disputes MAGAZINE

ISSUE 6

FINANCIAL INSTITUTIONS LITIGATION

INTRODUCTION

"Exploration is the engine that drives innovation. Innovation drives economic growth. So let's all go exploring."

- Edith Widder

We are delighted to present Issue 6 of Disputes Magazine, which discusses Financial Institutions Litigation ahead of the **Financial Institutions Litigation Conference** on **19th January 2023**. In this edition, our authors cover a variety of topics affecting the financial services sector including the recent Tecnimont v Natwest decision, the new FCA consumer duty, audit reform and more.

Thank you to our community partners, members and authors for their continued support. The Disputes community is loaded with events for the rest of 2022 and into 2023, and we hope to see you there.

The ThoughtLeaders4 Disputes Team

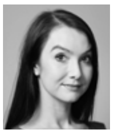
Paul Barford
Founder / Director
020 7101 4155
email Paul

Chris Leese
Founder / Director
020 7101 4151
email Chris

Danushka De Alwis
Founder / Director
020 7101 4191
email Danushka

Maddi Briggs
Strategic Partnership Manager
email Maddi

Chloe Gibbs
Commercial Director
07983 505 171
email: Chloe



Dr Jennifer White
Head of Production
07733 854 996
email: Jennifer

Yanis Lau
Conference Producer
07525 450 694
email: Yanis

Fatema Rasul
Conference Producer
07701 307284
email: Fatema

CONTRIBUTORS

Dan Smith, **Stephenson Harwood**
Nick Ractliff, **PCB Byrne**
Andrew McLeod, **PCB Byrne**
Michael Canale, **BRG**
John DelPonti, **BRG**
Laura Gudaitus, **BRG**
Emily Ness, **BRG**
Mikhail Vishnyakov, **Cooke, Young & Keidan**
Yajur Mittal, **Cooke, Young & Keidan**
Andrew Williams, **HFW**
Gordon Rieck, **HFW**
Fiona Simpson, **Kingsley Napley**
Mike Hawthorne, **Pinsent Masons**
Elena Rey, **Brown Rudnick**
Tristan Dollie, **Brown Rudnick**
Sue Millar, **Stephenson Harwood**
Sophia Mahal, **Stephenson Harwood**
Rebecca Garrick, **Stephenson Harwood**
Harriet Campbell, **Stephenson Harwood**
Kit Smith, **Keidan Harrison**
Jon Felce, **Cooke, Young & Keidan**
David Pickstone, **Stewarts**
James Le Gallais, **Stewarts**
Alex Lerner, **Stewarts**
Grace Spurgeon, **Stewarts**
Mubin Shah, **Joseph Lopez**
Kyle Yew, **Joseph Lopez**
Rachael Cederwall, **Baker McKenzie**
Gabriel Tsui, **PwC Hong Kong**
Vivian Leu, **PwC Hong Kong**
Darren Kidd, **Stewarts**

CONTENTS

60-SECONDS WITH:

DAN SMITH
PARTNER
STEPHENSON HARWOOD

Q What do you like most about your job?

A The ability to connect people to the right ideas. We're fundamentally a communication service aimed at a social good: advising and guiding clients, inspiring colleagues, persuading other parties, convincing judges. In many situations there's only one person you need to influence and, once you realise who it is, what you want to say, and how you need to go about it, it's immensely satisfying whenever you know you've absolutely landed something

Q What would you be doing if you weren't in this profession?

A The prosaic answer would be most likely someone in the white collar services sector, but in an alternate reality I'm convinced there's a version of me who's either a comedian or a very bad drummer – probably both.

Q What's the strangest, most exciting thing you have done in your career?

A The strangest was attending a three hour Saudi Arabian wedding celebration; the most exciting (and you have to understand I'm speaking subjectively here) was shadowing Court of Appeal judges when I was a judicial assistant, and listening in on them discussing cases, litigants and their advocates just before going into court.

Q What is one of your greatest work-related achievements?

A Thanks to our good friends confidentiality and privilege, there are many I'm simply not permitted to talk about. However, I once managed to successfully defend a case at trial on the merits, despite the judge having previously struck out my client's defence.

Q If you could give one piece of advice to aspiring practitioners in your field, what would it be?

A Respect your gut instinct in complex and uncertain decisions: it often knows far more than you will ever be able to analyse out.

Q What do you see as the most significant trend in your practice in a year's time?

A Unfortunately, I think we'll see a lot more disputes over assets, and insolvencies, as we head towards a national and global recession. In terms of the operation of litigation, I hope we continue to see a willingness in judges to encourage litigants and their lawyers to discuss and resolve procedural disputes sensibly.

Q What personality trait do you most attribute to your success?

A Persistence in doing what you think is the right course of action. Far more often than not, it's better in the long run than any alternative.

Q Who has been your biggest role model in the industry?

A No single person. There are a number of lawyers I've worked with over the years who I've tried to emulate with various degrees of success, but I won't embarrass myself or them by naming them. In the fictional world: Jed Barlett from The West Wing, especially that bit where he puts his hands in his pockets in the second season finale.

Q What is something you think everyone should do at least once in their lives?

A Enjoy a tasting menu at the best restaurant you can find, regardless of expense. Especially if it's a rare treat, it will be worth it.

Q You've been granted a one-way ticket to another country of your choice. Where are you going?

A Assuming I can magically become bilingual: Japan.

Q What is a book you think everyone should read and why?

A The Graveyard Book, by Neil Gaiman. It's a masterclass in storytelling, and is hands down the best book I have ever had the pleasure of reading to my kids.

Q If you had to sing karaoke right now, which song would you pick?

A My singing voice is renowned for scaring away wildlife, but if I had to choose: "My Shot", from Hamilton.

Disputes

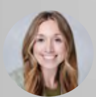
Upcoming Events

Event	Date
Group Litigation and Class Actions	19-20 Oct 2022
Corporate Disputes	21-22 Nov 2022
Financial Institutions Litigation	19 Jan 2023
Sovereign & States Disputes and Enforcement	24-25 Jan 2023
ESG Litigation	7 Feb 2023
India Dispute Resolution Forum - London	7-8 Jun 2023

For events enquiries contact:

Yanis Lau, Conference Producer
e: yanis@thoughleaders4.com
m: +44 (0) 7525 450694

For partnerships enquiries contact:



Chloe Gibbs, Commercial Director
e: chloe.gibbs@thoughtleaders4.com
m: +44 (0) 7983 505171

STEPHENSON HARWOOD

Corporate and commercial disputes

Stephenson Harwood's highly regarded corporate and commercial disputes team advises on the full range of disputes. We represent clients in High Court litigation, international and domestic arbitration, and advise and assist clients on ADR, including mediation. Most of what we do is truly international and often multi-jurisdictional; we manage complex proceedings in other jurisdictions and co-ordinate proceedings in more than one jurisdiction. The team is renowned for its depth and ability to handle a broad range of disputes but has particular expertise in banking and financial services litigation and regulation, competition litigation, fund litigation, shareholder disputes and corporate litigation, professional and management liability and sanctions litigation.

Sue Millar

Partner

T: + 44 20 7809 2329
M: + 44 7825 625 898
E: sue.millar@shlegal.com

TECNIMONT V NATWEST

UNJUST ENRICHMENT IN THE CONTEXT OF AUTHORISED PUSH PAYMENT FRAUDS

Authored by: Nick Ractliff and Andrew McLeod - PCB Byrne

Introduction

In Tecnimont Arabia Ltd v National Westminster Bank Plc,[1] the High Court considered the application of the principles of unjust enrichment to a payment passing through the international banking system in the context of an authorised push payment fraud. That system does not usually involve funds actually being transferred between the banks, but instead involve banks communicating using SWIFT messaging services to effect the payment by way of adjusting balances between them. This mechanism is commonplace and a crucial part of the international banking and finance systems.

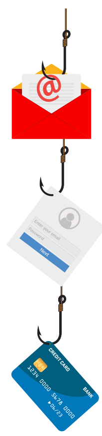
The particular transfer in Tecnimont involved the recipient bank receiving funds from the claimant via an intermediary bank. In his judgment, Mr Justice Bird found that this could not be considered to found an unjust enrichment claim against the recipient bank, on the basis that the nature of the transaction meant it could not have been enriched “at the expense of” the sender. The case demonstrates the difficulty of cases where a claimant has not directly conferred the benefit on or dealt with property, and has potentially wide-reaching application across other types of banking transaction.

Background

The claimant was Tecnimont Arabia Limited (“Tecnimont”), a company operating in Saudi Arabia and part of a multi-national Italian corporation. In 2018, as a result of deception on the part of a fraudster(s) (who had compromised the business email of one of Tecnimont’s suppliers), Tecnimont instructed its bank to pay US$5 million to an account held at the National Westminster Bank (“NatWest”). The funds had been transferred using the standard mechanism for an international foreign currency transfer, with an adjustment of balances between the victim’s bank (Saudi British Bank, “SAAB”), an intermediary bank (Citibank in the US), and the recipient’s bank (NatWest). Naturally, the NatWest account was controlled by the fraudster(s); and, naturally, essentially all of the funds were dissipated over the following two days to various overseas accounts.

The story above is one familiar to those who have acted for a client or even themselves fallen victim to such a fraud. Commonly known as authorised push payment fraud, they are simple scams that usually rely on some kind of apparently legitimate email communication from an email that has been compromised (accessed by the fraudster(s)) or simply bears a close resemblance to one. In such situations, funds are often withdrawn quickly, and the victim is left with limited recourse for recovery.

Ultimately, Tecnimont was able to recover $650,000 of the funds lost. It brought proceedings against NatWest for unjust enrichment and knowing receipt for the remainder. The knowing receipt claim was “not actively pursued”[2]. The Court was therefore left to consider the unjust enrichment claim.



The key sections of the judgment on unjust enrichment

The basic requirements of a claim in restitution are well established. A claimant must show that (1) the

1 Tecnimont Arabia Ltd v National Westminster Bank Plc [2022] EWHC 1172 (Comm).
2 Ibid. at [3].

defendant has been enriched, (2) at the claimant's expense, and (3) the enrichment was unjust. If these factors can be made out, and the defendant cannot rely on any defences, the claim will succeed.

The "real battleground"[3] was the second requirement: whether NatWest had been enriched "at the expense of" Tecnimont. This turns on whether there has been a "transfer of value" i.e. that the defendant has received a benefit from the claimant and the claimant has suffered a loss or detriment through their provision of that benefit.[4] Where the claimant directly confers a benefit on the defendant, this requirement is simple (at least in principle). However, in this case the transfer from SAAB to NatWest had been made via Citibank, i.e. indirectly. Where a claimant does not deal directly with a defendant, this raises a question as to whether an enrichment had been "at the expense of" the claimant.

Mr Justice Bird's decision was that any enrichment by NatWest had not been at Tecnimont's expense. His conclusion placed great emphasis on the Supreme Court's "watershed"[5] judgment in HMRC v The Investment Trust Companies[6] ("ITC"), which dealt with a claim brought against HMRC by claimants who had overpaid VAT on invoices issued by their agents, and claimed HMRC had been unjustly enriched as a consequence. Mr Justice Bird saw the Supreme Court in ITC as having identified "an important difference between 'economic reality' (which is an impermissible yardstick) and what might be described as 'transactional reality'":[7]

- "Economic reality" comes from the Supreme Court's view was that cases had conceived of the connection between the parties' respective benefit and loss "merely as a matter of economic or commercial reality",[8] which was "too vague to provide certainty",[9] rather than being "determined by rules of law which are ascertainable and consistently applied".[10]

- "Transactional reality" was a term adopted by Mr Justice Bird to encapsulate the Supreme Court's position on co-ordinated transactions—i.e. situations where a sequence of events "should be seen as a single scheme or transaction, on the basis that to answer the question by considering each of the individual transactions separately would be unrealistic",[11] satisfying the requirement for a transfer of value, whilst (technically) there has been no direct provision of a benefit by the claimant to the defendant.

Mr Justice Bird's judgment placed these two concepts as contrasting forces: "In dealing with the "realistic" treatment of the transactions, I remind myself that I must consider "transactional reality" and not the "economic reality" of a transaction".[12] He set out factors derived from ITC, as well as other cases, which he considered to be relevant when considering if a set of co-ordinated transactions should be treated as a direct transfer of value.

In particular, Mr Justice Bird stated that "[t]he analysis must focus on the transactions and not the effect of the transaction. This reflects the need to avoid considering the "economic reality" of the transaction" (emphasis added).[13]

Other relevant factors were the substance of the transaction (rather than its form), the nature of the transactions, and the number of parties providing (in this case) funds.[14]

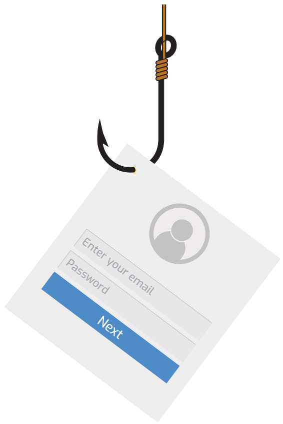
Having applied those factors, (in his eyes),

"it is clear that it would be wrong to treat the international inter-bank transactions in the present case as forming a single scheme or transaction. On analysis it is necessary (and realistic) to treat individual transactions separately. It is only by taking a broad (and impermissible) view of "economic reality" that it could be said that the present case should be treated as a direct transaction case…"[15]

The outcome of the judgment and its potential reach

The judgment suggests its reach is limited to "international bank transfers of the type which are present here",[16] i.e. those involving "the adjustment of balances" between two pairs of banks (in this case: SABB and Citibank; and Citibank and NatWest). The interbank accounts are settled in the normal course of business by a running account and it is usually unnecessary for either bank to transfer funds to the other.[17]

3 Ibid. at [103].
4 HMRC v The Investment Trust Companies [2017] UKSC 29, [2017] 2 WLR 1200 at [43].
5 Tecnimont Arabia Ltd v National Westminster Bank Plc [2022] EWHC 1172 (Comm) at [108].
6 HMRC v The Investment Trust Companies [2017] UKSC 29, [2017] 2 WLR 1200.
7 Tecnimont Arabia Ltd v National Westminster Bank Plc [2022] EWHC 1172 (Comm) at [115].
8 HMRC v The Investment Trust Companies [2017] UKSC 29, [2017] 2 WLR 1200 at [59].
9 Ibid. at [37].
10 Ibid. at [39].
11 Ibid. at [61].
12 Tecnimont Arabia Ltd v National Westminster Bank Plc [2022] EWHC 1172 (Comm) at [129].
13 Ibid. at [130.a]
14 Ibid. at [130].
15 Ibid. at [139], [140].
16 Ibid. at [147].
17 Ibid. at [132].



However, Mr Justice Bird's reasoning has potentially a broader effect:

- First, it would appear to apply directly to any interbank transfer through a common correspondent bank, whether through a bilateral arrangement or through a clearing house (such as CHAPS).

- In much the same way, it could be said apply to a transfer from Bank A to Bank B that are made through the books of a central bank in a real-time gross settlement system, such as that adopted by banks in the United Kingdom.

- Nor would it appear that the international nature of the transaction (which was not identified in the judgment as a relevant factor) is significant, given the mechanisms of credit transfers are basically the same for international transfers as for domestic ones.[18]

The reasoning would not appear to apply to situations where:

- Funds are transferred "in-house" (i.e. both debtor and creditor are with the same bank), though this would appear to fall squarely within the exception for transactions involving agents.

- A bank transfers funds pursuant to a payment order from another bank (without any common correspondent bank), without relying on any offsetting of balance between the two banks—an occurrence which the judgment itself notes is not "usually necessary".[19]

The position is less clear where the two banks are correspondents of each other. The situation is in practical terms much the same, with the banks maintaining corresponding nostro/vostro accounts with adjustments of balances meaning that it is usually unnecessary for either bank to transfer funds to the other.[20] Whilst the judgment appears to equate this with a direct transfer between the customers,[21] this must surely be an error, since any dealing is indirect in nature, occurring between the customers' banks as their respective agents. Presumably, in such a case, the agency exception might be applicable in the alternative.

For victims of authorised push payment frauds, the consequences of the case are that a claim in unjust enrichment against the recipient bank is unlikely to be available as a form of relief when monies are transferred via an intermediary bank. However, such a claim may still be available where payments are made pursuant to a payment order, or directly between banks with a correspondent relationship. From a practical perspective, the judgment is unlikely to discourage victims from taking quick and effective steps to investigate the path of their funds and to locate the ultimate recipient, which remains the best hope of recovering funds—nor, regrettably, is it likely to discourage the occurrence of this type of fraud.

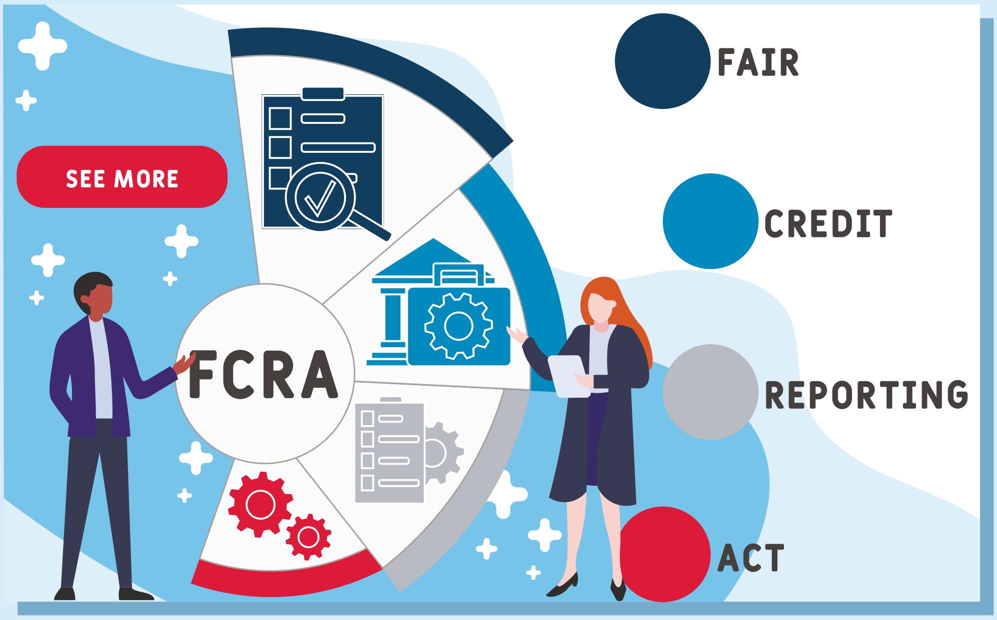
18 Goode and McKendrick Commercial Law: 6th Edition at [18.25].

19 Tecnimont Arabia Ltd v National Westminster Bank Plc [2022] EWHC 1172 (Comm) at [17].

20 Goode and McKendrick Commercial Law: 6th Edition at [18.26], as is quoted in Tecnimont at [17].

21 Tecnimont Arabia Ltd v National Westminster Bank Plc [2022] EWHC 1172 (Comm) at [128]. Having said at [126] that "it is necessary to consider if the claimant and the defendant had direct dealings"), in an apparent application of this requirement, the judgment states "In the present case there is clearly no direct transfer between SABB and the Bank…." (emphasis added).

REINTRODUCTION TO THE FCRA



Authored by: Michael Canale, John DelPonti, Laura Gudaitus and Emily Ness - BRG

Introduction to FCRA

Enacted in 1970, the Fair Credit Reporting Act (FCRA) ensures the accuracy, integrity, fairness, and privacy of information in consumer credit bureaus. The Federal Trade Commission (FTC) and Consumer Financial Protection Bureau (CFPB) enforce the FCRA, which regulates obtaining and using consumer reports, sharing information among affiliates, disclosures to consumers, consumer alerts and ID theft, and—most important—the duties of furnishers and users of consumer reports.

The FCRA defines a consumer report as any written or oral communication that was prepared by a consumer reporting agency (CRA); contains information on creditworthiness, standing, capacity, character, or reputation; and is used for eligibility for credit, insurance, or employment. The three major CRAs are Equifax, Experian, and TransUnion. In addition, nationwide specialty CRAs maintain and compile files relating to medical records or payments, residential or tenant history, check-writing history, employment history, and insurance claims.

Under FCRA rules, furnishers must submit information with both accuracy and integrity, as defined under the Fair and Accurate Credit Transactions (FACT) Act. The FCRA also requires that a furnisher's policies and procedures be appropriate to the nature, size, complexity, and scope of the furnisher's activities. This includes establishing and implementing appropriate internal controls regarding the accuracy and integrity of information about consumers furnished to CRAs, such as implementing standard procedures and verifying random samples of information provided to CRAs.

Why is the FCRA important?

The FCRA protects the rights of borrowers in how their credit reports are being used and for how long derogatory or negative information may stay on one's credit report. It ensures both lenders and furnishers are reporting information to the bureaus with accuracy and integrity to avoid misreporting or misrepresenting delinquency information on consumers' credit reports. The requirements to have policies, procedures, and controls aim to prevent inaccurate reporting.

The FCRA also gives consumers the power to review their credit reports and the right to dispute inaccurate information, either with the CRAs or directly with furnishers. Consumers are ensured a timely response and updates, if required.

A 2012 FTC study found that 20 percent of consumers had an error in at least one of their credit reports, with 5 percent reporting errors that were economically damaging.[1] A follow-up study in 2015 confirmed that 70 percent of the consumers surveyed in 2012 continued to dispute errors in their reports.[2]

Inaccurate reporting on a credit report may impact a borrower's credit score, affecting their ability to receive a loan, employment, insurance, or housing. An error on a credit report may follow a consumer for years, forcing them to pay more for credit or causing them to be denied loans, jobs, or housing due to inaccurate reporting.

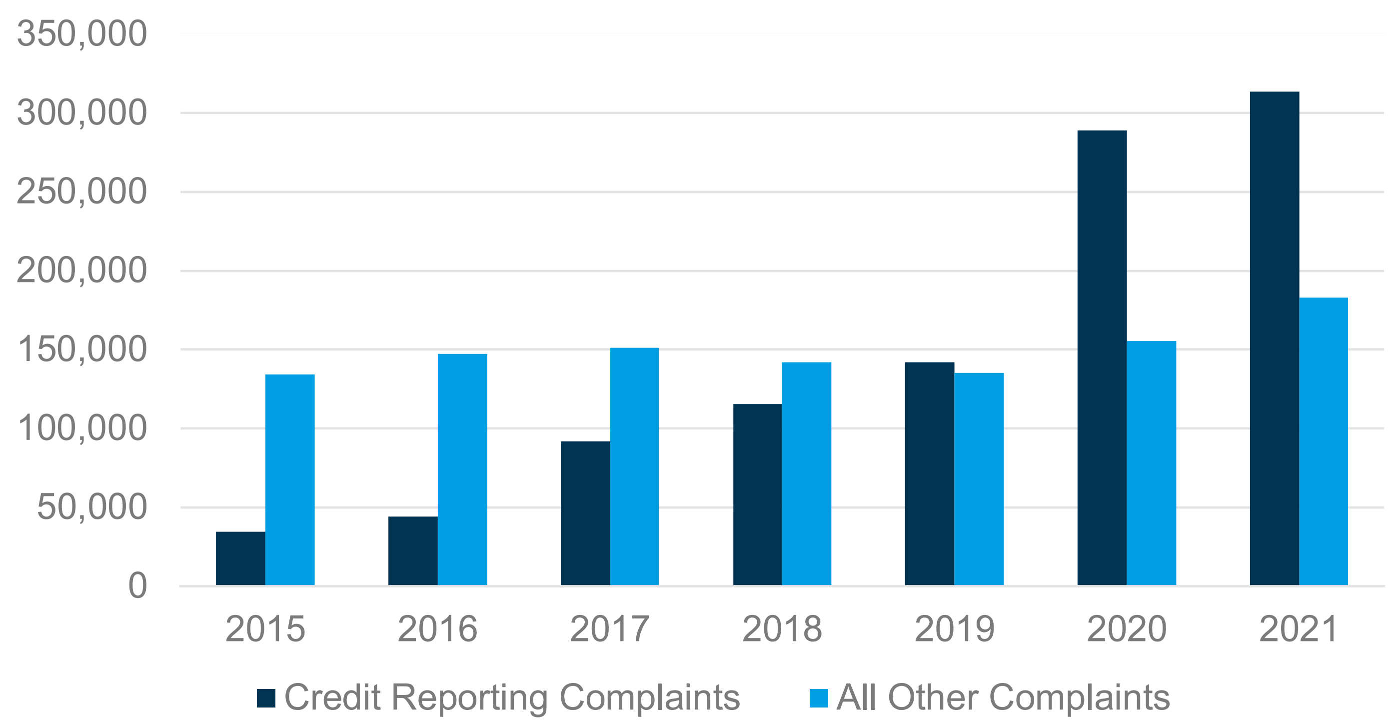
Credit reporting complaints to the CFPB have increased 815 percent since 2015 and are one of the top issues submitted to the CFPB, constituting over 60 percent of all CFPB complaints[3].

1 FTC, Report to Congress under Section 319 of the Fair and Accurate Credit Transactions Act of 2003 (December 2012). https://www.ftc.gov/sites/default/files/documents/reports/section-319-fair-and-accurate-credit-transactions-act-2003-fifth-interim-federal-trade-commission/130211factareport.pdf

2 FTC, Report to Congress Under Section 319 of the Fair and Accurate Credit Transactions Act of 2003 (January 2015) https://www.ftc.gov/system/files/documents/reports/section-319-fair-accurate-credit-transactions-act-2003-sixth-interim-final-report-federal-trade/150121factareport.pdf

3 BRG analysis of data pulled from the CFPB's Consumer Complaint Database on February 6, 2022. https://www.consumerfinance.gov/data-research/consumer-complaints/#download-the-data

Figure 1. **CFPB Credit Reporting Complaint Volume Compared to All Other CFPB Complaints[4]**



Given these trends, regulatory and legislative scrutiny will continue to focus on credit reporting and FCRA compliance. Financial institutions will need to find creative solutions to improve the accuracy and efficiency of furnishing and disputes processes, while containing costs in a challenging labor market.

Letter from senators to the CFPB

In November 2021, seven Senate Democrats—Senate Banking, Housing, and Urban Affairs Committee Chairman Sherrod Brown (D-OH) and Senators Brian Schatz (D-HI), Ron Wyden (D-OR), Elizabeth Warren (D-MA), Jack Reed (D-RI), Chris Van Hollen (D-MD), and Ben Ray Luján (D-NM)—sent a letter to CFPB Director Rohit Chopra urging him to take strong action to reform the credit reporting industry.[5]

The senators detailed six key actions for the CFPB to consider:

1. Evaluate persistent errors in credit reporting and how CRAs consistently fail to resolve these errors, especially by failing to devote sufficient personnel and resources for dispute resolution.
2. Create an ombudsperson position at the CFPB to facilitate the dispute resolution process and help ensure accuracy.
3. Require nationwide CRAs to match all nine digits of a consumer's Social Security number versus the current practice of using partial Social Security numbers to match data from an information furnisher to a consumer's file.
4. Require nationwide CRAs to perform periodic accuracy audits on information furnishers.
5. Potentially codify provisions of the nationwide CRAs' settlement with state attorneys general that delayed reporting of medical debt for six months and removed debts paid by insurance.
6. Require CRAs to address concerns relating to algorithmic bias, which presents a risk of amplifying racial disparities, and failure to provide reports in Spanish and other languages to consumers with limited English proficiency.

The issues highlighted by the senators mirror the 2021 complaints received by the CFPB (see table 1). In 2021, 35 percent of credit reporting complaints indicated that the information belonged to a different consumer. The top five issues account for 74 percent of all 2021 credit reporting complaints.

4 Ibid.

5 US Senate Committee on Banking, Housing, and Urban Affairs, "Schatz, Brown, Senators To CFPB: Fix The Broken Credit Reporting System, Hold Credit Reporting Agencies Accountable" (November 10, 2021). https://www.banking.senate.gov/newsroom/majority/schatz-brown-senators-to-cfpb-fix-the-broken-credit-reporting-system-hold-credit-reporting-agencies-accountable

Table 1. 2021 Top 5 CFPB Credit Reporting Complaint Issues[6]

Rank	Issue	Senate Issue #	Sub-issue	2021 Credit Reporting Complaints	2021 Credit Reporting Complaints %
1	Incorrect information on your report	3	Information belongs to someone else	110,384	35%
2	Problem with a credit reporting company's investigation into an existing problem	1,2	Their investigation did not fix an error on your report	44,507	14%
3	Problem with a credit reporting company's investigation into an existing problem	2	Investigation took more than 30 days	29,932	10%
4	Problem with a credit reporting company's investigation into an existing problem	2	Was not notified of investigation status or results	29,573	9%
5	Improper use of your report	N/A	Credit inquiries on your report that you don't recognize	18,076	6%
		N/A	*All Other Sub-issues*	*81,073*	26%
			Total Credit Reporting Issues	**313,545**	**100%**

As consumers continue to submit high volumes of complaints related to their credit reporting, institutions should expect to see significant scrutiny from regulators and legislative bodies around FCRA enforcement.

FCRA Litigation: Current State

For the FCRA, successful plaintiffs may recover actual damages, statutory damages between $100 and $1,000 per violation, attorney's fees and costs, and punitive damages, depending on whether the violation was intentional or negligent. FCRA litigation has seen a considerable increase in the past fifteen years, more than doubling between 2009 and 2018. In 2021, 4,910 consumer protection cases alleging FCRA violations were filed.[6] The stakes can be high for consumer protection cases (of which FCRA cases are a subset); the average damages award for cases closed in 2021 was $8.9 million.[7]

Conclusion

The FCRA continues to be a hot topic for financial institutions, consumers, regulators, and even legislators. Given the renewed focus of the CFPB under the Biden administration, and recent legislative focus on the accuracy of credit reporting data, financial institutions should prepare for renewed focus on their compliance with the FCRA. Combined with pressure to contain costs, financial institutions need solutions to improve furnishing and dispute accuracy, expand quality assurance testing, and monitor performance in ways that reduce compliance program costs.

BRG's FCRA experts can help financial institutions get exam ready. Our team has extensive advisory expertise in creating and implementing FCRA program operating models to increase operational maturity. Our tech experts provide solutions that reduce manual effort, increase monitoring, and ultimately help institutions do more with less.

6 LexMachina, "Federal Court – Consumer Protection Cases – with Consumer Protection: Fair Credit Reporting Act case tag; filed between 2021-01-01 and 2021-12-31; pending between 2009-01-01 and 2022-08-09," LexisNexis. Accessed August 18, 2022

7 LexMachina, "Federal Court – Consumer Protection Cases - pending between 2009-01-01 and 2022-08-09; with damages awarded between 2021-01-01 and 2021-12-31," LexisNexis. Accessed August 18, 2022.

ARBITRATION AND FINANCIAL INSTITUTIONS

Authored by: Mikhail Vishnyakov and Yajur Mittal - Cooke, Young & Keidan

In 2016, the ICC Commission on Arbitration and ADR published its seminal report on "Financial Institutions and International Arbitration" (the "ICC Report").

The ICC Report found an "overall lack of awareness" of the benefits of arbitration among financial institutions.

Additionally, it found a "marked reticence" to use arbitration in international financing transactions, where "the outwardly straightforward nature" of the claim against defaulting debtors meant that it made little sense to arbitrate. As put by one institution: "you borrowed the money and you didn't pay it back"[1].

Courts in England and in the US (particularly popular for financial disputes), among other jurisdictions, permit summary determination (i.e., determination without a full trial) of "straightforward" claims. In the years after the ICC Report, the rules of major arbitral institutions have been amended, expressly adding summary determination mechanisms.

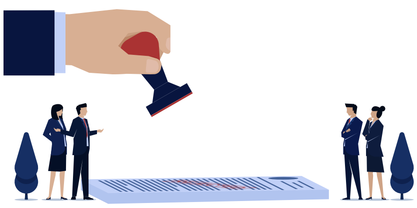
Given the findings of the ICC Report and the subsequent changes to the arbitral rules, this article outlines the benefits of international arbitration and considers whether the changes to the rules are sufficient to convert the reticent.

Benefits of arbitration

The benefits of international arbitration may include:

- Ease of enforcement of arbitral awards – this is often stated to be the key reason why parties choose arbitration for resolving cross-border disputes.
- Neutrality – courts are perceived to be unreliable in certain jurisdictions.
- Technical expertise – the dispute may be resolved by sector-specific experts.
- Finality – there are limited grounds for appealing an arbitral award.

Another advantage is confidentiality, albeit financial institutions do not always consider this to be an advantage, because it leads to reduced predictability (tribunals may reach different outcomes on similar issues) and absence of precedent (which may be helpful when determining the interpretation of standardised documents).



Arbitration in "simple debt claims"

Even in the so-called "simple debt claim" scenario, financial institutions may nonetheless opt for arbitration for reasons such as: (i) unreliability of the relevant local courts; (ii) the borrower's assets are in a jurisdiction where it might be easier to enforce an award; and/or (iii) if a (typically, state-owned) borrower refuses to submit to the jurisdiction of a foreign court.

1 Supplementary Materials to the ICC Report, pages 82 and 93

Changes to arbitral rules

The changes to the arbitral rules since the ICC Report, and the thresholds imposed for summary determination, include:

- SCC Rules 2017: "an allegation of fact or law material to the outcome of the case is manifestly unsustainable" (Article 39(2)(i)).
- HKIAC Rules (2018): "manifestly without merit" (Article 43.1).
- ICC Rules: "claims or defences are manifestly devoid of merit" (the ICC Rules were not amended but the ICC confirmed this mechanism in its Notes to Parties of 1 January 2019 and 1 January 2021).
- LCIA Rules (2020): "inadmissible or manifestly without merit" (Article 22.1(viii)).
- PRIME Finance (2022): "manifestly without legal merit" (Article 35(1)(c)).

The precise procedure to be adopted for such determination is left to the tribunal's discretion, with some rules imposing deadlines by which the determination must be made (for example, the HKIAC Rules (2018) provide that the determination shall be made within 60 days from the tribunal's decision to grant the request for summary determination).

Impact of the changes

Given that the changes are relatively recent, their impact is difficult to assess. That said, the HKIAC statistics appear to be encouraging. In 2017 (i.e., prior to the amendment), only 6.2% of its cases were in the "banking and financial" sector, rising to 16.2% in 2021. On the other hand, LCIA has seen a decline in cases in the "banking and finance" sector; 26% in 2021, down from 32% in 2019; similarly, the SCC statistics do not evidence an upward trend: in 2016, 11 arbitrations (out of 199 new arbitrations) were commenced under credit/loan agreements, falling to 7 out of 165 in 2021. No statistics are available since the changes to the PRIME Finance rules earlier this year, and the ICC statistics do not appear to provide a sector-by-sector breakdown.

Therefore, it remains inconclusive whether the addition of the summary resolution claims mechanism serves to resolve the perceived unsuitability of arbitration for finance transactions. Additionally, a meaningful analysis would need to consider similar statistics in litigation.

As things stand, it is difficult to confirm whether arbitration has gained any ground over litigation in banking and finance cases at all in recent years.

The importance of a transaction-by-transaction analysis

The ICC Report confirms that because financial institutions are involved in a broad range of transactions, a "one size fits all" approach is unsuitable. Accordingly, the benefits of arbitration need to be weighed against its potential disadvantages, such as:

- Inability to obtain judgments (awards) in default: typically, courts have the power to enter judgment against a non-appearing defendant automatically. In arbitration, the UNCITRAL Model Law on International Commercial Arbitration, on which the arbitration laws of many jurisdictions are based, requires the arbitration to continue in the absence of the respondent (Article 25(b)).
- Enforcement of security: as the ICC Report explains: "an arbitral tribunal cannot replace a court with respect to enforcement matters that are exclusively attributed to that court by the relevant statutes" (paragraph 65). Accordingly, the enforcement of some types of security requires the involvement of a national court.
- Interim remedies: arbitral tribunals are unable to grant orders against third parties, given the consensual nature of arbitration. Similarly, obtaining ex parte relief (i.e., relief sought without notice to the other party in circumstances where such notice may defeat the purpose of the relief sought) is likely to be challenging.

Therefore, although the evolution of arbitral rules may make arbitration a more suitable option in a broader range of transactions, that is unlikely to displace the need for a transaction-by-transaction analysis.

Conclusion: keep your options under review

Financial transactions tend to draw on precedent documentation and market practice. Accordingly, the choice between litigation and arbitration may not always be the product of considered analysis. However, the changes to the arbitral rules of major institutions, combined with the existing advantages of arbitration, merit further scrutiny of the dispute resolution mechanism selected by financial institutions.

COOKE, YOUNG & KEIDAN

COMMERCIAL DISPUTES LAWYERS

"More of a powerhouse than a boutique these days" (Legal 500)

CYK's team of tenacious, innovative and personable lawyers is delighted to support TL4

Jon Felce
PARTNER

Founding Committee Member,
FIREStarters nextgen community

Mob: +44 (0)7769 316 592
Email: jon.felce@cyklaw.com

CV here

Natalie Todd
PARTNER

Founding Committee Member,
Disputes nextgen community

Mob: +44 (0)7879 018 014
Email: natalie.todd@cyklaw.com

CV here

THE QUINCECARE DUTY

WHAT HAS CHANGED IN THE 30 YEARS SINCE ITS FORMULATION AND WHAT ARE THE IMPLICATIONS FOR BANKS AND VICTIMS OF FRAUD?

Authored by: Andrew Williams and Gordon Rieck - HFW

Mr Justice Steyn (as he was then) first formulated the Quincecare Duty in his 1992 judgment[1] following a hearing in 1988. In summary, the Quincecare Duty imposes a fiduciary duty on a bank to observe reasonable skill and care when executing its customers' instructions.

Until the interaction between banks and their customers became digitalised and thereby increasingly vulnerable to attacks by fraudsters, the relevance of the Quincecare Duty was generally under-appreciated and the scope of the Quincecare Duty remained untested with it taking until 2017 for another judgment to consider and apply the Quincecare Duty. Since then, the Quincecare Duty has been considered in a further eighteen cases with five this year alone.

Notwithstanding the recent focus on the Quincecare Duty its core tenets have remained largely unchanged since 1992.

If nothing else, the repeated failure to expand the scope of the Quincecare Duty is significant for victims of fraud.

Developments in the law

Since 2017, an increasing number of claimants have asked the courts to consider, apply and on occasion, extend the scope of the Quincecare Duty.

- The first of those cases was Singularis[2] in which the High Court found that the bank had acted in breach of its duty as it had given effect to payment instructions when any reasonable banker would have realised that a fraud was being perpetrated. The Singularis case was also the first example of damages being awarded for a breach of the Quincecare Duty.
- In 2019 the Court of Appeal considered in JP Morgan Chase v The FRN[3] whether it was possible for a bank to exclude the effect of the Quincecare Duty. Whilst it was found that the bank had not excluded the effect of the Quincecare Duty, the court held that it was possible to exclude the Quincecare Duty from a bank / customer relationship if the exclusion was clearly worded.

1 Barclays Bank plc v Quincecare Ltd [1992] 4 All ER 363
2 Singularis Holdings Ltd (in liquidation) (a company incorporated in the Cayman Islands) v Daiwa Capital Markets Europe Ltd [2017] EWHC 257 (Ch)
3 JP Morgan Chase Bank N.A. v The Federal Republic of Nigeria [2019] EWCA Civ 1641

- In 2021 the Commercial Court was asked to determine whether the bank was obliged to protect its customer from an authorised push payment fraud[4]. It was held that the bank's primary duty was to act on its customer's instructions and that the bank would not be acting in breach of the Quincecare Duty when the relevant payment instructions were properly authorised.
- However, the matter was re-considered by the Court of Appeal, which in March 2022 determined that the Quincecare Duty arose and stood to be satisfied whenever a bank was put on inquiry and that a number of factors would be taken into account when deciding whether a bank was on inquiry[5].
- In May 2022, when asked to extend the scope of the protection afforded by the Quincecare Duty to non-customers in RBS v JP SPC,[6] the Privy Council definitively excluded non-customers from the scope of the Quincecare Duty.
- The clarity provided in RBS v JP SPC meant that those unable to seek recourse against their own banks / a recipient bank by reference to the Quincecare Duty had to seek other causes of action. In Tecnimont[7] the customer's bank had not been put on inquiry as to the existence of the fraud and the victim was not a customer of the recipient bank; thereby negating a breach of Quincecare Duty argument in respect of both banks. Accordingly, the victim brought a claim for restitution of misappropriated monies against NatWest (being the recipient bank). Whilst this case did not result in the development of the Quincecare Duty, it did provide an insight into the difficulties faced by victims of fraud if they cannot seek recourse against their own banks by reference to the Quincecare Duty and offered a possible alternative.
- With the Court of Appeal having, in the context of a summary judgment application made by JP Morgan Chase, considered the ability of the bank to exclude the applicability of the Quincecare Duty in JP Morgan Chase v The FRN, the Commercial Court was subsequently asked to consider the underlying factual matrix and determine whether JP Morgan Chase had acted in breach of the Quincecare Duty[8]. One of the court's central findings was that a bank cannot act in breach of the Quincecare Duty unless it is on notice that the payment instruction is an attempt to misappropriate funds. Whether the bank was put on notice was again decided by reference to whether any reasonable banker would have realised that a fraud was being perpetrated or that the payment instructions had been made fraudulently.

Implications for Banks & Victims

It is widely expected that the number of cases in which the courts are asked to consider and interpret the Quincecare Duty will continue to rise, not least because the number of cyber fraud cases is increasing. In turn, victims of fraud will continue to seek recourse against those with the deepest pockets, being the banks.

However, banks can take some comfort from the recent glut of cases (resting with the decision in The FRN v JP Morgan Chase) where the scope of the Quincecare Duty has not been unduly widened as the courts seek not to burden the banks in an unreasonable and disproportionate manner. Whilst the courts recognise the need to afford sufficient protection to customers where a fraud has occurred and the bank in question should have been on notice / inquiry of the risk that a fraud was being perpetrated, these cases show that it will not be easy for victims to seek recourse against their own banks by reference to the Quincecare Duty, particularly where banks are increasingly seeking to exclude the Quincecare Duty.

4 Philipp v Barclays Bank UK Plc [2021] EWHC 10 (Comm)

5 Philipp v Barclays Bank UK Plc [2022] EWCA Civ 318

6 Royal Bank of Scotland International Ltd v JP SPC 4 and another [2022] UKPC 18

7 Tecnimont Arabia Limited v National Westminster Bank Plc [2022] EWHC 1172 (Comm)

8 The Federal Republic of Nigeria v JP Morgan Chase [2022] EWHC 1447 (Comm)

60-SECONDS WITH:

FIONA SIMPSON
PARTNER
KINGSLEY NAPLEY

Q **What do you like most about your job?**

A Two things - I get a real buzz seeing junior solicitors and trainees who are being nurtured by my team grow, blossom and succeed. I also love, and feel very privileged, that on a daily basis I meet so many interesting people (colleagues, clients and contacts) and get to go to so many brilliant places, whether to a conference abroad (in Portugal maybe!) or to a business development event at a famous landmark or fancy restaurant.

Q **What would you be doing if you weren't in this profession?**

A When I left university, I had the choice between joining the Foreign Office or going to Chester College of Law to study the law conversion course. I decided on law. Had I chosen the Foreign Office, I like to think that I would now be a British Ambassador somewhere exotic.

Q **What's the strangest, most exciting thing you have done in your career?**

A The strangest was as a Supervising Solicitor. Unusually, the Court had permitted the Search Order to be served at a weekend. On the Friday evening of an August bank holiday weekend, with one of my colleagues and a trainee solicitor from the Applicant's solicitors, I took a mainline train out of London aiming to serve the Respondents at their home. En route we were informed that the Respondents had moved location, so we had to change trains. The Respondents had been followed to a hotel and so we went there. Unsurprisingly, the hotel receptionist wouldn't give me their room number. This meant we had to stay the night in the hotel (fortunately the hotel was able to provide us with toothbrushes and deodorant!). I then served the Respondents with the Search Order on the Saturday morning as they left the restaurant after breakfast. We subsequently went to their home to carry out the search.

Q **What is one of your greatest work-related achievements?**

A Successfully defending in the High Court and the Court of Appeal (working with a great KN and counsel team), the claim by JSC BTA Bank against Madiyar Ablyazov, the son of Mukhtar Ablyazov. At the time it was, and may still be now, the only successful defence of the bank's claims by the family/ associates of Mr Ablyazov.

Q **If you could give one piece of advice to aspiring practitioners in your field, what would it be?**

A Take pride in everything you do.

Q **What do you see as the most significant trend in your practice in a year's time?**

A With the costs of living and running a business rising (and continuing to rise) well beyond anything seen in recent times, exacerbating the position of businesses already struggling as a result of Brexit and covid, directors are facing increased pressures and problems. I believe this will result in more disputes between directors and between directors and shareholders, more fraud and an increased need for advice on directors' duties.

Q **What personality trait do you most attribute to your success?**

A Organisation – in order to keep all the plates (work and home) spinning I need to be supremely organised and would not be without my trusty "To Do" list.

Q **Who has been your biggest role model in the industry?**

A Tim Daniel who was my litigation principal when I was training at DJ Freeman. Tim showed me the importance of being on good terms with the other side's solicitors, remaining calm and being organised. He also helped me fall in love with litigation.
I am where I am thanks to Tim.

Q **What is something you think everyone should do at least once in their lives?**

A Take yourself out of your comfort zone. Whether that is trying an extreme sport, public speaking or asking a client or colleague for feedback, it is good to challenge ourselves.

Q **You've been granted a one-way ticket to another country of your choice. Where are you going?**

A Without a doubt to Australia. I have been lucky enough to travel a little in Australia on holiday and to go to Sydney on a case. Australia is such a vast country with so many beautiful places to visit and so much to do. I love the thought of the outdoor life I could live there, and the weather would be a huge plus.

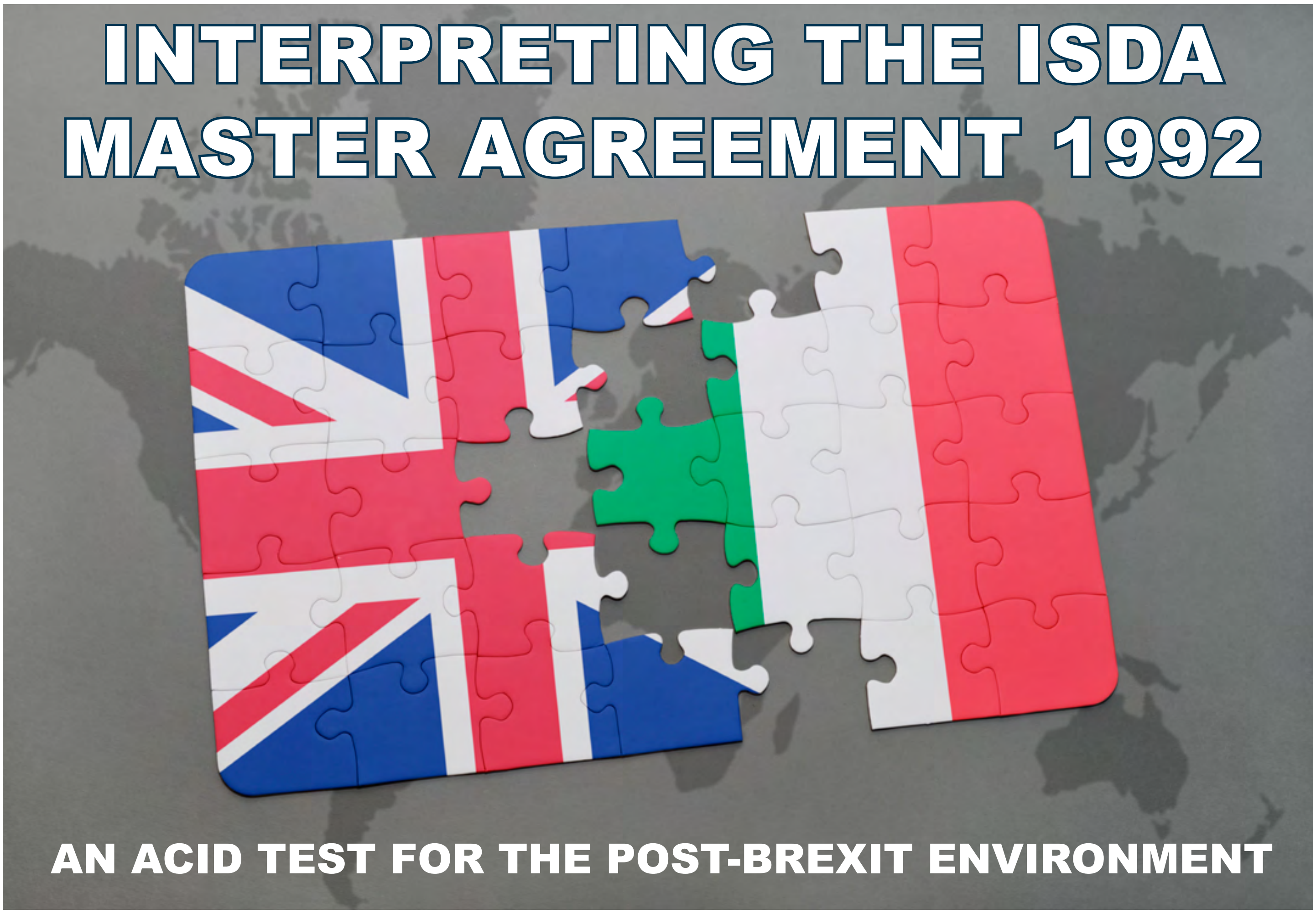
Q **What is a book you think everyone should read and why?**

A I was tempted to say the White Book, but actually it is Watership Down by Richard Adams - a beautiful story of adventure, courage and friendship.

Q **If you had to sing karaoke right now, which song would you pick?**

A "I Love Rock 'n' Roll" by Joan Jett & the Blackhearts.

INTERPRETING THE ISDA MASTER AGREEMENT 1992



AN ACID TEST FOR THE POST-BREXIT ENVIRONMENT

Authored by: Mike Hawthorne - Pinsent Masons

Over the last ten years or so there have been a number of disputes in the English courts concerning interest rate swaps where the customers are Italian local authorities. These cases are a small subset of a much wider litigation episode in Italy in which the local authorities' ability to enter into these transactions has been extensively disputed. In a nutshell, the local authorities typically say that they did not have the power or capacity to enter into the transactions and/or that the transactions are void for reasons of Italian contract law. Many of the transactions were under English law and so banks have sued in England for declarations that the transactions are legal, valid and binding.

Post-Brexit, a new issue emerged in this line of cases, concerning whether the jurisdiction clause in the 1992 ISDA Master Agreement continues to provide, in English law transactions, for the exclusive jurisdiction of the English courts within Europe. There are a number of pending Italian cases where local authorities have challenged the jurisdiction of the English court, and a decision is expected soon in the first of those challenges to reach a hearing.

The point is of interest for all ISDA-documented derivatives with European counterparties as the Brexit argument (if it is right) would apply to any European counterparty, not just the Italian counterparties for which it is currently a hot topic. Given the number of interested parties, this issue may give rise to appeals.

The issue

Clause 13 of the 1992 ISDA Master Agreement reads as follows, with the critical words in bold and underlined:

13. Governing Law and Jurisdiction

(a) Governing Law. This Agreement will be governed by and construed in accordance with the law specified in the Schedule.

(b) Jurisdiction. With respect to any suit, action or proceedings relating to this Agreement ("Proceedings"), each party irrevocably —

(i) submits to the jurisdiction of the English courts. If this Agreement is expressed to be governed by English law, or to the non-exclusive jurisdiction of the courts of the State of New York and the United States District Court located in the Borough of Manhattan in New York City; if this Agreement is expressed to be governed by the laws of the State of New York; and

(ii) waives any objection which it may have at any time to the laying of venue of any Proceedings brought in any such court, waives any claim that such Proceedings have been brought in an inconvenient forum and further waives the right to object, with respect to such Proceedings, that such court does not have any jurisdiction over such party.

Nothing in this Agreement precludes either party from bringing Proceedings in any other jurisdiction (outside if this Agreement is expressed to be governed by English law, the Contracting States, as defined in Section 1(3) of the Civil Jurisdiction and Judgments Act 1982 or any modification, extension or re-enactment thereof for the time being in force) nor will be bringing of Proceedings in any one or more jurisdictions preclude the bringing of Proceedings in any other jurisdiction.

The accepted pre-Brexit position in relation to an English-law governed transaction was that the English courts would have jurisdiction, as would any other court outside the "Contracting States" in which a party chose to bring proceedings, but no other Contracting State (such as Italy, for example) would have jurisdiction.

The fact pattern of these cases usually involves a sale process in another EU state (for example Italy), and that activity is often enough under the foreign law of that state for its courts to take jurisdiction over at least some aspects of the dispute. The bank then sues in England saying that all aspects of the dispute fall under the jurisdiction clause in the agreement. Pre-Brexit, given the exclusive jurisdiction clause in favour of the English courts, the foreign court was then required to stay its proceedings under Article 31(2) of the Brussels Recast Regulation. Post Brexit, there is – regardless of the jurisdiction clause - no automatic requirement for the foreign court to impose a stay. As a result, the non-bank party, wishing the dispute to continue to be heard by the foreign court and not in England, has a greater incentive to challenge the jurisdiction of the English court.

This has led to some innovation as regards the possible construction of the jurisdiction clause, in particular the prohibition on the bringing of proceedings in another "Contracting State".

"Contracting State"

Pre-Brexit, section 1(3) of the Civil Jurisdiction and Judgments Act 1982 ("CJJA") defined "Contracting State" as follows:

"Contracting State", without more, in any provision means—

(a) in the application of the provision in relation to the Brussels Conventions, a Brussels Contracting State;

(b) in the application of the provision in relation to the Lugano Convention, a State bound by the Lugano Convention; and

(c) in the application of the provision in relation to the 2005 Hague Convention, a 2005 Hague Convention State.

The definition thus encompassed: (a) the EU nations (Brussels Conventions); (b) the EFTA nations, excluding Liechtenstein (Lugano); and (c) the 2005 Hague Convention nations (which after 2015 included the EU nations). The UK acceded to the 2005 Hague Convention in 2020 when its accession in its capacity as an EU member ended.

Upon Brexit, Part 2, Regulation 6 of the Civil Jurisdiction and Judgments (Amendment) (EU Exit) Regulations 2019 deleted points (a) and (b) of the definition, so that the definition of "Contracting State" is now only the old item (c) which reads "in the application of the provision [of the CJJA] in relation to the 2005 Hague Convention, a 2005 Hague Convention State".

So, the CJJA now applies to 2005 Hague Convention contracting states, and they are the "Contracting States" as that term is defined in the CJJA. But does that mean that the jurisdiction agreement in the 1992 ISDA Master Agreement applies in relation to each of those states, thereby preventing proceedings from being brought in any such state except England, in an English law-governed transaction?

There are essentially two challenges:

1. Is the jurisdiction clause "ambulatory", meaning capable of changing its meaning over time? Those challenging the English court's jurisdiction say that the phrase "or any modification, extension or re-enactment thereof for the time being in force" envisages that the meaning of the term "Contracting States" may change during the life of the transaction.

2. If the definition of the term "Contracting States" is capable of changing after the parties enter into a transaction, are the 2005 Hague Convention states "Contracting States" for the purpose of the jurisdiction clause?

The competing arguments

As to the first question - whether the jurisdiction clause is "ambulatory" - the competing arguments are, in summary:

1. For the challenger: the phrase "or any modification, extension or re-enactment thereof for the time being in force" envisages that the meaning of "Contracting States" could change during the lifetime of a transaction, and that is what has occurred.

2. For the banks: the ISDA Master Agreements are standard form contracts which, when they were published by ISDA, could be

foreseen to remain in use for many years to come. As a result, the phrase “or any modification, extension or re-enactment thereof for the time being in force” envisages that the meaning of “Contracting States” in the 1992 Master Agreement should be read as allowing the contract to continue to function as a standard form even if the Contracting States changed over time, but the list of Contracting States for any particular transaction is fixed for all time at the date of the contract as being the Contracting States as they were on that date.

For the second question – whether, if the jurisdiction clause is “ambulatory”, the 2005 Hague Convention states are “Contracting States” for the purpose of the clause - the competing arguments are, in summary:

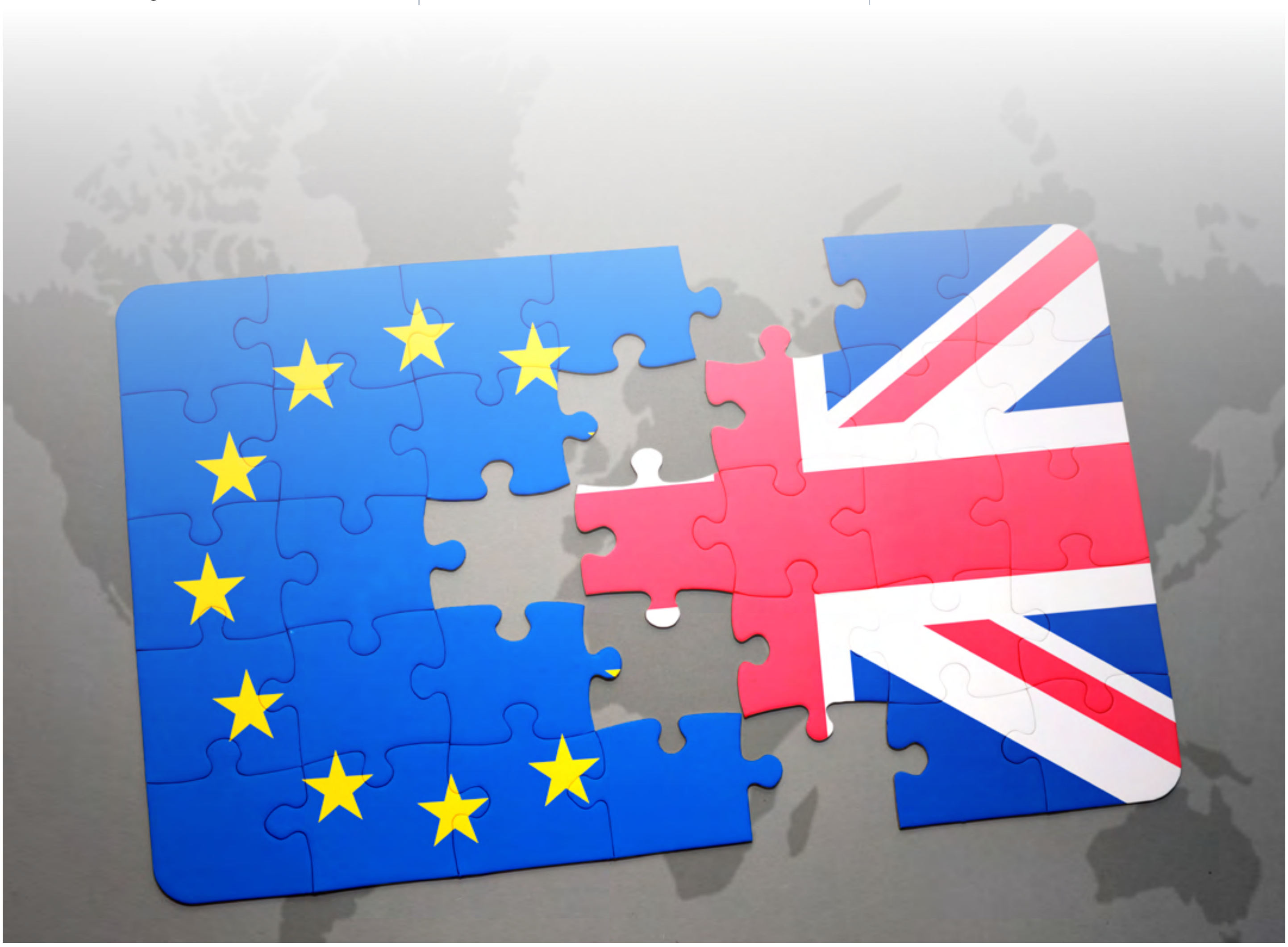
1. For the challengers: the 2005 Hague Convention only applies to international cases where there is an exclusive choice of court agreement (Article 1 of the Convention). The jurisdiction agreement in the 1992 ISDA Master Agreement is not an exclusive jurisdiction agreement because it functions in two ways for English law transactions: (a) for claims brought in any Contracting States, exclusive jurisdiction for England; but (b) non-exclusive jurisdiction for England so as to also allow parties to bring claims outside the Contracting States.

2. For the banks: unless there is an actual issued claim outside the Contracting States, the jurisdiction clause acts in practice as an exclusive jurisdiction clause. In any event, the purpose of the reference to “Contracting States” in the jurisdiction clause is to import into the contract a list of nations within which there is exclusive jurisdiction. The 2005 Hague Convention parties can function as a list, notwithstanding that for the purpose of enforcement and recognition of judgments the CJJA applies to cases in which the 2005 Hague Convention applies (that is, those involving an exclusive jurisdiction agreement).

Comment

There are of course many other more subtle issues and sub-issues. Given that the issue is likely to be decided soon, I will not tempt fate by predicting which way the court may decide the point. For present purposes, the action point is simply to be aware that this is an issue of general market significance, it will be decided soon, and depending on how it is decided parties to transactions which are not currently in dispute may wish to proactively draft around the standard form jurisdiction agreement so as to ensure that they get what they want as regards jurisdiction.

For market participants who look to English law and courts for certainty and predictability, this issue is something of an acid test for the post-Brexit environment. My view is that certainty and predictability would require the terms of a contract to be fixed so far as possible at the date of entry, and that would militate against the “ambulatory clause” argument.



CLASS ASSIGNMENT

FACILITATING DAVID VS GOLIATH

Authored by: Elena Rey and Tristan Dollie - Brown Rudnick

Class Actions

Following the widely publicised class actions against the VW Group regarding "cheat devises" for measuring emissions, litigation funding of class actions and the number of litigation funders has increased significantly in the UK and Europe as investors seek to diversify their investment portfolios with investments in uncorrelated asset classes that continue to offer attractive yields but are less susceptible to macro-economic and political volatility.

Group litigations such as those arising from breaches of consumer rights are being complemented by nascent and relatively novel class actions in the crypto currency sector and will, we anticipate, start to emerge in the non-fungible token (NFT) space.

Given the increasing complexity of the underlying claims (particularly in relation to crypto assets) and relevant funding arrangements required for class actions of this nature, there are various issues that need to be considered when funding a class action. We have highlighted and discussed a few of the most noteworthy below.

1. Consumer Credit Regulations:

Historically, litigation funding was advanced to a claimant in order to establish a contractual link between the claimant and the funder, thus allowing the deduction of the funder's fee/return from the proceeds awarded to a claimant of a successful litigation.

In class actions, where claimants are generally individuals often unfamiliar with complex legal and financial documents, the relevance of consumer credit regulations needs to be considered carefully so as to avoid breaches or unlawful lending by funders. The application of the consumer credit regulations is highly dependent on the nature of the proposed funding arrangement. Traditionally, litigation funding, being a non-recourse investment where a funder's fee/return was only paid if the litigation was successful, has not been considered lending within the meaning of the consumer credit regulations. However, each funding arrangement needs to be considered in the context of the consumer credit regulations at the outset of a transaction to avoid any issues for funders.

Aside from a non-recourse funding arrangement, there are other ways to mitigate (or remove) the risk associated with the consumer credit regulations. For example, funding can be made available by a funder to a special purpose vehicle (an "SPV") as a borrower given that consumer credit regulations only capture lending to individuals (not corporate entities). Such an SPV could then represent the claimants with authority to bind the claimants and approve the terms of the funding (whether through a power of attorney or otherwise). In such circumstances, the board of such an SPV is usually made up of claimants which form a "claimants' committee".

A further way to structure funding to class action claimants but sidestepping consumer credit regulations is through a sale and purchase of receivables, where the claimants sell a portion of their anticipated receivables from their anticipated damages to the funder and, in exchange, the funder provides funding through the purchase price for such receivables.

2. Funding law firms:

An additional structure that is becoming increasingly common for law firms often engaged in class action litigation is for funds to be advanced directly to the claimants' law firm. This simple bilateral structure avoids issues with consumer credit regulations and also allows for the funding arrangement to be put in place before the book building of claimants is completed. In this structure, the claimants' committee is often set up once the book building has been completed for and such committee can then approve the funding arrangement entered into by the law firm. Such a structure also has the added benefit of providing the funder a higher degree of control over litigation cost expenditure as a budget will often be pre-agreed with the law firm.

Despite its seemingly simple nature, there are a few important points for funders to note when adopting this structure:

(a) Direct contractual relationship with claimants: The lack of any direct contractual nexus between the funder and the claimants means that the funder is fully reliant on the law firm to ensure that the conditional fee agreements (CFAs), engagement letters and book building documentation include appropriate wording to ensure that the claimants acknowledge and agree to the funding arrangements (including the deduction of the funder's fee/return from the damages awarded to claimants), and authorise the claimants' committee to approve these. This risk can be mitigated by the operation of a trust that can be established under the funding documentation. Ideally, law firms seeking funding should engage with funders early in order to agree to the form of such documentation. However, where documentation has already been entered, well-advised funders should ensure that a detailed review of such documentation is undertaken early in the due diligence stage of the transaction.

(b) Insolvency risk: As with any financing, funding to a law firm also needs to be structured to effectively mitigate against the risk of the law firm's insolvency, and should set out the consequences of what happens if the law firm goes insolvent. Regulatory aspects also interplay here, with the SRA rules on transfer of clients and cases, in particular, needing to be considered.

(c) Indebtedness restrictions: Many law firms that are involved in pursuing class action litigations are often dependent on various funders in respect of each of their ongoing class actions, and may also have an umbrella corporate facility for working capital purposes. Well-advised funders should understand the existing financing arrangements by undertaking due diligence and consider whether intercreditor arrangements are necessary.

3. CFA:

As mentioned above, various points need to be complied with when drafting the CFAs for a class action, including the enforceability of the funding arrangement and the ability of the law firm to deduct relevant fees. An assessment of the CFAs and similar documents should be carried out as part of the due diligence process.

Another important point to note is that under SRA rules, a law firm is under an obligation to provide details of the funding arrangement and is required to set out the reasons why the funding is in the best interests of the claimants. Funders should consider this from a confidentiality perspective.

This can be more straightforward in class actions where all claimants are in a similar position regarding the estimated losses and expected damages. In certain class actions centred on regulatory breaches, however, this may be sensitive, as the size of the effected investment can vary significantly. Given this proportionality point and the traditional deduction of a percentage from the overall damages of a claimant, a more thorough analysis and appropriate wording in the CFA may be necessary to set out the benefit of such funding for those claimants with higher expected damages.

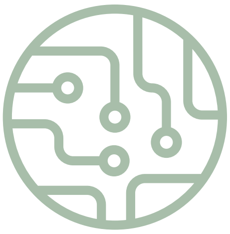
4. Security:

Security, which is an essential element in many financing arrangements, is not always granted in the context of litigation funding and, specifically, class action cases where the beneficiaries of the funding are individual claimants. When taking security connected to the underlying claims, such security should be structured as an assignment of receivables rather than an assignment of the claims themselves to avoid triggering champerty provisions.

5. Opt-in and opt-out:

Another layer of complexity arises on opt-out class actions, as appropriate measures need to be taken to represent the class and arrange funding. Adjustments to the traditional opt-in priority rankings in waterfall provisions may be necessary to reflect an opt-out litigation, and the payments mechanics may need to be amended to reflect that the funder's fee/return can only be received by the funder and other parties after reasonable time has passed for the claimants to claim their damages.

Further, with more opt-out cases being brought against tech giants and social media networks in respect of image rights or GDPR breaches where claimants are likely to include minors, another aspect to consider is how to cater representation arrangements and documentation for child claimants in a class. Extra protections are needed to represent minors and, in particular, a 'litigation friend' should be carefully selected and appointed.



6. Settlements in tech class actions:

Care needs to be given in class actions, specifically against tech companies and social networks, as a conflict may arise between the interests of the claimants and the interests of a funder / other parties if part or all of the settlement is offered in kind; such as in the form of iPhones or free subscription to services. Funders will need to consider what extent they can control the form of settlement that may be offered to claimants to protect their fee/return.

7. Costs overrun or additional funding:

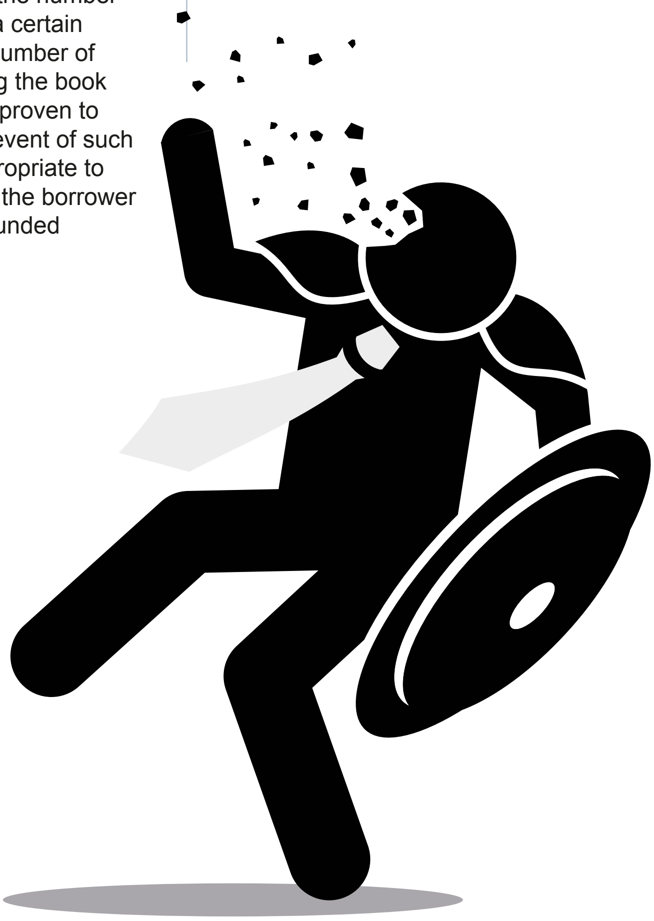
At the outset, it is important to agree what happens if/when litigation costs overrun, to avoid a situation where the funder's return is no longer commercially viable, the law firm may not be paid in full or the litigation stalls. This is especially important in class actions where it may be difficult to renegotiate the return, given the number of counterparties as a certain percentage of damages is already promised to the claimants under the CFAs. Funders may wish to consider whether they require a right of first refusal for additional funding to be provided and whether, given the risk, a higher return is warranted.

8. Right to terminate the funding arrangement:

Funders should detail their rights to stop funding in agreed circumstances. For example, where the borrower commits a material breach or in the event of a material and detrimental change of circumstances in relation to the litigation. For class actions, it may be helpful to include a termination event if the class has not reached a certain number of claimants, or if the number of claimants drops below a certain threshold or a significant number of claimants registered during the book building process have not proven to have a valid claim. In the event of such termination, it may be appropriate to negotiate an obligation on the borrower to repay all or part of the funded amount.

The nature of class action claims is evolving rapidly and is increasingly focused on tech companies, crypto assets, privacy and data.

Given the frequency at which the nature of such claims change and complexity of the required funding arrangements, it is vital that practitioners keep abreast of regulatory and market developments and the key commercial points to consider as they negotiate and navigate the terms of increasingly sophisticated litigation funding documents and transaction structures.



HOW TO TERMINATE A CONTRACT

Authored by: Sue Millar, Sophie Mahal, Rebecca Garrick and Harriet Campbell - Stephenson Harwood

Exercising a contractual right of termination might sound simple but it can be a complicated matter.

First of all, a valid termination notice must comply strictly with any termination conditions in the contract. To borrow the analogy of Lord Hoffman in the leading case of Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd [1997] UKHL 19, "[i]f the clause [in a contract] had said that the [termination] notice had to be on blue paper, it would have been no good serving a notice on a pink paper".

Secondly, a party might lose its right of termination if it acts in a manner inconsistent with termination. This often happens, for example, when a party demands payment of arrears which have accrued under a contract, waiving the right to terminate for those arrears.

Incorrectly terminating a contract is an expensive lesson: a party that incorrectly terminates a contract will, generally, be liable to the other party for the resulting losses.

Lombard v Skyjets

Lombard North Central Plc v European Skyjets Ltd [2022] EWHC 728 (QB) provides some important reminders on what may (and may not) be required to validly terminate a contract, as well as when a right of termination may be lost through waiver.

European Skyjets Limited (the "Borrower") took out a loan (the "Loan Agreement") with Lombard North Central Plc (the "Lender"), secured by way of first priority legal charge over an aircraft.

The Borrower regularly paid its monthly instalments late and the Lender sought to apply late payment charges and default interest on outstanding arrears.

The Lender subsequently emailed the Borrower that its account was in arrears and that it remained uncomfortable with the Borrower's payment history and cash flow. Nevertheless, as "a gesture of goodwill", the Lender offered to "allow more time to bring the balance of the arrears up to date". This email contained the statement that it was "…without prejudice and [that the lender] fully reserves its rights in respect of the identified breaches being arrears on the Loan Agreement…" (a so-called "Reservation Statement").

The Loan Agreement provided that the Lender was entitled to terminate "[a]t any time after the occurrence of an Event of Default" by giving notice to the Borrower (the "Termination Clause"). The Lender terminated the Loan Agreement by giving notice relying on purported arrears as an 'Event of Default' and subsequently sought to enforce its security over the aircraft. The Lender then brought a claim against the Borrower for the outstanding balance under the Loan Agreement, which the Borrower denied.

The Court held that the Lender had validly terminated the Loan Agreement.

Key Takeaways

1. The Termination Clause did not require the default to continue when the notice was served. Rather, it specified that the right could be exercised “at any time” after an Event of Default. It was irrelevant whether the arrears were still outstanding at termination.

   Interestingly, the Court considered that even if the Termination Clause had required the arrears to be outstanding at the point of termination, a failure to pay a sum as small as $179.99 (which the Lender claimed was an undisputed outstanding sum) would have been sufficient to justify termination.

2. The Lender had waived its right to terminate by offering the Borrower additional time to pay arrears and asserting its right to penalty charges on the Borrower’s late payments (which was inconsistent with terminating the Loan Agreement). Although there was a ‘no waiver clause’ in the Loan Agreement which stated that “[n]o failure or delay in exercising… any right… shall operate as a waiver…”, this could not overcome a waiver resulting from positive statements and assertions (and not merely a failure or delay in exercising the right to terminate). Nor could the Reservation Statement prevent things previously said or done from having their objective effect.

   While there are ways to minimise the risk of losing the right to terminate (such as labelling communications ‘without prejudice’, using language which seeks to reserve a party’s rights, and relying on ‘no waiver’ clauses), these are by no means fail-safe.

Any party considering termination should seek advice to ensure that any interactions with the defaulting party do not result in the termination right being lost.

3. Although the notice specified alleged arrears as the reason for termination, the Lender could rely on other reasons not specified in the notice as a basis for termination. This was because the Termination Clause did not require the basis of termination to be specified[1]. Here, there were other reasons which justified termination, including the Borrower’s financial position (which constituted an Event of Default under a ‘material adverse change’ clause).

4. The Borrow argued that the Termination Clause was a ‘penalty’ (i.e. void and unenforceable due to its oppressive and unconscionable nature) on the basis that it entitled the Lender to terminate for what might be a trivial Event of Default. The Court considered this argument “hopeless”.

Practical consequences:

While any contractual termination notice needs to comply strictly with all conditions in any termination clause, it should not be assumed that a valid termination notice needs to specify (or correctly specify) the reason for termination. Whether or not this is a condition of a valid termination notice will turn on the proper construction of the relevant termination clause(s). Where it is not necessary to specify reason(s) for termination, it may be advisable to refrain from doing so to ensure that the terminating party is not precluded from subsequently relying on additional or alternative reasons for termination.

Where an election of a contractual right to terminate must be exercised within a reasonable time, an unreasonable delay will mean that right is lost. What is reasonable will turn on the facts of the case, but may be a very short period of time and so termination must be considered quickly. In DD Classics Ltd v Chen [2022] EWHC 1357 (Comm) a 13-day delay meant that the defendant had waived his right to terminate the contract for the sale of his rare Ferrari.

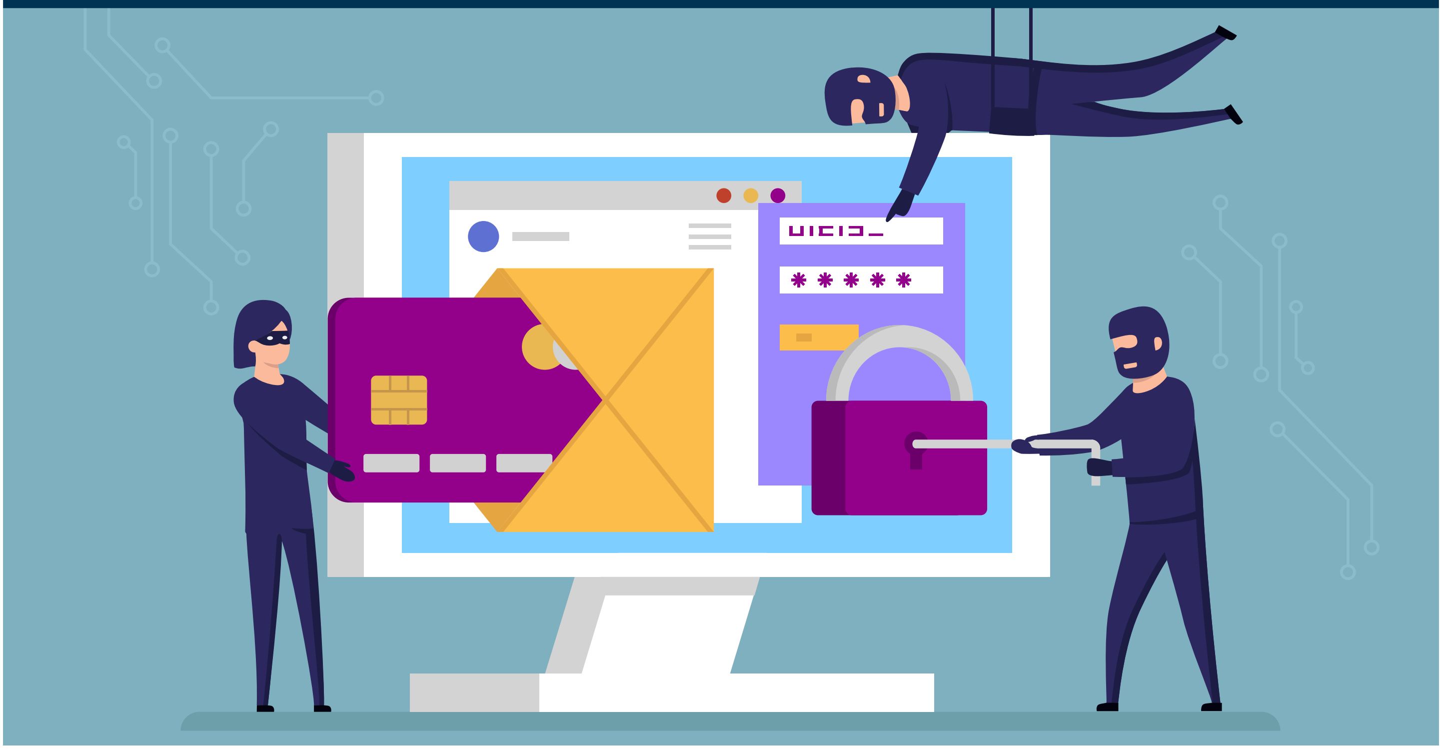
A party seeking to terminate a contract should always consider whether it would be preferable to seek to terminate under the common law for ‘repudiatory breach of contract’ rather than under a contractual termination clause[2]. If so, any termination notice will need to be carefully drafted in a way which seeks to preserve a party’s right to rely on repudiation as a primary basis for termination, with contractual termination as an alternative basis for termination.

1 This is consistent with Boston Deep Sea Fishing v Ansell (1888) 39 Ch D 339: it is possible to terminate at common law for a ‘repudiatory breach of contract’ without identifying the breaches justifying termination.

2 While terminating under a contractual termination clause is often less risky, due to greater certainty that the right to terminate exists, there may be a substantial difference in the level of compensation that a terminating party will stand to receive (with potentially more favourable damages for repudiation).

TECNIMONT:

RECIPIENT BANK LIABILITY FOR RECEIPT OF FRAUDULENT FUNDS



Authored by: Kit Smith - Keidan Harrison

Introduction

Victims of Authorised Push Payment ("APP") fraud received welcome news from the Court of Appeal in the decision of Philipp v Barclays[1] of March 2022. That decision confirmed that the Quincecare duty of care can be engaged where an individual customer of a bank has dealt with their own funds pursuant to a fraud. The duty is not engaged only where an agent of a corporate client defrauds that client in circumstances which should have put the bank on notice of that fraud.

However, whilst the duty of care as regards transacting banks has been clarified to include individual clients, in the recent decision of Tecnimont Arabia Limited v National Westminster Bank plc[2], in May 2022, the High Court found that NatWest had not been unjustly enriched as the recipient of a fraudulent payment and that, absent highly specific facts putting the bank on notice of third party property/property subject to a trust, no liability will be owed by the receiving bank to victims of fraud.

Tecnimont provides a helpful restatement of the law relating to knowing receipt and unjust enrichment (as the primary means by which a bank may be liable to a third party), but it also raises questions as to the present state of the law regarding recipient bank liability to third party victims of fraud, in light of the sophisticated nature of frauds these days.

Executive Summary

Tecnimont failed in its claim against NatWest for knowing receipt, since it failed to establish that the funds transferred as part of the fraud were trust property. It is a fundamental tenet of knowing receipt that the property transferred to the receiving party is subject to a trust.

Tecnimont's alternative claim for unjust enrichment failed, since the enrichment of NatWest (by receiving funds) was not "at the expense of" Tecnimont since the funds had passed through international correspondent banks before reaching NatWest.

Claims against recipient banks remain exceptionally difficult to successfully advance. Claimants will require a very concise alignment of facts concerning the transfer of trust property, which the bank is on notice of before in order to mount a claim for Knowing Receipt. For unjust enrichment, the claimant will need to clear the difficult hurdle of the recipient bank having been unjustly enriched at their direct expense, with the absence of a defence such as change of position (a comparatively low hurdle).

1 Fiona Lorraine Philipp v Barclays Bank UK PLC [2022] EWCA Civ 318

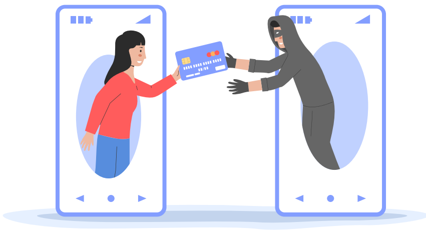
2 Tecnimont Arabia Limited v National Westminster Bank PLC [2022] EWHC 1172 (Comm)

Background

In October 2018, Tecnimont was the victim of business email compromise (a form of phishing attack). The fraudsters instructed Tecnimont to pay an upcoming loan repayment to a new bank account, owing to purported scrutinization of their usual account. This amounts toa typical APP fraud. Tecnimont transferred USD$5m to an account (in the name of Asecna Limited) held by fraudsters with NatWest in Brixton. Crucially for the decision arrived at by the Court (regarding unjust enrichment at least), the payment was made by Tecnimont from its account with Saudi British Bank SJSC in Saudi Arabia ("SABB"), via Citibank in the US as SABB's correspondent/intermediary bank, to NatWest.

The NatWest account was opened on 10 May 2018 with a deposit of $990. On 23 May, $890 was paid out leaving a credit balance of $100. The stolen funds were credited to the account on 30 October 2018. On that day and over the next two days substantially all of those funds were dissipated, via 29 transactions, to accounts in multiple jurisdictions including Hungary, Croatia, the Czech Republic and Hong Kong. Fraud alerts were generated within NatWest following an attempted payment to China, however those within NatWest reviewing the system did not have the account's full history to view (which would have shown how recently it had been set up and how minimal its previous fund position had been) – instead only the three previous days' activity was visible, showing a USD$5m payment in and various payments out.

Tecnimont brought claims against NatWest for knowing receipt (of property subject to a trust), or in the alternative, for unjust enrichment.



Knowing Receipt

The equitable principle of knowing receipt imposes a liability to account as "a constructive trustee of assets received by a person in breach of trust or fiduciary duty where the recipient knows of that breach of trust or fiduciary duty, or otherwise has a state of mind that makes it unconscionable for the recipient to retain the benefit of the receipt."[3]

The claim for knowing receipt failed in Tecnimont because they had paid monies away acting under a mistake induced by the deceit of a third party which the bank had no knowledge of. As such, no trust, whether constructive or otherwise, could be construed in such circumstances. If the transferred property is not trust property, there can be no liability for knowing receipt, pursuant to Byers v Samba[4]. Further, NatWest received the deposit for its customer (despite their being a fraudster(s) – a fact that was averred not to be known by NatWest) and not for its own account so no claim could lie against NatWest for knowing receipt. As such this claim was dismissed by the court in short order.

Unjust Enrichment

There are four principal matters[5] to be considered when advancing an unjust enrichment claim, namely:

a) Has the defendant benefited, in the sense of being enriched?

b) Was the enrichment at the expense of the claimant?

c) Was the enrichment unjust?

d) Are there any defences such as change of position or ministerial receipt.

NatWest had clearly been enriched since it had received USD$5 million. But, crucially, that enrichment was deemed not to have been at the expense of Tecnimont.

In order to satisfy the "at the expense of"[6] condition, a claimant must show that there has been a "transfer of value". In other words, that the defendant has received a benefit from the claimant and the claimant has suffered a loss or detriment through the provision of that benefit. The fraud here concerned foreign payment transfers which were transacted through the US correspondent bank, Citi – therefore there was no direct transfer between Tecnimont and NatWest.

Despite the claim falling down on the second limb of the test, the court went on to make observations concerning the final two limbs for unjust enrichment. Regarding the third limb, the enrichment was deemed to be unjust as it resulted from a payment made under a mistake of fact induced by the third-party fraudsters.

Regarding the fourth limb, the bank had a complete defence, owing to change of position, having paid away the funds in a genuine manner. It followed that Tecnimont's claims failed and that there was held to be no liability on the part of NatWest.

Is the law fit for purpose?

Claiming against recipient banks is not impossible, but it remains a fact-sensitive and difficult challenge. The seminal decision in unjust enrichment stems from the 1991 case of Banque Financière de la cite v Parc (Battersea) Limited (reflecting the thoughts of Peter Birks in his "Introduction to the Law of Restitution" 1989). It is trite to say

3 Goff and Jones: The Law of Unjust Enrichment

4 Byers v Samba Financial Group [2021] EWHC 60 (Ch)

5 Banque Financière de la cite v Parc (Battersea) Limited [1999] 1 AC 221

6 See Menelaou v Bank of Cyprus [2016] AC 176; Relfo v Varsani [2015] 1 BCLC 14; and Investment Trust Companies [2015] STC 1280

that the nature of fraud has developed exponentially since this time.

When onboarding clients, most banks will take information concerning, amongst other things, their clients' business areas, expected monthly/annual receipts and outward payments. Further, once the banking relationship is established the bank will continue to monitor banking patterns as part of their anti-money laundering obligations, including the filing of Suspicious Activity Reports where payments may be received outside of the standard banking pattern (e.g. in large quantities and/or from high risk jurisdictions).

In such circumstances, the receiving bank has a wealth of information concerning their clients' banking patterns and history that is simply not available to the paying party. The information imbalance between such parties and their ability to identify the fraud being perpetrated on them/by their client is therefore similarly imbalanced.

In Philipp, Barclays submitted that investigating every suspicious instruction would render the banking system unworkable, particularly given the volume of instructions received. The Court of Appeal was not persuaded by this. Where banks are subject to existing duties not to facilitate money laundering by their clients, it is not a sizeable leap to question whether such a duty could extend to include not facilitating fraud by their clients.

If a bank receives a sizeable payment (perhaps far exceeding anything previously received) into an account that previously had little or no activity and a nominal balance and then proceeds to execute payment instructions passing those funds to accounts in other jurisdictions (including high risk of money laundering jurisdictions), then simply executing payment instructions to those accounts in accordance with the mandate could, the critic may say, amount to Nelsonian blindness to the reality of that payment. Philipp confirmed that a paying bank's duty to its customer was not as an execution only (in strict accordance with the terms of the mandate) agent. If a paying bank ignores red flags concerning potential frauds on its client, then it may be liable in damages caused by that breach of duty. This position is to be contrasted with that of the recipient bank who pays away funds received as part of a fraud, in accordance with its client's instructions – then, on the present basis of the law, no liability can arise.

Where a receiving bank is armed with a wealth of information of its customer's banking patterns, it would appear unjust to say that the receiving bank's duties are confined to simply executing its client's instructions. To do so would be to (unwittingly, the banks may say) assist in the completion of that phase of the fraud, further damaging the position of the innocent paying party. Placing the funds further beyond their reach.

There is a fine balancing act to be struck over the tension between a bank's compliance with its own client's mandate, the role of banks not to play investigator and the requirement for banks to play part of the front line defence against fraud.

It is likely that we will continue to see these issues play out before the court for some time before the needle settles.

60-SECONDS WITH:

JON FELCE
PARTNER
COOKE, YOUNG & KEIDAN

Q What do you like most about your job?

A The people with whom I work. CYK is a really collegiate team, and a great place to work!

Q What would you be doing if you weren't in this profession?

A Something to do with sports, most likely football, and maybe in journalism. In my younger years when I had a fuller head of hair, I was often confused for Statto from Baddiel & Skinner days…

Q What's the strangest, most exciting thing you have done in your career?

A The cut and thrust of disputes can be exhilirating, especially in the fraud and asset recovery space where I tend to spend a lot of my time. It's difficult to single out any one example, but personally serving a worldwide freezing order flanked by police officers in case matters got out of hand was pretty exciting. As for strange things, trying to persuade a disbelieving art expert of a client that an artwork he had acquired was a forgery was a unique experience!

Q What is one of your greatest work-related achievements?

A Turning a case around where the consensus had been that it was bound to go to trial and the client was likely to lose. I came up with a strategy and it worked, so we ended up getting summary judgment and the case settled pending an appeal. The happy client ended up paying a fraction of the amount it was potentially liable for.

Q If you could give one piece of advice to aspiring practitioners in your field, what would it be?

A Be positive and enjoy what you do! It goes a long way…

Q What do you see as the most significant trend in your practice in a year's time?

A There are a lot of issues which are likely to converge at around the same time, the economic and political climate here and abroad in particular. One issue perhaps garnering less headlines will be the new procedural gateways in the CPR that are due to come into force from October. I think that this will encourage a lot more fraud and asset recovery cases in the courts.

Q What personality trait do you most attribute to your success?

A Being calm under pressure. There's always a solution out there, the calmer you are the more likely you are to find it and achieve it.

Q Who has been your biggest role model in the industry?

A I can't say there has been any one person in particular. I've learned lots from a wide range of people through the years – what to do, and perhaps most importantly things not to do… That's probably a second piece of advice I would give to aspiring practitioners: try to expose yourself to working with a range of people and styles, and then use what you learn to turn yourself into the type of lawyer you want to be and the one that best reflects who you are.

Q What is something you think everyone should do at least once in their lives?

A Go to a TL4 event of course… if not that, then doing something you dreamed of when growing up, something on your bucket list… . After Italia 90 I always wanted to go to a football World Cup or Euros final, and watch England win it… I made it to the final in 2010 in South Africa, but England's golden generation didn't keep up their end of the bargain. Last year, I was at Wembley for the Euros final, but penalties got in the way. On the back of that, I actually bought tickets for the recent Women's Euros final at Wembley, but ended up transferring them a while ago to go on holiday…. Still, I enjoyed watching England win it on TV with my young girls, one of whom now wants to win a football trophy when she grows up… maybe that will make it third time lucky…

Q You've been granted a one-way ticket to another country of your choice. Where are you going?

A This may come as a surprise to some, but despite the amount of time I spend in Italy, it's not Italy! I can say that with my (Italian) wife's blessing, because as much as we love the Italian, people, food and culture, there's one place that we both reminisce about a lot… and that's Bhutan. We travelled around the country for two weeks about a decade ago, and it was an experience like no other. The thing that resonates most for us is the peace and tranquility of Bhutan, and the nature (and the flight into Paro, which is something else…).

Q What is a book you think everyone should read and why?

A Aside from the White Book? If I went to a desert island (or maybe that should be when I go…) I'd take any book by Ben Macintyre, The Times journalist who now dabbles in writing books about spies. I did a paper on the history of 20th century intelligence at university, so it's been something about which I have always been interested. While a lot of history and modern-day news focusses on (in)famous and larger than life characters, it's actually pretty fulfilling to read and learn how a dead homeless man or the granny next door probably had just as much of an influence – if not more – on the course of history.

Q If you had to sing karaoke right now, which song would you pick?

A It's got to be Bohemian Rhapsody, doesn't it?!

AUDIT REFORM: TOO LITTLE, TOO LATE?

Authored by: David Pickstone, James Le Gallais, Alex Lerner and Grace Spurgeon - Stewarts

Global markets are under serious strain and are bracing for further economic headwinds. The risk of corporate failure is high. Set against that backdrop, the government's introduction of an audit reform bill (albeit in outline form) is welcome.

In the first of a series of blog posts on the audit market, David Pickstone, James Le Gallais, Alex Lerner and Grace Spurgeon consider whether the audit reform bill will deliver much-needed change in a timely fashion and the likely consequences if it does not.

What went wrong?

Misfortune never comes singly, but sometimes the occurrence of multiple unfortunate events is not misfortune at all. It is a symptom of market failure. One has only to look at a succession of incidents between 2014 and 2019 to understand the issues facing auditors, audited companies and accountancy firms more generally. For example:

- In November 2014, an investigation by the International Consortium of Investigative Journalists revealed confidential information about Luxembourg tax rulings between 2002 and 2010. The so-called 'Luxembourg Leaks' triggered investigations into the tax affairs of major multinational corporations, including McDonald's, Amazon and Ikea. As a consequence, the European Commission concluded that the "Excess Profit" tax scheme was illegal under state aid rules and that approximately €700m was to be recovered from 35 multinational companies.
- In 2016, the Financial Reporting Council (FRC) announced it was investigating Sports Direct's auditors for failing to disclose the relationship between Sports Direct International (now Frasers Group, in which Mike Ashley is the controlling shareholder) and a company controlled by Mike Ashley's brother. The non-disclosure related to Frasers Group's use of a VAT scheme. The scheme involved contracting out deliveries to a company set up by Mike Ashley's brother, which had no vehicles or drivers. Potential losses to European tax authorities resulting from various companies' use of this scheme are likely to be significant, perhaps running into the billions, and litigation is likely to follow.
- Between 2016 and 2019, there was a succession of high-profile insolvencies in the UK, involving the likes of BHS, Carillion, Conviviality, London Capital and Finance, Patisserie Valerie, Thomas Cook and Stagecoach. These insolvencies had serious implications for the UK economy in terms of job losses, pensions deficits and impacts on small and medium-sized enterprises. In some instances, they have also given rise to heavy litigation.

Unsurprisingly, there is consensus in the market that reform is needed.

The long road to reform

Since the collapse of BHS, there have been three major reviews on audit reform, a Department for Business, Energy and Industrial Strategy (BEIS) consultation paper (to which the government has recently published its response) and an outline draft audit reform bill (included in the supporting papers for the Queen's speech in May 2022).

First, in 2018, Sir John Kingman led an independent review of the FRC to ensure it could fulfil its corporate governance function and to safeguard the reputation of the UK as a world-leading financial and commercial hub. The Kingman Review made 83 recommendations, including replacing the FRC with a new independent regulator, the Audit, Reporting and Governance Authority (ARGA), which would be accountable to parliament.

The Kingman Review was scathing in its assessment of the FRC. It described it as a "ramshackle house", and, strikingly, the CEO of the FRC, Sir John Thompson, agreed. He accepted that the FRC had been "asleep at the wheel". He also said: "Were we complicit or in some way responsible for corporate failure? Well, it's probably arguable that as a regulator we weren't anywhere near strong enough, we weren't big enough, and we weren't transparent enough to make a difference to the system."

Second, in 2019, the Competition and Markets Authority produced a market study into the statutory audit market, which concluded that, among other things, the Big Four should introduce an operational split between their audit and non-audit businesses to ensure focus on audit quality.

Third, also in 2019, Sir Donald Brydon produced a report into the quality and effectiveness of statutory audit in the UK. His report called for urgent reform to win back public and shareholder confidence in audit and avoid further "unnecessary corporate failures".

Next, in 2021, BEIS published a consultation paper called 'Restoring trust in audit and corporate governance'. BEIS's consultation proposed wide-ranging and major reforms for the audit industry, including:

- a wider definition of so-called 'public interest entities' (PIEs) to make more large businesses of public importance subject to regulation, whether or not they trade on a regulated market. (The proposed definitions under consideration were (i) more than 2,000 employees or a turnover of more than £200m and a balance sheet of more than £2bn or (ii) over 500 employees and a turnover of more than £500m. It was estimated that definition (i) would increase the number of PIEs by approximately 1,960 PIEs, whereas definition (ii) would lead to an increase of 1,060 PIEs);
- greater accountability for directors, including proposals to address the lack of board reporting on the adequacy and effectiveness of internal controls and risk management;
- new corporate reporting requirements, including an annual resilience statement covering business resilience over the short, medium and long term to consolidate and build on existing going concern and viability statements;
- the establishment of a new 'standalone' audit profession with a regulatory framework to cover both audit of financial statements (statutory audit) and audit of other information (wider audit);
- a new proposed 'purpose' of audit, being to "help establish and maintain confidence in a company, in its directors and in the information for which they have responsibility to report, including the financial statements";
- duties to take a wider range of information into account when conducting audits (such as director conduct);
- duties to report on anti-fraud measures;
- operational separation between audit and non-audit practices within major accounting firms;
- publication of audit quality review reports on individual audits to be published by the regulator without the need for consent from the audit firm and audited entity;
- the FRC to take responsibility for the registration of auditors of PIEs from recognised supervisory bodies; and
- for ARGA to be given two operational objectives (a quality objective and a competition objective), supplemented by regulatory principles and a host of statutory powers intended to strengthen its position as regulator.

In early May this year, an outline for the draft audit reform bill was included in the supporting papers for the Queen's speech. Although detail was lacking, the main elements of the bill were:

- Establishing ARGA to protect and promote the interests of investors, other users of corporate reporting and the wider public interest;
- Providing new measures to open up the audit market, including a new approach of managed shared audits in which challenger firms undertake a share of the work on large-scale audits. (The intention here is to improve the quality and usefulness of audit and boost resilience, competition, and choice in the audit market, but whether managed shared audits are workable and effective in practice remains to be seen.);
- Bringing the largest private companies in scope of regulation via the definition of PIEs and recognising the public interest in such companies;
- Giving ARGA effective powers to enforce directors' financial reporting duties, supervise corporate reporting, and oversee and regulate the accountancy and actuarial professions;
- Reforming the regulation of insolvency practitioners to give greater confidence to creditors and strengthening the corporate governance of firms in or approaching insolvency so that 'asset stripping' can be more effectively tackled.

Then, on 31 May, the government published its long-awaited response to BEIS's consultation paper. The government's response envisages a substantial scaling back of BEIS's ambitious proposals. Most notably, the scope of the definition of PIE has been significantly narrowed (to £750m or more turnover and over 750 (global) employees). In addition, several proposed measures, such as the requirements for a Resilience Statement, an Audit and Assurance Policy, directors' statements on steps taken to prevent and detect material fraud and new measures on dividends and distributable reserves, will only apply to PIE companies.

Further, proposals regarding audit purpose, scope and auditor liability have been left for ARGA to implement and/or for the market to shape, while the proposal for establishing a separate professional body for audit has been dropped. However, measures regarding managed shared audits and the operational separation of audit and non-audit businesses have survived.

Analysis

A lot of (worthy) ink has been spilled in the name of audit reform, and some progress has already been made. For instance:

- Work has already begun to establish ARGA, and the FRC announced its principles for the operational separation of the audit practices of Big Four firms in 2020.
- In 2021, the FRC published a revised UK standard for auditors' responsibilities relating to fraud in an audit of financial statements (ISA (UK) 240) and began publishing summaries of its corporate reporting reviews.
- Ernst & Young has recently announced that it is drafting plans for a voluntary split of the firm's advisory and audit divisions (to be considered and voted on by the firm's partners. If approved, the move would go further than 'operational separation' because it would create two separate companies altogether).
- Research from Ernst & Young shows that 67 of the companies in the FTSE 100 have already taken steps to enhance their internal controls over financial reporting. Many have also taken steps to assess and improve components of their fraud risk framework.

Despite that progress, and even though reform is now firmly on the legislative agenda, it is difficult to escape the conclusion that inertia for reform has done little to mitigate the risk of litigation, particularly for audit firms. Had reforms been implemented more quickly, they could have offered a degree of protection against the exact sorts of issues that gave rise to the tax scandals and collapses noted above. Add rising inflation, rising energy prices, supply chain disruption, the war in Ukraine and the fact that markets are still dealing with the ongoing impacts of the pandemic and Brexit to the mix, and it would hardly be farfetched to put money on more litigation resulting from the next major collapse or tax scandal. It is more than likely the next one is already brewing.

The reality is that there is no comprehensive plan as to when and how audit reform will be implemented. It is unlikely that legislative reform will be introduced until after June 2023 (albeit some reforms will be implemented without legislation) and ARGA will likely only be established in or after April 2024. Events in the wake of Boris Johnson's resignation may even further delay legislative reform. What is more, the government's response to BEIS's consultation indicates that its appetite for reform has been significantly scaled back.

An opportunity to reform the UK business ecosystem is being passed up. Knowing that a watered-down set of reforms is on the horizon will likely be cold comfort to auditors, investors and other stakeholders caught up in the next major collapse. Audit firms such as Ernst & Young and those in the FTSE 100 that have taken it upon themselves to drive change in their own businesses are to be commended. These companies will likely reap the rewards as a result.

However, as far as the market at large is concerned, it looks as though audit reform will ultimately deliver too little, too late.

Audit firms in particular are likely to continue to be targeted as the 'deep-pocketed' defendants of choice.

Our next article in the series will look in more detail at the sort of claims against auditors that have arisen in recent years and potential areas of litigation in the coming years.

Transforming human performance, impact and wellbeing in legal business

Ineo develops individuals, teams and businesses for profound impact and lasting change beyond the realm of workplace

For further details contact
Steve Smith - Managing Director
M: +44 7545 814368
E: steve.smith@ineo-life.co.uk
www.ineo-life.co.uk

ineo
our future is human

FINANCIAL INSTITUTIONS LITIGATION:

AN INVESTOR'S RECOURSE IN SWAP AGREEMENTS DISPUTES IN SINGAPORE

Authored by: Mubin Shah and Kyle Yew - Joseph Lopez

Introduction

Singapore's competitiveness as a major financial hub in Asia has increased over the years. Notwithstanding the COVID-19 pandemic, there has been an influx of burgeoning wealth into the country, coming in the form of family offices from billionaire entrepreneurs such as James Dyson and Haidilao co-founder Shu Ping.[1] The growth of family offices creates a demand for sophisticated financial services, provided by financial institutions ("FI") which are also attracted to set up in Singapore given the pro-business environment, excellent infrastructure, and international connectivity.[2] This translates to an interest for advanced investment products like swap agreements, which essentially involve an exchange of financial instruments (such as interest rate, foreign exchange, or commodities) for a period of time.

Given the fluctuating and variable value of such financial instruments, it is unsurprising that disputes do arise from time to time in respect of swap agreements. For instance, what happens if representations/advice given by the FI's relationship manager/sales representative ("Representative") to the investor customer ("Investor"), is not subsequently reflected in the eventual swap agreement? What recourse would the Investor have for losses arising from transactions that were made based on these representations/advice? This article explores some common legal issues in such situations, from a Singapore law perspective.

Swap Agreements

It is first helpful to understand how swap agreements are structured, before considering the legal implications thereunder. Generally, pursuant to discussions between the Investor and the FI's Representative, the Investor and the FI enter into a "Master Agreement" known as the International

1 Channel News Asia article published on 30 June 2022: https://www.channelnewsasia.com/commentary/hong-kong-emigration-exodus-singapore-asian-financial-hub-zero-covid-finance-business-jobs-economy-2780811#:~:text=Meanwhile%2C%20Singapore%20is%20strengthening%20its,and%20a%20stable%20regulatory%20environment

2 MAS website accessed on 22 August 2022: https://www.mas.gov.sg/development/why-singapore

Swaps and Derivatives Association ("ISDA") Agreement.[3] The Master Agreement contains detailed provisions to govern the parties' relationship, which typically include clauses that are in the FI's favour, like an entire agreement clause and exclusion of liability for representations. Subsequent individual transactions are then recorded in separate documents known as the "Confirmations".

Unwinding the Contract

If the representation/advice from the FI's relationship manager/sales representative led to the Investor's entry into the Master Agreement or execution of a Confirmation, a key issue is whether the Investor should be bound by the Master Agreement or the relevant Confirmation.

Under established principles of contract law, the Investor may attempt to argue unilateral mistake at common law. In short, the Investor has made a mistake as to the terms of the contract and that mistake is known to the FI, hence the contract should not be binding since the parties are in fact not in agreement.[4] To do so, the Investor has to prove that (i) he actually thought or believed that the transaction that he intended to enter into was different from that which he entered into; and (ii) the FI had knowledge of the mistake.[5] The contract would then be rescinded, and the parties restored to their respective positions as if no contract had been entered into in the first place.[6]

Further or in the alternative, under equitable principles of restitution, where the Investor paid monies to the FI who had acted ultra vires in entering into the Master Agreement or Confirmation, the Investor may have a cause of action in resulting trust.[7] If successfully proven, the FI who was enriched under the ultra vires contract (which is hence void) is obliged to account for the payments received and repay the monies to the Investor.[8]

Damages for Misrepresentation and/ or Breach

Separately, another issue is whether the Investor is entitled to any damages. For instance, the Investor may attempt to seek damages for misrepresentation, breach of duty of care in contract, breach of duty of care in tort, and/or breach of fiduciary duties.[9]

However, the feasibility of these causes of action depends on the facts of each case, such as the nature and effect of representations made, the background knowledge/experience of the Investor, and the relationship between the Investor and the FI. In particular, the Investor's background knowledge/ experience is relevant in determining whether the Investor was advised on certain matters but did not understand the advice, versus where the Investor was not advised at all.[10] This crucial distinction may have a significant impact on whether the above causes of action may succeed.

Conclusion

The Singapore government announced in the recently held National Day Rally 2022, Singapore's desire to continue attracting more investments and top talent to secure Singapore's success in a post-COVID-19 world.[11] Given Singapore's track record of attracting affluent Investors and sophisticated FIs over the past few years, the influx of such parties is only set to increase in the upcoming years, with a corresponding growth in demand for advanced investment products like swap agreements.

It is thus important for commercially savvy Investors, FIs, and their legal and tax advisors to understand the potential legal issues that may occur with such investment products.

This enables them to effectively manage any disputes arising from such investment products, or better still, to anticipate and reduce the risk of such disputes occurring in the first place.

3 Singapore High Court case of ACC v Comptroller of Income Tax [2011] 1 SLR 1217 at [5]: https://www.elitigation.sg/gdviewer/s/2010_SGHC_316

4 Singapore International Commercial Court case of Macquarie Bank Ltd v Graceland Industry Pte Ltd [2018] 4 SLR 0087 ("Macquarie") at [112]: https://www.elitigation.sg/gd/s/2018_SGHCI_5

5 Macquarie at [88] and [113]

6 Macquarie at [112]

7 Singapore High Court case of Skandinaviska Enskilda Banken AB (Publ), Singapore Branch v Asia Pacific Breweries (Singapore) Pte Ltd and another and another suit [2009] 4 SLR(R) 788 ("Skandinaviska") at [293]: https://www.elitigation.sg/gd/s/2009_SGHC_197

8 Skandinaviska at [297]

9 Singapore Court of Appeal case of Wee Soon Kim Anthony v UBS AG (No 4) [2004] SGCA 33 ("Wee Soon Kim") at [17]

10 Wee Soon Kim at [40] to [49]

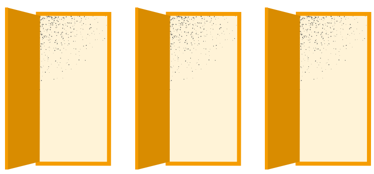
11 The Straits Times article published on 21 August 2022: https://www.straitstimes.com/singapore/politics/ndr-2022-singapore-to-attract-and-retain-top-talent-with-new-initiatives

NORWICH PHARMACAL ORDERS AND THE EXPANSION OF THE JURISDICTIONAL GATEWAYS

Authored by: Rachael Cederwall - Baker McKenzie

According to financial institutions, the criminal threats against them are increasing and growing in sophistication and effectiveness. Office of National Statistics data[1] shows that reported fraud offences in England & Wales are increasing at significant rates, particularly in relation to banking and credit industry fraud (up 43% in the year ending March 2022), and fraud involving financial investments such as pyramid or Ponzi schemes and share or bond sale fraud (up 59% and 57% respectively in the year ending September 2021).

Norwich Pharmacal Orders ("NPOs") are an effective tool for victims of such fraud. They assist the victim to obtain the information needed to get redress. The ability to use this tool in the context of cross-border fraud will soon become easier by virtue of recently approved amendments[2] to Practice Direction 6B of the Civil Procedure Rules 1998 ("PD6B"), which will create a new gateway to serve Norwich Pharmacal Orders out of the jurisdiction. However, it remains to be seen whether the change will make a meaningful difference to parties' ability to obtain documents in a cross-border context.



Fundamentals of NPOs

Where a victim knows (or suspects) a wrongdoing has happened but either they do not have the evidence to prove it or they don't know the identity of the wrongdoer, NPOs can provide a means for the victim to obtain the missing information from an innocent third party. With the upsurge of fraud offences in recent years, financial institutions are increasingly on the end of NPOs by virtue of their innocent facilitation of the fraud. NPOs have become even more useful in recent years in the context of crypto-fraud.[3] Victims of crypto-fraud will often want to access information in the control of third party institutions, such as crypto exchanges, and NPOs can be a valuable mechanism to obtain that information.

To secure an NPO a victim must satisfy a number of criteria: there must be a good arguable case that there has been wrongdoing, in which the respondent was 'mixed up', and the victim must need the order to take action against the ultimate wrongdoer. Crucially, NPOs will only be made where strictly necessary and cannot be used as a fishing expedition to turn up documents.

1 https://www.ons.gov.uk/peoplepopulationandcommunity/crimeandjustice/datasets/crimeinenglandandwalesappendixtables

2 https://www.justice.gov.uk/__data/assets/pdf_file/0007/177388/cprc-149-pd-update.pdf

3 By way of example, in Mr Dollar Bill Limited v Persons Unknown and Others [2021] EWHC 2718 (Ch), the High Court granted a NPO meaning that the relevant exchange was ordered to disclose information to assist in determining what happened to the Claimant's cryptocurrency.

New Gateways

The cross-border nature of much of the fraud perpetrated in recent years can undermine the expediency of NPOs where the necessary information or documents are held by institutions outside the jurisdiction. As matters presently stand, the general view is that NPOs cannot be served on parties outside the jurisdiction.[4] Although in some instances,[5] the English Courts have granted permission to serve a Norwich Pharmacal application on a respondent based in a foreign jurisdiction. This has resulted in inconsistent case law, with the Court's territorial jurisdiction being impacted by the nature of the Claimant's substantive claim and whether or not the claim is proprietary. As a result of the inconsistency and unpredictability, some victims have looked to creative methods to obtain material located abroad, for example, in Credit Suisse Trust v Banca Monte Dei Pasche Di Siena [2014] EWHC 1447 (Ch), the applicants obtained an NPO against two foreign-based financial institutions on the basis that they had branches in London even though the information was held offshore.

Such creative strategies may soon be unnecessary. This is because the recently approved reforms expand the circumstances in which the English courts can grant permission to serve out of the jurisdiction. This includes a new gateway for litigants to pursue third party information claims, such as NPOs (PD6B, paragraph 3.1(25)).

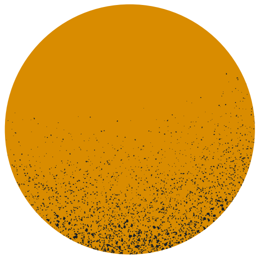
What next?

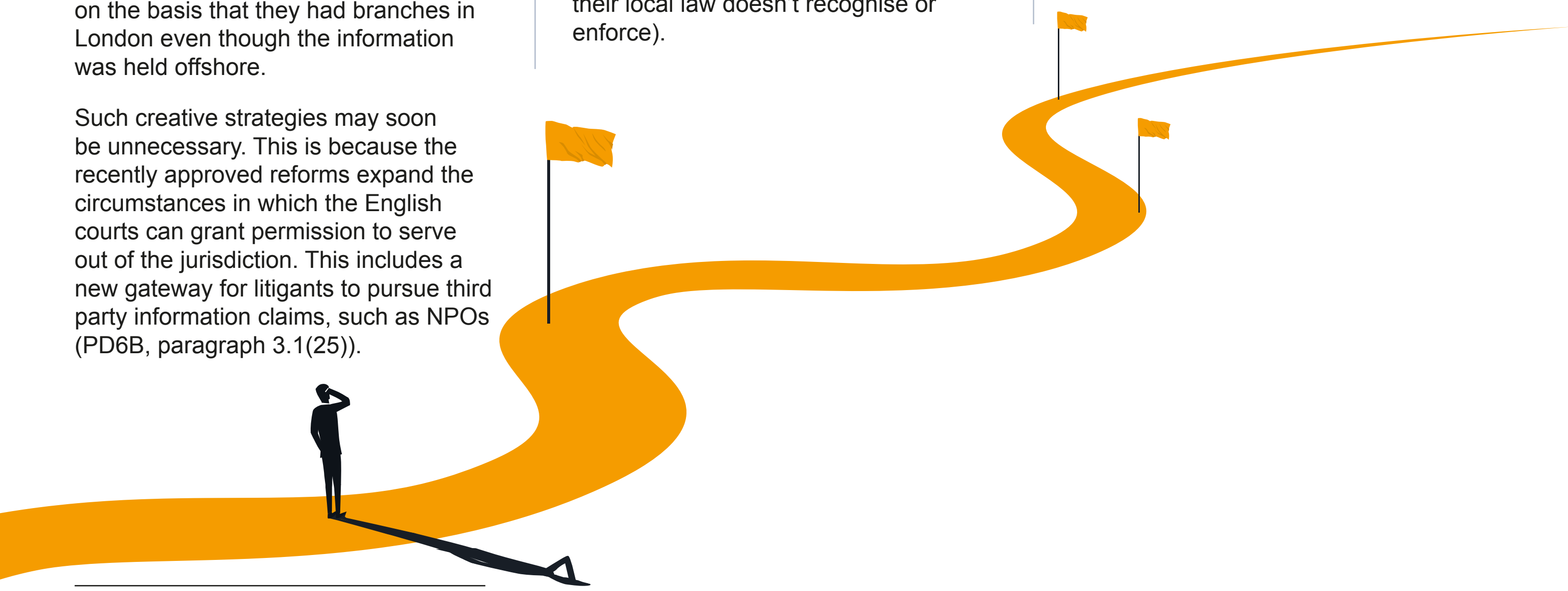
The amendments to PD6B will take effect from 1 October 2022 and the resultant expansion of jurisdiction gateways and enhanced ability to seek NPO relief outside the jurisdiction are likely to be especially important for financial institutions, particularly as we see even more conventional financial institutions expand into emerging financial technologies and the growing field of cross-border fraud litigation in that regard.

Whilst the amendments will be welcomed by victims of fraud and other litigants seeking to obtain information from parties outside the jurisdiction, how effective they are in practice remains to be seen. Many foreign jurisdictions will not recognise or enforce English non-final and/or non-money orders. This is particularly relevant to financial institutions in those jurisdictions, whose client confidentiality obligations are typically only over-ridden by compulsion of their local law (and therefore not by virtue of an English court order which their local law doesn't recognise or enforce).

The changes may have more effect if English courts make and enforce contempt orders against third party recipients who don't comply, but that depends on both the English courts being willing to make such orders, and the contempt orders being an effective threat to the third parties, which will not always be the case. The UK's bilateral mutual legal assistance treaties could provide some further assistance in this regard.

Overall, the changes are welcome, and should enhance the reputation of English courts as a good place to seek justice. Just how much enhancement they provide, time will tell.





4 [2016] EWHC 2082 (Comm), held that NPOs could not be served outside of the jurisdiction

5 In Mr Dollar Bill Limited v Persons Unknown and Others [2021] EWHC 2718 (Ch) permission was given to serve an NPO out of the jurisdiction


RPC
#Disputespowerhouse

WHOSE FAULT???

FRAUD AND QUINCECARE DUTY FROM AN INVESTIGATION PERSPECTIVE

Authored by: Gabriel Tsui and Vivian Leu - PwC Hong Kong

Quincecare duty, a financial institution's duty being first established in Barclays Bank Plc v Quincecare Ltd [1992] 4 All ER 363, is an implied term of the contract between a bank and its customer that the bank will use reasonable skill and care in executing the customer's orders.

Since Quincecare duty was established, the nature of banking activities and fraud schemes have evolved extensively. A larger reliance has been placed on internet banking in recent years, which can mean more sophisticated methods are involved in defrauding financial institutions and/or their customers. The pandemic has further accelerated the transition of spending patterns from offline to online. Financial institutions inevitably have become easy targets of the victims who look for a compensation.

Very often, accountants assist financial institutions to investigate alleged fraud schemes and related transactions. Quincecare duty has been receiving heightened attention in both English courts and Hong Kong courts in recent years:-

1. Federal Republic of Nigeria v JP Morgan Chase Bank [2022] EWHC 1447 (Comm)

The Federal Republic of Nigeria ("FRN") brought a claim against JP Morgan, attempting to recover funds that had been paid out of a depository account in its name with JP Morgan Chase Bank ("JP Morgan"). In 2011 and 2013, JP Morgan made payments totalling approximately a billion US dollars to accounts held by a Nigerian company, on instructions conveyed by authorised officers of FRN.

FRN alleged that JP Morgan was in breach of its Quincecare duty, as the payment instructions were allegedly fraudulent, which JP Morgan should have been able to detect. FRN claimed that the act of JP Morgan making such payments was grossly negligent.

The Judge rejected FRN's claim and held that the existence of fraud had not been proven, and considered that even if it did, the bank did not act with gross negligence in making the payments in 2011 and 2013.

2. Philipp v Barclays Bank UK Plc [2022] EWCA Civ 318

This case arose when the claimant, Mrs Philipp, became the victim of an authorised push payment ("APP") fraud in 2018. The claimant was convinced by the fraudster to transfer GBP700,000 from her account with Barclays Bank UK Plc ("Barclays") to third party accounts in the United Arab Emirates, believing her act would assist the Financial Conduct Authority and the National Crime Agency to bring a fraudster into justice.

The judge at first instance ruled in favour of Barclays but it was overturned in the Court of Appeal. The judge commented "The key is the careful calibration of the Quincecare duty itself. It is a duty conditioned by whatever ordinary banking practice is at the relevant time. A finding that the facts of Mrs Philipp's case would, when considered alongside ordinary banking practice in March 2018, have put an ordinary prudent banker on inquiry about APP fraud, simply does not mean that the circumstances associated with any one of the many millions of low value BACS transfers would do so."

3. Luk Wing Yan v CMB Wing Lung Bank Ltd [2021] HKCFI 279

In 2010, the plaintiff entered into a number of investments offered by one of the CMB Wing Lung Bank Ltd's ("CMB Wing Lung") employees. The investments promised high returns at 100% return over a few months or even some at an annualised rate in excess of 500%. The plaintiff invested in approximately HK$35 million, but around HK$23.8 million was never been returned to her and was completely lost.

The judge ruled in favour of the bank and commented "…that would involve potentially significant invasions of privacy and other matters which would require careful consideration and, as I have already indicated, industry-wide consultation and implementation… It would be better for customers to raise questions when there are suspicions of the sort which must have been triggered in this case. As I said at the beginning, if it seems too good to be true, it probably is."

The above cases show how far Quincecare duty may stretch.

The public expects that financial institutions will protect their customers from fraud. In the event of suspicious fraudulent acts that may involve internal or external parties or whistle-blowing of such, taking earlier actions to investigate is always better than later:-

1. Investigate any unusual transactions by performing detailed fund flow diagrams and checking the timeline of events, and analysing contemporaneous accounting and financial records.
2. Estimate a loss or damage arising from the fraudulent acts.
3. Call in investigative accountants to assist the legal team and to testify in court.

Conclusion

It remains uncertain how far Quincecare cases may stretch in the future. Alongside any investigation, a team of experienced consultants could also assist in reviewing the financial institution's processes and internal control systems, and provide recommendations for potential enhancements, in order to cope with the rapidly evolving fraud schemes and sophisticated techniques used by fraudsters.

FCA CONFIRMS NEW CONSUMER DUTY TO IMPROVE CONSUMER PROTECTION IN RETAIL FINANCIAL MARKETS

Authored by: Darren Kidd and Alex Lerner - Stewarts

The Financial Conduct Authority ('FCA') is taking steps to improve levels of consumer protection in retail financial markets by introducing a 'Consumer Duty'. The FCA has said the Consumer Duty will "fundamentally improve" how firms serve customers. It hopes the Consumer Duty will bring about a fairer, more consumer-focused and level playing field in which firms consistently place their customers' interests at the centre of their businesses.

Darren Kidd and Alex Lerner outline the Consumer Duty and consider some of the implications of the FCA's proposal not to create a private right of action in relation to it.

Prioritising consumer outcomes

The FCA is concerned that regulated firms are not consistently and sufficiently prioritising consumer outcomes, and this causes consumer harm and erodes trust. It wants to set a higher expectation for the standard of care firms give consumers and see firms compete vigorously in consumers' interests.

The Consumer Duty will require a significant shift in both culture and behaviour for many firms. They will need to focus consistently on consumer outcomes and put customers in a position where they can make effective decisions.

The Consumer Duty

The proposed duty is essentially a package of measures consisting of the following elements:

1. A Consumer Principle requiring firms to "act to deliver good outcomes for retail customers". The wording is intended to emphasise the expectation for firms to consistently focus on consumer outcomes and put consumers in a position where they can act and make decisions in their own interests. Notably, the FCA opted against introducing a higher standard of care (ie acting in consumers' "best interests").
2. Cross-cutting rules requiring firms to (i) act in good faith towards retail customers, (ii) avoid foreseeable harm to retail customers, and (iii) enable and support retail customers to pursue their financial objectives.
3. Outcomes providing more detailed expectations for the key elements of the firm-consumer relationship, which the FCA considers to be instrumental in helping to drive good outcomes for customers:

i. products and services – all products and services for retail customers should be fit for purpose

ii. price and value – all consumers should receive fair value

iii. consumer understanding – firms' communications should support and enable consumers to make informed decisions about financial products and services by giving consumers the information they need at the right time, presented in a way they can understand

iv. consumer support – firms should provide a level of support that meets consumers' needs throughout their relationship with the firm, enabling consumers to realise the benefits of the products and services they buy and ensure that they are supported when they want to pursue their financial objectives.

The Consumer Duty is underpinned by the concept of reasonableness. This is an objective test. It means the rules must be interpreted in line with the standard that could reasonably be expected of a prudent firm carrying on the same activity in relation to the same product and taking appropriate account of the needs and characteristics of its customers based on the needs and characteristics of retail customers in the relevant target market or of individual customers as the context requires.

It imposes a higher standard of conduct than exists under Principles 6 and 7 of the Principles for Business in the FCA Handbook. This is underlined by the FCA's decision for the Consumer Duty to be enabled by introducing a new principle rather than adapting old ones. (The FCA's existing principles require firms to pay due regard to the interests of their customers and treat them fairly, and pay due regard to the information needs of their clients and communicate information to them in a way that is clear, fair and not misleading.)

In short, the message from the FCA is that the new rules will set higher standards and be backed up with assertive supervisory and enforcement action. This aligns with the FCA's focus on being more assertive, innovative and adaptable in its regulatory approach.

The FCA wants the Consumer Duty to be in effect as soon as practicable so that consumers can start to benefit from enhanced protections sooner rather than later. The FCA has therefore proposed a phased approach to the introduction of the Consumer Duty, which will apply to new and existing products and services open to sale (or renewal) from 31 July 2023. This only gives a relatively short period for firms to implement the significant changes the Consumer Duty entails.

No private right of action

The Consumer Duty sets higher expectations for the standard of care firms give customers, aiming to put consumers' needs first. It is a positive and welcome step for consumers.

There are, however, some limitations. Although the new duty will give the FCA a greater ability to hold firms and their senior management to account if poor outcomes are identified, the proposed duty stops short of introducing a private right of action.

The FCA decided against this because of industry and consumer concerns that the higher standards of the Consumer Duty or increased compliance costs associated with it could lead to firms removing products from the market. This could impact consumers in vulnerable circumstances. It also took the view that allowing the industry adequate time to embed the Consumer Duty without the prospect of private actions being brought would be important to fully realise the consumer benefits of the cultural and mindset changes the Consumer Duty aims to achieve.

Although such concerns are well founded, the proposal not to make the new Consumer Duty actionable by the individuals whose treatment and experiences are at the heart of the proposals is unfortunate for the following reasons:

1. While in most cases the Financial Ombudsman would be able to provide sufficient redress for breaches of the Consumer Duty, compensation limits make this avenue unsuitable for larger claims.

2. Without a private right of action, there will not be any industry wide consumer redress scheme under section 404 of the Financial Services and Markets Act 2000 (FSMA), and the Financial Services Compensation Scheme will not be able to provide compensation for breaches of the Duty.

3. The absence of a private right of action may mean the Consumer Duty lacks a sufficient 'deterrent' effect.

Nevertheless, the FCA has indicated it will keep the possibility of a private right of action under review. In the meantime, in response to feedback from consumer organisations in the course of its consultations, the FCA has strengthened the governance and accountability and redress requirements. Further, the FCA has the power to require restitution from firms in breach of the Consumer Duty under section 384 FSMA.

Networking Seminars Podcasts

TDN is an inclusive group of legal and tech professionals interested in learning how to avoid, manage and win technology disputes.

Join TDN to hear about our next event.

https://disputes.tech

Disputes

Upcoming Events

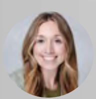
Group Litigation and Class Actions	**19-20** Oct 2022
Corporate Disputes	**21-22** Nov 2022
Financial Institutions Litigation	**19** Jan 2023
Sovereign & States Disputes and Enforcement	**24-25** Jan 2023
ESG Litigation	**7** Feb 2023
India Dispute Resolution Forum - London	**7-8** Jun 2023

For events enquiries contact:

Yanis Lau, Conference Producer

e: yanis@thoughleaders4.com
m: +44 (0) 7525 450694

For partnerships enquiries contact:

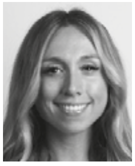


Chloe Gibbs, Commercial Director

e: chloe.gibbs@thoughtleaders4.com
m: +44 (0) 7983 505171

ThoughtLeaders Disputes

Meet ThoughtLeaders

							
Paul Barford Founder / Director 020 7101 4155 email Paul	**Chris Leese** Founder / Director 020 7101 4151 email Chris	**Danushka De Alwis** Founder / Director 020 7101 4191 email Danushka	**Maddi Briggs** Strategic Partnership Manager 07825 557739 email Maddi	**Chloe Gibbs** Commercial Director 07983 505 171 email: Chloe	**Dr Jennifer White** Head of Production 07733 854 996 email: Jennifer	**Yanis Lau** Conference Producer 07525 450 694 email: Yanis	**Fatema Rasul** Conference Producer 07701 307284 email: Fatema

Our Disputes Community Partners:

3VB Three Verulam Buildings Barristers
Blackstone Chambers
BRG
brownrudnick
BYFIELD Reputation Counsel
Cooke, Young & Keidan Commercial Disputes Lawyers
deminor Litigation Funding
Gatehouse Chambers
HFW
keidan harrison disputes and insolvency lawyers
Kingsley Napley When it matters most
Mintz Group
PCB Byrne
Peters & Peters
Pinsent Masons
Radcliffe Chambers
RPC
serle court
Stephenson Harwood
TDN Tech Disputes Network