DLA PIPER

BANKING DISPUTES

QUARTERLY

Q3 2014

DLA Piper's Banking & Finance Litigation team welcomes you to our quarterly round-up, designed to keep you informed of the latest news and legal developments, and to let you know about future developments that may affect your practice.

ON THE HORIZON

In this section we summarise cases, legislation and other developments in prospect in coming months:

- **On Wednesday 5 November the Supreme Court will hand down a significant judgment in the case of AIB Group (UK) plc v Mark Redler & Co Solicitors.**

  The ruling will determine once and for all how much compensation lenders can expect to recover when they pursue claims for breach of trust. Should lenders be entitled to recover their entire loss (i.e. their entire advance, less receipts) as equitable compensation (and thereby be able to recover losses caused by a fall in the property market)? Or should their losses be limited by the same principles of causation which apply in claims based on breach of contract and negligence?

  The decision promises to be one of the most significant in this area since the seminal case of Target Holdings Ltd v Redferns [1995] UKHL decided nearly 20 years ago. We will provide a detailed analysis of the Supreme Court's decision in our next issue of Banking Disputes Quarterly.

- **Competition and Markets Authority investigation to SME current accounts**

  The Competition and Markets Authority is expected to confirm this Autumn whether it will proceed with a market investigation reference in relation to both the provision of personal current accounts and the provision of retail banking services to SMEs. If a market investigation is made, then the CMA would be subject to the new statutory deadline of completing the investigation within 18 months of reference, plus a further six months for implementation of remedies.

- **Payment Systems Regulator**

  Certain provisions of the Financial Services (Banking Reform) Act 2013 (Banking Reform Act) come into force on 1 November 2014. From that date the Payment Systems Regulator (PSR) will have certain competition functions allowing it to investigate and address restrictions and distortions of competition if they relate to the payment systems sector.

  The PSR is also expected to publish a consultation paper which will set out policy proposals across a broad range of issues. Key areas of focus will be governance, access, infrastructure, innovation and appropriate boundaries for collaboration and competition. The consultation process will last eight weeks. Once the PSR has had time to consider responses it will release a final policy statement before it becomes fully operational on 1 April 2015.

  In the meantime the Treasury has proposed designating: BACs; CHAPS, Faster Payments; LINK; Cheque and Credit; Northern Ireland Clearing; Visa and Mastercard as being within the scope of the PSR. It does not currently think that there is sufficient evidence to justify designating: American Express; Diners Club; PayPal or Paym, though they could potentially be designated at a future date.

Once a payment system is designated the PSR will have a range of powers over its participants (operators, infrastructure providers and payment service providers that provide payment services using the system).

- **UK bonus cap challenge**

The Advocate General will deliver his opinion on the Government's attempt to overturn the cap on banker's bonuses on 20 November 2014. The final judgment from the court will come sometime later (probably in February 2015) though the court usually follows the Advocate General's opinion.

- **Godiva Mortgages Limited v Travelers Insurance Company Limited**

In November 2014 the Commercial Court will hear a landmark case concerning the aggregation of professional indemnity (PI) claims. "Aggregation clauses" allow insurers to limit the amount they pay out by treating multiple claims with common denominating factors as if they were a single claim and subject to the indemnity cap which would apply to any one claim.

In this case the insurer, Travelers Insurance Company Limited (Travelers), is seeking to limit its exposure to a now defunct firm of solicitors arising out of the allegedly fraudulent conduct of one of the firm's former partners. That partner had been involved in respect of a whole series of conveyancing actions involving a number of different lenders which led to claims totalling approximately £50m. The instant case arose after one lender, Godiva Mortgages Limited (Godiva), sued the solicitors for negligence and breach of contract in respect of a mortgage transaction and obtained judgment in default. The solicitors went into administration and Godiva looked to their PI insurers, Travelers. Godiva claimed that the partners' rights to be indemnified by Travelers had been transferred to and vested in Godiva under section 1 of the Third Parties (Rights Against Insurers) Act 1930. Travelers however refused to pay out, arguing that its policy had been exhausted prior to Godiva obtaining judgment, as its £2m limit of indemnity had already been paid out against numerous other earlier claims which, under the terms of the policy, it could treat as a single claim.

This will be the first opportunity for the courts to consider the precise meaning of the Minimum Terms and Conditions (MTC) required by the Solicitor's Indemnity Rules 2008 and might result in changes to the MTC in due course. The outcome could have far-reaching implications for lenders, solicitors and insurers. Such is the importance of the case that both the Law Society and the Solicitors Regulation Authority have been given permission to intervene.

RECENT DEVELOPMENTS & CASES

In this section, we take a more in-depth look at cases and other developments affecting the banking and financial industry in recent weeks.

TWO KEY SWAPS MIS-SELLING CASES:

Since the last issue of our Banking Disputes Quarterly there have been two key case developments in relation to swaps mis-selling claims:

- **Crestsign Ltd v NatWest and RBS [2014] EWHC 3043 (Ch)**

  This recent judgment is one of only a few full judgments to arise from the swaps mis-selling scandal (the majority of cases against the banks having been settled, discontinued by the claimant following the outcome of the parallel FCA supervised review, or dismissed by the courts at an interlocutory stage).

  In this case, the judge dismissed all of the claimant's claims and found in favour of the bank. Although the judge concluded that communications from the bank's salesperson to the customer would have amounted to negligent advice, he held that the bank had successfully avoided any duty of care to the customer by virtue of terms in its supporting documentation (which, on the facts, the claimant had received and read before entering into the swap). This set out the basis upon which the parties would deal with one another and made clear that the bank would not be acting as an adviser. The judge held that relevant provisions of the documents were 'basis' terms rather than exclusion clauses and therefore the 'reasonableness test' under UCTA did not apply.

  Further, whilst the bank owed a duty to provide a factually accurate and not misleading explanation of the products it offered, on the facts of this case the information provided did satisfy that duty, and the judge rejected the claimant's argument that the scope of this information duty effectively extended to a duty to 'educate' the customer about the products. The judge denied the claimant permission to appeal and awarded the bank 75% of its costs and a payment on account of those costs (suspended pending the claimant's application to the Court of Appeal for permission to appeal).

  DLA Piper represented Natwest and RBS in this case, with a team led by Hugh Evans (Partner) and Paul Smith (Legal Director).

- **Deutsche Bank AG v Unitech Global Limited [2014] EWHC 3117 (Comm)**

  In the last edition, we reported on the linked cases of *Barclays Bank plc v Graiseley Properties Limited* & *Deutsche Bank AG v Unitech Global Limited*, which had been widely publicised as test cases for LIBOR manipulation claims. Barclays settled the mis-selling claim brought against it by Graiseley, whilst the Unitech claim was still proceeding.

  In November 2013, the Court of Appeal had overturned a first-instance finding that rescission was not available to Unitech as a defence to the US$177m claim brought against it. In the light of that decision, Unitech applied to set aside an earlier order for summary judgment in the bank's favour. The bank sought an order for payment into court of US$120m and/or an interim payment on the basis that even if the Defendants' rescission defence was successful at trial, they would still owe the bank a minimum of US$120m.

  Following a hearing on 16 September 2014, Mr Justice Teare set aside the summary judgment order,

but declined to order any payment into court or an interim payment. Whilst the judge acknowledged that this was an unsatisfactory outcome for Deutsche Bank given the amount that would be owed to the bank even if Unitech's defence was successful, he did not accept that any of the CPR provisions relied upon by the bank were applicable on the particular facts of this case. The judge made a costs award in favour of the bank, including an interim costs payment, and made some critical remarks about the Defendants' failure to take steps to prepare for the substantial payments that will have to be made to the bank, even if their defence is successful.

Absent any settlement, this case seems likely to run for some time, and we will await further developments with interest since the court's determination of Unitech's rescission defence may well have an impact on other outstanding LIBOR-fixing claims.

Protecting the bank's position when customers fall hook, (on)line and sinker for vishing frauds

By Adam Ibrahim (Partner) and Claire Clayton-Stead (Associate). This article first appeared in the Butterworths Journal of International Banking and Financial Law in September 2014.

As fraud continues to cost the UK economy billions each year, bank customers are now looking to the banks to cover their losses. What steps should banks take to defend themselves against such claims?

Online banking fraud continues apace with the targeting of instantaneous online payment systems offered by all banks, which provide businesses with a swift and efficient payment capability. Common scams include "vishing" telephone calls, where customers are deceived into providing online banking security details, and viruses using harmful software to gather those details. With this information the fraudster effectively has a signed blank cheque against all the customer's online accounts and can misappropriate thousands – if not tens or hundreds of thousands – in a short space of time. From the bank's point of view, these frauds often pass under the radar because, by virtue of the security information the fraudster has garnered, the bank has no way of knowing that it is not the customer undertaking the payments. Despite this, customers are turning to the law in their fight to recover fraudulent payments, yet their target is not the fraudster who has spirited their cash away, but their bank. The legal claims typically fall into three categories:

- Breach of mandate: the bank had no authority to make the payments.
- Breach of duty of care: the bank should have detected the payments were fraudulent.
- Claims for a refund under terms and conditions or the Payment Services Regulations 2009 (PSR) (SI 2009/209)

For once, the court of public opinion seems to be on the banks' side. The law, however, may not be so straightforward. At present, a bank's duty of care does not extend to detecting fraud on customer accounts (although there is a duty, once "on notice" of fraud, to halt transactions and alert the customer). However, given this law is over twenty years old, largely pre-dating online banking, it may be ripe for renewal by the courts so as to oblige banks, as a legal duty to their customers, to have fraud detection systems in place. This would have industry-wide connotations and place an expensive burden on the banking system, and despite the fact that all banks have invested heavily in technology such as real-time code-generating devices which provide far greater protection against fraud than was ever available in the days of cheque payments.

Furthermore, unless a bank's terms and conditions disapply certain of the PSR, banks must refund unauthorised transactions unless undertaken intentionally or fraudulently by the customer or caused by their gross negligence. Whilst there are certainly grounds to argue that disclosure by the

customer of all their online banking security information is grossly negligent, there is presently no useful guidance – either from the courts or the FCA – on what constitutes grossly negligent conduct, leaving banks in a state of uncertainty.

There are, nonetheless, practical steps that can be taken:

- Ensure terms and conditions are clear about where responsibility for unauthorised payments lies and in what circumstances. They must also be PSR-compliant, and if banks want to opt out, it must be clear to which customers the opt-out applies and which of the PSR are being disapplied.
- The PSR state that any refund due is to be made immediately. FCA guidance suggests this means the same or next business day after notification of the fraud. If a refund is to be delayed pending investigation of the fraud, communicate this to the customer in the same timeframe and investigate promptly.
- Warn customers often and clearly about the hallmarks of online fraud and how to guard against it.
  The prospects of demonstrating that the customer was grossly negligent increase the more warnings and advice they can be shown to have received.
- Keep good records of activity on the customer's online banking facility: banks need to be able to evidence how the fraud occurred, especially since customers may not be able to recall or may be unwilling to admit exactly what information they shared with the fraudster.
- Have a voice-recorded fraud-reporting telephone line to capture any helpful early disclosures customers make about the information shared with the fraudster.
- Have in place procedures to contact third party banks swiftly to maximise funds recovery. The faster this contact, the greater the recovery and the lower the prospect of the customer claiming against the bank.
- Communicate regularly with customers during any investigation: litigation often arises as much out of customers' dissatisfaction with how their case has been handled as out of the underlying circumstances of the claim.

In short, in the face of the current legal uncertainties, banks should do all they can to control the limited factors within their control, to protect against claims. Whether that is enough will have to be determined by the courts and the FCA.

Mistaken electronic money transfers – procedure for Norwich Pharmacal orders clarified

By Paul Smith (Legal Director), Natascha Steiner (Associate) and Sophie Payton (Associate)

Electronic payment systems such as Faster Payments and CHAPS have become standard in personal and business banking. According to its 2013 Annual Report, CHAPS turns over payments equivalent to the UK's annual GDP every 5 working days, and in August 2014 alone CHAPS processed 2.9 million payments worth £5.2 trillion.

Amongst these many payments, payments to the wrong bank account or duplicated payments do sometimes occur, albeit infrequently. If these mistaken payments cannot be recovered by co-operation between the relevant bank, its own customer and the recipient bank, such that the identity of the recipient account holder cannot be identified, it then becomes necessary for the paying bank to apply to court for a *Norwich Pharmacal* order, compelling the receiving bank to disclose the identity of the recipient so that recovery action can be pursued.

In *Santander UK Plc v National Westminster Bank Plc and others* [2014] EWHC 2626 (Ch) the High Court considered the procedural issues arising from a series of applications for *Norwich Pharmacal* orders made by Santander against other banks, seeking disclosure of the names and contact details of those banks' customers who had received mistaken payments from Santander.

Nature and merits of the applications

The High Court considered a representative sample of a larger volume of applications submitted by Santander. The applications were made pursuant to CPR Part 23 and related to cases where Santander had exhausted all other avenues for identifying the recipients of the mistaken payments, whether through Santander's own customers or

through the receiving banks where the recipients held their accounts. The amounts of the mistaken payments were mostly small, ranging from approximately £350 to £15,000. Some of the applications had been dealt with by masters and some by judges. The Chancery Division had noted the volume of applications and the potential for inconsistent outcomes and proposed a hearing to address the issues raised by these applications, which was held on 16 September 2014 and attended by Santander but not by representatives of the recipient banks.

In considering the merits of the applications, the High Court accepted that Santander appeared to have a good claim in each case to recover the monies paid by mistake but emphasised that *Norwich Pharmacal* orders should only be made in exceptional circumstances where the court is satisfied that it is necessary and proportionate to do so. In making this assessment, the court had to balance the applicant's rights to recover the mistaken payments against the rights and obligations of the recipients and their banks, including as regards privacy and data protection. On the applications before it, the court held that the orders should be made since they represented a step of last resort for Santander. The court noted that the outcome might have been different if, for instance, Santander had sought more than the minimum information required to identify the recipients (e.g. for account statements) or if Santander could have asked its own customers to help identify the recipients and had failed to do so.

Practical guidance for future applications

Having considered the merits of the applications, the court turned to some of the practical issues raised by these applications, from which the following key points arise:

- Future applications of this nature would be better made under CPR Part 7 or Part 8, rather than under Part 23. Whilst Santander acted appropriately in making its applications under CPR Part 23, an unintended consequence of this was that the applications had no claim number and were therefore difficult to identify and track (multiple applications having been brought in the name of the same applicant against the same receiving bank). Bringing the application under Part 7 or 8 would address this issue, although the court said that it would also consider whether using the solicitors' case reference or some form of docketing by the court might provide alternative solutions.
- Draft orders and supporting witness statements need to be drafted consistently and to explain all relevant background, and an applicant and its solicitors may wish to consider using a checklist to ensure consistency across a volume of applications.
- If an applicant has a large number of these applications to bring in future, it may be sensible to inform the court at the outset and invite the court to agree an approach to deal with the volume of claims.

Costs

A final point arises in relation to the costs of these applications. The court highlighted the distinction between the costs of the applications seeking the *Norwich Pharmacal* orders and the costs of any subsequent proceedings against the recipients, once disclosed, for recovery of the mistaken payments. In this case, Santander did not seek orders for the costs of the applications against the ultimate recipients, and further indicated that it would not seek to recover the costs of these applications in future proceedings against the recipients. The court therefore made no comment as to whether it would have made an order against the recipients on these applications, or as to whether an applicant could legitimately seek to recover costs of prior applications in subsequent proceedings. Future applicants may choose to take a different approach to costs, but this is likely to be a judgment call on the factual background and circumstances of the relevant applications.

JSC BTA Bank v Mukhtar Ablyazov and others – Iniquity as an exception to privilege

By Jeremy Andrews (Partner) and Joanne Jones (Associate)

The latest decision of the English Commercial Court in the long-running saga of *JSC BTA Bank v Ablyazov* has highlighted an exception to the scope of legal professional privilege ("LPP") which is of potential use in

circumstances where a defendant is seeking to conceal assets and avoid enforcement proceedings. The Court held that certain documents held by Mr Ablyazov's current and former solicitors should be disclosed pursuant to the *iniquity* exception, as a result of a "*strategy of concealment and deceit*" undertaken by Mr Ablyazov. This exception to LPP is well-established, but it is rarely invoked and the decision offers a useful illustration of the circumstances in which it might arise.

Background

In 2009 the claimant bank accused Mr Ablyazov, its former chairman, of misappropriating around US$6 billion of its funds and successfully obtained a worldwide freezing order against him. Rather than complying with the terms of the freezing order, Mr Ablyazov sought to conceal his assets, lie to the court and forge documents in order to support this false evidence. In subsequent proceedings, Mr Ablyazov was debarred from defending his case, sentenced to 22 months in prison for contempt of court (in absentia, having fled the jurisdiction) and now faces a judgment of US$4.6 billion made in favour of the claimant.
Mr Ablyazov was subsequently arrested in France in 2014 and is currently embroiled in proceedings for his extradition to the Ukraine and Russia, as well as being the subject of on-going criminal proceedings in Kazakhstan.
In the meantime, the claimant bank is attempting to enforce the judgement against Mr Ablyazov but has encountered difficulty due to assets being concealed through an elaborate matrix of intermediaries and special purpose vehicles. The bank therefore sought disclosure of documents from Mr Ablyazov's current and former solicitors on the basis that they were likely to have information which could cast light on the whereabouts of his assets.

The iniquity exception

The right of an individual to consult a lawyer in absolute confidence, and therefore to withhold from disclosure communications passing between them, is long-established under English common law and, once established, is generally considered inviolate. However, an exception arises where the communication between client and lawyer is made in furtherance of a criminal or fraudulent purpose, in breach of a duty of good faith or contrary to public policy of the interests of justice (the iniquity exception).
In such circumstances, whether or not the solicitor is aware of his client's criminal purpose, privilege in respect of the communications can be set aside.

The iniquity exception is not relevant to all situations in which there is some deception on the part of the client – clients will, not infrequently, tell their solicitors untruths in order to convince the court of their story. However, as Mr Justice Popplewell explained in his judgment, the touchstone is whether the communication between client and solicitor is made for the purpose of giving or receiving legal advice, or the conduct of actual or contemplated litigation – i.e. whether the communication is within the ordinary course of the professional engagement of a solicitor:

> *"But where in civil proceedings there is deception of the solicitors in order to use them as an instrument to perpetrate a substantial fraud on the other party and the court, that may well be indicative of a lack of confidentiality which is the essential prerequisite for the attachment of legal professional privilege. The deception of the solicitors, and therefore the abuse of the normal solicitor/client relationship, will often be the hallmark of iniquity which negates the privilege."*

The judge also noted that client-solicitor communications have the potential to engage both Article 6 (right to a fair trial) and 8 (right to privacy) of the European Convention on Human Rights. However, in respect of Article 8, it was held that where there is an abuse of the professional relationship, proportionate interference is deemed acceptable, whilst Article 6 was held incapable of being applicable to communications that were in furtherance of a

purpose which was the very opposite of securing a fair trial. Arguments based on privilege against self-incrimination were also dismissed.

Application to the facts of *Ablyazov*

The enormity of the evidence left no doubt that there was *"a very strong prima facie case"* that Mr Ablyazov had been "*bent on a strategy of concealment and deceit in relation to his assets*" from the first moment he instructed the various firms of solicitors involved. It should be stressed that there was no allegation that the solicitors had been aware of Mr Ablyazov's true intent – rather, the solicitors had been used as an instrument to pursue a strategy of concealment, which amounted to an abuse of the professional relationship between solicitor and client, and no confidence could therefore attach to the communications between them.

In the circumstances, the judge granted the claimant's application for an order allowing them to search the documentation held by Mr Ablyazov's solicitors, notwithstanding the practical difficulties and costs of searching a very substantial body of electronic and hard copy documents, without knowing exactly what to look for (and without, for example, being able to apply key word searches). Mr Justice Popplewell held that there was a real prospect of material being disclosed that would assist the Bank in enforcement, and that "*the scale and expense of the exercise had to be judged against the scale of the litigation and sums at stake*".

However, the Court noted that not all client-solicitor communications would fall to be disclosed – the iniquity exception would apply only to those communications which could be said to be in furtherance of the iniquitous strategy i.e. those communications concerning or containing information about current and former assets. The Court also acknowledged that some documents might have a dual purpose, in that they might simultaneously have been sent in furtherance of the concealment of assets and at the same time form part of the ordinary course of defending the claim. For these documents, privilege would only attach where the dominant purpose of the communication was legitimate; should the legitimate and iniquitous purpose bear the same weight, privilege could not be maintained.

Implications

Cases involving deliberate concealment of assets on the scale seen in *Ablyazov* are rare, and on one level this judgment needs to be read in light of its specific (and extreme) facts. In dealing with the issues before him, the judge did not attempt to set out general guidance on how the iniquity exception might apply in more common cases of deception, and the dividing line between iniquity and what the judge referred to as the "*ordinary run of cases*" is not clear. Those cases in which the exception has been successfully invoked have involved deception and fraud on a grand scale, suggesting that it will remain relatively rare. However, in circumstances where a party appears to be deliberately misleading the court as to the extent of his assets, for example to avoid enforcement of an order or security, claimants may wish to considering the extent to which his solicitors might themselves be being used as part of an iniquitous strategy, as a means of assisting those enforcement efforts.

SPOTLIGHT ON...

OUR BANKING LITIGATION PRACTICE IN GERMANY

DLA Piper's banking litigation practice in Germany is concentrated in our offices in Frankfurt and Munich, and represents significant players in the German and international banking and financial services sector in both civil disputes and regulatory matters. As in the rest of the world, the legal landscape in Germany for banks and other financial institutions continues to change rapidly, and our lawyers are able to address all areas of financial law, including in disputes on market conduct supervision, licence applications, structured products, general and manager liability, duty of care issues, financing, securities and insolvency matters.

Our German team has extensive experience in a wide range of commercial and retail banking and financial disputes, such as directors' liability and negligent advice/duty of care issues, issues arising under loan agreements, enforcement of security rights, netting, funds transfers, fraud and asset tracing, bank payments and settlements. We are frequently involved in high profile banking cases, including advising and representing Bayerische Landesbank in its lawsuit against its former board and supervisory board members due to breaches of duty in the context of the acquisition of the Hypo Group Alpe Adria, failed ABS-investments during the global financial crisis and the purchase of shares in the holding company of Formula-1. We are also representing a large international bank in a multi-million Euro claim against an insurance company arising from breaches of regulatory requirements under the German Banking Act, and we are defending an international bank in Federal Administrative Court proceedings regarding the annual bank contribution levied by the Financial Market Stabilisation Agency. A further area we are currently advising on is a state-owned bank's exposure arising from the sale of "toxic" derivatives.

Our banking litigation team in Germany frequently works alongside teams in DLA Piper's other offices on multi-jurisdictional disputes, and in cross-practice teams (particularly in collaboration with our specialist restructuring and finance & projects lawyers). Our specialists are frequent commentators on current affairs and legislative and judicial developments in both the legal press and wider media.

For further information about our banking litigation practice in Germany, please contact Dr Thomas Gaedtke (of our Munich and Frankfurt offices) or Dr Wolfgang Jaeger (of our Frankfurt office).

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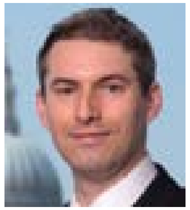

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