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BANKING DISPUTES
REVIEW

Welcome to our latest issue of Banking Disputes Review: a collection of recent articles on cases and legal developments of interest to those working in the financial services sector.

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WHO HAS TERRITORIAL JURISDICTION: INDIAN COURTS OR ENGLISH COURTS?

By Adam Ibrahim (Partner) and Sohail Ali (Senior Associate)

An earlier version of this article first appeared in the February 2018 issue of Butterworths' Journal of International Banking and Financial Law

INTRODUCTION

The recent New Delhi High Court decision in *Bharat Heavy Electricals Limited v Electricity Generation Incorporation & Others* [2017] upheld an English law jurisdiction clause contained in a bank guarantee. The decision is significant because it suggests that Indian courts will recognise English law jurisdiction clauses even where there is no connection with England.

FACTS

The claimant, Bharat Heavy Electricals Limited (BHEL), a public sector undertaking of the Government of India, had entered into a contract in April 2015, as contractor, with Electricity Generation Incorporation & Others (EGI), a Turkish state owned company, for the rehabilitation of a Turkish hydroelectric power plant. The contract conferred jurisdiction on the Ankara Courts in Turkey.

Pursuant to the terms of the contract, BHEL provided a Performance Bank Guarantee from AK Bank (a Turkish bank based in Istanbul) in favour of EGI. BHEL obtained a further Counter Guarantee from Bank of Baroda, an Indian state owned bank in New Delhi, in favour of AK Bank for c.€4 million. Both guarantees conferred jurisdiction in respect of any disputes on the Commercial Court in London.

In March 2017 EGI issued a termination letter to BHEL for alleged failure by BHEL to perform the contract in accordance with the contractual terms. EGI therefore sought to enforce the Performance Bank Guarantee. BHEL, however, alleged that the termination by EGI was illegal and sought a declaration and injunction from the New Delhi High Court (asserting a paucity of time to proceed against the parties in London) preventing the enforcement of the Performance Bank Guarantee and the Counter Guarantee.

The defendants argued that the Indian Courts had no jurisdiction to hear the dispute and any application had to be made to the Commercial Court in London.

The preliminary question that the Indian Court had to determine therefore was whether or not it had jurisdiction to hear the application.

ARGUMENTS

BHEL advanced a number of arguments to assert that the Indian Courts had jurisdiction. These included the following:

- The relationship between BHEL and Bank of Baroda was governed by an omnibus agreement which had been entered into in Delhi.
- The Counter Guarantee had been issued in Delhi.
- The word "only" was missing from the jurisdictional clauses in the guarantees and therefore did not vest exclusive jurisdiction on the Commercial Court in London.
- Since EGI had allegedly acted fraudulently, equity demanded that BHEL's application be heard and not rejected on the grounds of territorial jurisdiction.
- The was no single contract governing the relationship between all the parties and since BHEL could not sue or enforce any judgment against Bank of Baroda either at Ankara or in London, the Delhi court had territorial jurisdiction.

JUDGMENT

The New Delhi High Court emphatically rejected BHEL's arguments and held that it did not have jurisdiction to hear the application. The Court held as follows:

- Paucity of time was not a ground which entitled BHEL to proceed in New Delhi rather than in London. The Court held that even if it was a valid justification, time could be (and was) granted to BHEL to approach the Commercial Court in London.
- The omnibus agreement between Bank of Baroda and BHEL was irrelevant. No relief was being sought based on the omnibus agreement. The Counter Guarantee was an independent contract and the existence or non-existence of any underlying contract was therefore irrelevant.
- The absence of the word "only" from the jurisdiction clause was not decisive and made no material difference. The intention of the parties to confer jurisdiction on the Commercial Court in London was clear and unambiguous.
- Whether EGI had acted fraudulently as alleged would be a matter for the court with territorial jurisdiction to decide.
- If a cause of action had arisen in India and Indian law applied, the parties could not choose to vest territorial jurisdiction in a court which did not have jurisdiction. However, in this case, where one party was not subject to the law of India, the parties were entitled to vest jurisdiction outside India to a 'neutral court'.

LESSONS

Given the attractiveness of English law as a choice of law, this decision will be welcomed by both legal practitioners and commercial parties that do business in India or with Indian clients. The Indian Courts have shown that, whilst they will take into account certain factors in determining jurisdiction, they will respect overseas jurisdiction clauses.

From a banking perspective the decision is important because (i) the Indian Courts have recognised that a bank guarantee is separate and independent of any underlying contractual obligations; and (ii) the fact that a bank guarantee has been issued in India does not mean that an Indian Court will automatically deem that it has territorial jurisdiction.

The decision also reaffirms the importance of very careful drafting, particularly of jurisdiction clauses, to ensure that the parties' intentions can be clearly implemented.

SINGULARIS V DAIWA: COURT OF APPEAL DISMISSES FINANCIAL INSTITUTION'S APPEAL ON LIABILITY FOR FRAUDULENT TRANSACTIONS

By Adam Ibrahim (Partner) and Claire Clayton-Stead (Senior Associate)

In February 2017 Mrs Justice Rose delivered judgment in the first case in the courts of England and Wales in which a financial institution was found to have breached what is commonly known as the "Quincecare duty". That duty follows the 1992 decision of Steyn J in *Barclays Bank plc v Quincecare Ltd*, which remains the leading authority for a bank's duty in negligence to its customer to refrain from executing a payment instruction when and for so long as it has "*reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of the company*". Despite clearly acknowledging that there can be a number of factors why it would be "*impractical to impose too heavy a duty on a bank*", Mrs Justice Rose had no hesitation in finding that Daiwa had breached its Quincecare duty to Singularis, albeit noting that the case before her was an unusual one.

A REMINDER OF THE FACTS

- The claim concerned eight instructions given to Daiwa to make payments totalling US$204 million out of Singularis's client account with it. The payments were fraudulently instructed by Mr Al-Sanea, the sole shareholder and one of the directors of Singularis, which had been established to manage Mr Al-Sanea's personal assets.
- The payments were made at a time when Singularis turned out to be on the verge of insolvency, to companies within a group owned and controlled by Mr Al-Sanea (the Saad group). They followed Daiwa raising concerns, not satisfactorily addressed, about Singularis's financial health, the freezing of Mr Al- Sanea's assets, the Saad group seeking to restructure its lending arrangements with 40 banks and the Saad group's downgrading to "junk" and default by credit rating agencies.
- These events had caused Daiwa's Head of Compliance to issue a warning internally about "*the need for care and caution in terms of any activity on [Singularis's] account with us*" and to ensure that "*any payment requests we receive [are] properly authorised and […] 'appropriate' in the context of our business relationship with them*".
- Despite this warning, Daiwa employees (including a senior compliance officer) authorised the payment instructions either with no enquiry at all or, having made enquiries, following explanations for the transactions having been "*produced like a rabbit from a magician's hat after the first explanation was rejected*".

THE APPEAL

Daiwa's appeal raised six issues for the Court of Appeal to consider. Tellingly, almost certainly in recognition of the force of Mrs Justice Rose's decision on the point, those issues did not include whether Daiwa had breached its Quincecare duty to Singularis. The only point on the scope of the duty was the narrower question of whether the duty arises where only the creditors of the company, to whom it is not directly owed, stand to benefit from it. Daiwa argued that the duty should not apply in these circumstances, relying on cases which have decided the scope of auditors' duties to third parties. The Court of Appeal firmly rejected that analogy and Daiwa's submissions on that point.

The other main points of appeal concerned whether Mr Al-Sanea's fraudulent knowledge and conduct could be attributed to Singularis, and if so, whether Singularis's claim should be barred by an illegality defence. The Court of Appeal endorsed Mrs Justice Rose's decision on the former issue, finding that attribution did not arise where Singularis was not a "one-man company", because it had directors other than Mr Al-Sanea who were not involved in the fraud, and because attribution would not be right when it would "*denude the duty of any value in cases where it is most needed*", i.e. where the payment is apparently properly authorised by someone with authority to make it. That finding meant the question

of the illegality defence did not arise, but the Court considered it nonetheless and found that Singularis's claim would not have been barred even if Mr Al-Sanea's knowledge and conduct had been attributed to it. One of the factors in the Court's reasoning was that barring Singularis's claim on these grounds would undermine the "*carefully calibrated*" Quincecare duty and would not be proportionate where "*Daiwa's breaches were so extensive and the fraud was so obvious*".

COMMENT

Whilst financial institutions are bound to remain concerned by the first finding in this jurisdiction of a breach of the Quincecare duty, both the first-instance and appellate courts were at pains to emphasise the unusual nature of the case before them. The Court of Appeal did so in forceful terms, the concluding paragraphs of the judgment reiterating that "*it will be a rare situation for a bank to be put on inquiry; there is a high threshold*", the case is "*an unusual one, the circumstances of which are unlikely often to arise*" and "*a banker's duties in respect of properly authorised instructions to make payments are strictly limited*". In our view those remarks clearly indicate to the judiciary hearing any follow-on cases that these Courts' findings should not be applied to drive a coach and horses through long-established case law on Quincecare duty claims.

Nonetheless, the Court of Appeal's judgment ends with a conspicuous re-endorsement of Steyn J's statement in Quincecare that "*the law should guard against the facilitation of fraud, and exact a reasonable standard of care in order to combat fraud and to protect bank customers and innocent third parties*". The unusual facts of this case are not instructive in determining what that reasonable standard of care might entail in cases of more "routine" or "typical" fraudulent transactions, and particularly where fraud is perpetrated via a customer's online banking facility, when the transactions are not scrutinised in real time by a human being. There are, in our view, good grounds on which claims against banks in respect of those types of transaction might be defended, but the reality is that the law still has some way to go to catch up with modern banking practices and the legal and policy arguments as to why the same high threshold for a bank to be put on inquiry in those cases as in more traditional banking transactions have yet to be aired before the courts.

CRIMINAL FINANCES ACT

By Sam Millar (Partner), Tony Katz (Partner), John Gollaglee (Partner), Francesca Ingram (Legal Director) and Laura Ford (Legal Director)

The Criminal Finances Act 2017 (**CFA**) has significantly changed the Suspicious Activity Report (**SAR**) mechanism. The Moratorium Period may be extended for a potential additional 6 months where consent to transact is refused by the NCA. Submitters can also be required to disclose further information. Overall, the impact of the changes will be that submission of SARs will be less frequent and more considered and a less straight forward means of de-risking a potential corporate transaction suspicion.

CHANGES TO THE SUSPICIOUS ACTIVITY REPORTING REGIME

The Proceeds of Crime Act 2002 (**POCA**) requires those operating in the UK's "Regulated Sector" (which includes those involved in banking, financial services, accounting, estate agency and law firms dealing with financial or real property transactions) to report any suspicion they hold of money laundering to the National Crime Agency (**NCA**), seeking consent to proceed with the relevant transaction.

Failure to submit a Suspicious Activity Report (**SAR**) of money laundering constitutes a criminal offence. If the NCA consents to the transaction proceeding, this is a defence to money laundering offences for the reporting organisation and its officers.

Prior to the CFA coming into force on 30 September 2017, the entity submitting the SAR, would either:

- obtain express consent from the NCA;
- rely upon implied consent from the NCA after 7 working days' silence; or
- if the NCA refused consent, but was then silent for 31 calendar days (the "Moratorium Period") from the refusal, rely upon implied consent from the NCA.

Historically, entities submitted SARs in a defensive manner, with the aim of 'covering their backs' in relation to transactions where they may have held a suspicion, even where the suspicion was remote. The flood of SARs has prompted the legislative change.

The CFA introduces ***two new powers*** for law enforcements agencies to use in relation to SARs:

- the power to extend the Moratorium Period in increments of 31 days, up to a maximum of 186 days (approx. 6 months) from the end of the initial 31 day Moratorium Period; and
- the power to obtain further information from the submitter of the SAR, or another person carrying on business in the Regulated Sector.

THE POWER TO EXTEND THE MORATORIUM PERIOD

The practical consequences for those conducting business in the Regulated Sector are potentially very significant, although in practice, instances where consent is refused by the NCA are rare (in 5.6% of SARs submitted, the NCA refuses consent).

Where a SAR is submitted in the middle of a corporate transaction, in respect of which the NCA refuse consent and the Moratorium Period is extended, the whole transaction could potentially be derailed. The SAR reporter would be left in the unenviable position of neither being able to proceed with the transaction, nor being able to explain the position to their client.

If a SAR is submitted and consent to transact is withheld or delayed, the entity must be careful not to commit an offence of "**tipping off**". If the entity that submitted the SAR informs anyone (for example, the person suspected of money laundering or a close associate), that a SAR has been submitted and/or that an investigation is being considered or is under way, it may commit a tipping off offence, if the disclosure is likely to prejudice the investigation.

In theory, the extension of the Moratorium Period may only be granted if the investigation is being conducted "diligently and expeditiously" and if the extension is "reasonable in all the circumstances", but how these terms will be interpreted by the courts is uncertain.

THE POWER TO OBTAIN FURTHER INFORMATION

The second power conferred by the CFA is to permit the NCA to apply to court for an order requiring the SAR submitter, or another person in the Regulated Sector, to disclose further information.

The information requested must (i) relate to the SAR submitted, (ii) assist with an investigation into money laundering, or assist in determining whether one should be started; and (iii) be reasonable in all the circumstances for the information to be provided.

Such orders can also be requested and made where a foreign country's authority has made a request in the context of a money laundering investigation.

The Information Order cannot require a respondent to disclose material protected by legal professional privilege or that would be self-incriminating.

The application may be determined in a private hearing at the Magistrates Court but is appealable by any party to the Crown Court. Failure to comply with a Further Information Order is punishable by a fine not exceeding £5,000.

It is unclear how much further information a respondent may be required to supply or how onerous the obligations will be to unearth information that is not readily accessible to them.

SHARING OF INFORMATION WITHIN THE REGULATED SECTOR

The CFA provides for information to be shared between entities in the Regulated Sector either where the NCA or the recipient entity has requested it. The purpose of the disclosure must be that it may/will assist in determining any matter connected to a suspicion that any person is involved in money laundering.

If the NCA has not made the request, the requesting entity must notify the NCA of their request and the grounds for it.

Those operating in the Regulated Sector must therefore be prepared to respond to information requests from other entities, and must take on a more active role in identifying information sources relevant to determining whether money laundering has or may have taken place.

Information sharing is voluntary under the CFA and there are no penalties for non-compliance.

CONSEQUENCES OF THESE CHANGES

The impact of lodging a SAR, and the risk that an extension to the Moratorium Period may be applied for, has potentially very disruptive consequences to on-going business.

The impact of these changes on the Regulated Sector may be that the number of "defensive" SARs will certainly decrease and only those where a considered and strong suspicion is present will be communicated to the NCA. Therefore overall the submission of "consent" SARs will be less frequent but more considered.

Therefore, the overall impact of the changes will be to increase the sharing of valid information in the industry and with the law enforcement agencies.

Entities considering a SAR may make information sharing requests of other entities in the Regulated Sector, and should expect to be on the receiving end of such requests also.

Firms are likely to invest in training to ensure their MLROs are trained to deal with these changes.

There may also be an increase in litigation challenging extensions to the Moratorium Period.

LESSONS ON EXERCISING A CONTRACTUAL DISCRETION POST *BRAGANZA*

By Adam Ibrahim (Partner) and Paula Johnson (Senior Professional Support Lawyer)

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Contractual terms which give one contractual party the power to exercise a discretion or form an opinion as to relevant facts are commonplace in financial agreements. Whilst parties are free to negotiate such terms it is important to note that they do not confer completely unfettered rights: decision makers may be constrained by what has come to be known as the *Braganza* duty. Four recent High Court judgments cast some light on the nature of this duty and when it might arise.

WHAT IS THE *BRAGANZA* DUTY?

Where contractual terms give one party the power to make decisions which affect the rights of both parties there is a clear potential for a conflict of interest. As Lady Hale noted in *Braganza v BP Shipping Ltd* [2015] UKSC 17 (***Braganza***), where such terms exist the court will not intervene to re-write the bargain agreed between the parties but will seek to ensure that the contractual powers are not abused. It may do this by implying a term that the discretion may only be exercised honestly and in good faith and not in an arbitrary, capricious or irrational way.

In assessing whether a discretion has been exercised rationally the court will review the decision in a way that is analogous to the judicial review of an administrative decision of a public body, applying what is known as the *Wednesbury* test. Prior to *Braganza*, courts focused on that limb of the *Wednesbury* test which asks whether the decision was so unreasonable that no reasonable person acting reasonably could have made it. In *Braganza,* however, the Supreme Court recognised that in some cases an assessment of rationality should also include the other limb which involves reviewing the decision making process itself. Did the decision maker properly take into account relevant factors and exclude irrelevant factors?

The precise nature of the term to be implied will depend upon the terms and the context of the particular contract. The *Braganza* case arose in an employment context where the potential for conflict of interest when exercising a contractual discretion is heightened due to the imbalance of power between employer and employee. As Lord Hodge noted, an employment context "*may justify a more intense scrutiny of the employer's decision-making process than would be appropriate in some commercial contracts.*"

WHEN WILL THE *BRAGANZA* DUTY ARISE?

Two important issues fall for consideration.

First, there is the issue as to whether a particular contractual clause actually bestows a contractual discretion at all or whether it simply gives a party a contractual right or power to act in a certain way. If the latter is true then the *Braganza* duty will not apply.

Second, if the clause does give a party a contractual discretion, then consideration needs to be given as to whether the *Braganza* duty can be said to arise in the particular context.

ABSOLUTE CONTRACTUAL RIGHT OR CONTRACTUAL DISCRETION?

In *Shurbanova v Forex Capital Markets Limited* [2017] EWHC 2133 (QB) Waksman J had to decide whether a clause in an agreement between a foreign exchange broker and a retail customer gave the broker a pure contractual right to revoke a transaction due to abusive trading or whether the broker was constrained by a *Braganza* duty.

He concluded that a *Braganza* duty did not arise. The clause did not require the broker to make an assessment or judgment about a variety of outcomes

but simply to decide whether it wanted to exercise an absolute contractual right to revoke. The clause did not give the broker a discretion to decide whether there had been abusive trading, that was for the court to decide. If the transaction was abusive then an absolute right to revoke arose. If not then any revocation in reliance on the clause would be of no effect.

The broker's power to revoke could not be turned into a *Braganza* type discretion. As Waksman J noted, a *Braganza* discretion will concern itself with a determination of a substantive matter, or an evaluation of some state of affairs which one party makes as the decision maker but which affects the interests of both, hence giving rise to a potential conflict of interest. Whilst an abusive trade could constitute an event of default under other provisions of this particular contract and thereby afford the broker alternative remedial actions in addition to revocation, it was meaningless to categorise this as a *Braganza* discretion. If it were one, then whenever a party had a choice as to whether to opt to rescind a contract for misrepresentation rather than seeking damages that could be characterised as a contractual discretion subject to the *Braganza* duty. That could not be right.

CONTEXTS IN WHICH A *BRAGANZA* DUTY MAY OR MAY NOT ARISE

In *Braganza* the Supreme Court appeared to leave open the issue as to whether a *Braganza* duty might arise in contexts other than employment. In *Lehman Brothers International (Europe)(in administration) v Exxonmobil Financial Services BV* [2016] EWHC 2699 (Comm) commercial parties had contracted with each other on the wholesale financial markets and one party had a contractual discretion involving the valuation of securities in case of default.

In that context Blair J did not think that *Braganza* required the kind of analysis of the decision-making process that would be appropriate in the public law context. In his view *Braganza* had expressly left open the question of the extent to which procedural judicial review objections could arise in commercial contracts. Scrutiny of the decision making process itself was not appropriate in a situation where both parties were commercial parties, the decision was one which could be and might need to be taken without delay and in which the non-defaulting party was entitled to have regard to its own commercial interests.

In *Watson and Others v Watchfinder.co.uk* [2017] EWHC 1275 (Comm) however, Waksman J concluded that a *Braganza* duty did arise in a commercial context. That case concerned a claim for specific performance of a share option agreement. Waksman J found that a clause which stipulated that the option could only be exercised with the consent of a majority of the board of directors was subject to a qualification that it be exercised in a way that was not arbitrary, capricious or irrational. Whilst noting that such a conclusion was not inevitable in every case, he concluded that it was "*clearly*" appropriate there. There was an obvious conflict of interest as far as the existing shareholders in the company were concerned since "*the grant of further shares would dilute their own holdings and/or restrict at least to some extent their availability for other investors who may have to pay much more*".

He therefore ruled that the decision maker was subject to a *Braganza* duty. That meant that there had to be a proper process for the decision in question which took into account material points and did not take into account irrelevant ones. It also meant that the outcome could not be outside what any reasonable decision maker could decide, regardless of the process adopted.

The evidence showed that there had been hardly any real exercise of discretion at all. The issue of board consent was dealt with extremely quickly and casually at the end of a board meeting, there was no real discussion such that the decision seemed to be based on a mistaken view that the board had an absolute right of veto rather than an obligation to consider whether the claimants had made a real or significant contribution to the progress or growth

of Watchfinder. Watchfinder had failed to comply with its *Braganza* duty and the claimants were entitled to an order for specific performance of the option agreement.

Hot on the heels of *Watchfinder* came another Waksman J decision in *BHL v Leumi ABL Limited* [2017] EWHC 1871 (QB). This concerned the exercise of a discretion in the context of a receivables finance agreement. The discretion granted the finance provider the right to recover fees of "*up to 15%*" of the receivables recovered.

Waksman J considered the intended "target" of this provision. He concluded that it allowed Leumi ABL Limited ("Leumi") to charge a fee which was meant to "*represent or capture or estimate in some way*" Leumi's future costs and expenses in respect of the collection of receivables. It afforded Leumi some flexibility since it could not know in advance precisely what those costs would be but it did not give Leumi an "*untrammelled discretionary power*". It had to be subject to some "*qualification*" otherwise it could be exercised oppressively or abusively.

When Leumi decided to charge the full 15% without making any attempt to calculate its likely costs recovery it breached its *Braganza* duty. It failed to take into account a number of relevant factors, including how long the collect out would take, how the process of the collection would change over time, who would do the collect out and what Leumi's own internal costs would be. It simply charged the maximum 15% without giving any proper consideration to the issue.

On the evidence the judge concluded that a fee of 4% was the absolute maximum Leumi could have charged in order to remain compliant with its *Braganza* duty.

COMMENT

These decisions help shed light on how and when the *Braganza* duty might apply but are very fact specific. As discretionary provisions are commonplace in finance agreements there is potential for a *Braganza* duty to apply in many different situations. Whilst binary decisions, such as when to make a demand or appoint administrators for example, may not be subject to challenge, other discretions, such as an ability to vary interest rates, might be. Further case law seems inevitable.

In the meantime the following practical points should be noted:

- Be aware that decisions made pursuant to the exercise of a contractual discretion may be subject to challenge and review. Bear this in mind both at the drafting stage and when a exercising a discretion;
- If you have a discretion to exercise, think about what the "target" of that discretion is, in other words consider what issue it allows you to determine and what considerations you should bear in mind;
- Keep a paper trail which demonstrates that a proper decision making process has taken place. Show that your decision was reached rationally, taking relevant factors into account but disregarding anything irrelevant. Make specific reference to any relevant evidence which you relied on in reaching your decision.

THE DIFFICULTIES IN CHALLENGING A FOS DECISION BY WAY OF JUDICIAL REVIEW

By Hugh Evans (Partner) and Paula Johnson (Senior Professional Support Lawyer)

An earlier version of this article first appeared in the September 2017 issue of Butterworths' Journal of International Banking and Financial Law.

In *Full Circle Asset Management Ltd v Financial Ombudsman Service Ltd* [2017] EWHC 323 (Admin) the Administrative Court refused to quash a decision of the Financial Ombudsman Service Ltd (FOS) following allegations that the Ombudsman had erred in law by departing from a regulator's standard without justification. The case illustrates the approach that FOS will take when determining a customer complaint and the inherent difficulties in challenging a FOS decision by way of judicial review.

BACKGROUND

Full Circle Asset Management Ltd (FCAM) provided Mrs King with a model portfolio discretionary investment service. Retired and in her early 60s, Mrs King required an income of £1,200 per month. According to FCAM's 'attitude to risk and loss' document she was a 'medium risk investor'. FCAM sent her a suitability letter proposing that she open an investment account which FCAM would manage along the lines of its model portfolio. Mrs King duly transferred about £450,000 to FCAM.

Over the next 15 months Mrs King lost some £90,000 on her investment. She complained to FCAM and later to FOS, arguing that her money had been invested in a portfolio which was too risky. FOS upheld her complaint and FCAM subsequently sought a judicial review of FOS's decision.

THE LEGAL FRAMEWORK

S.228(2) of the Financial Services and Markets Act 2000 stipulates that a complaint should be determined by reference to '*what is, in the opinion of the ombudsman, fair and reasonable in all the circumstances of the case'.*

As part of the complaint handling rules in the FCA Handbook, DISP3.6.4R provides that when considering what is fair and reasonable in all the circumstances of the case, the Ombudsman will take into account:

> *'(1) relevant*
>
> *(a) law and regulations;*
>
> *(b) regulators' rules, guidance and standards;*
>
> *(c) codes of practice;…'*

FCAM sought to challenge the Ombudsman's decision on the basis that:

- Mrs King had been prepared to accept a "medium risk";
- the portfolio she invested in had been "medium risk";
- a skilled person's report (SPR) had confirmed that the portfolio was properly characterised as "medium risk";
- the SPR had been accepted by both the Financial Services Authority and its successor, the Financial Conduct Authority (FCA), and this set a regulator's standard which should have been taken into account when considering what was "*fair and reasonable in all the circumstances of the case*";
- the Ombudsman had erred in law by failing to explain why he had departed from this standard and his decision should be quashed.

JUDICIAL REVIEW

In a judicial review the court is limited to reviewing the process by which a decision was made so as to assess whether the decision is fundamentally flawed due to some illegality, irrationality or procedural unfairness or because some legitimate expectation has not been met. It is not an appeal on the facts unless it can be shown that a factual

finding was infected with legal error. In the instant case, the court noted that contrary to FCAM's position, the Ombudsman had made a key finding of fact that FCAM had made a personal recommendation to Mrs King. That finding was not open to challenge in the judicial review.

In considering the Ombudsman's approach the court noted that he had not disagreed with the SPR's conclusion that the overall portfolio was of medium risk ***generally***, nor that the FCA had accepted this. He simply did not think that the SPR's conclusion disposed of Mrs King's complaint. In his view FCAM had made a personal recommendation and that meant that it should have carried out a proper suitability review in light of Mrs King's ***specific*** circumstances rather than relying on its rather crude classification of her as an '*average risk investor*'. Having examined what FCAM knew, or should have known, about Mrs King's personal circumstances, the Ombudsman had concluded that the portfolio was unsuitable for ***her***. It was not geared to produce adequate income and contained an excessive proportion of higher risk investments. She did not have the investment expertise to understand the inherent risks. Had she done so, she would not have made the investment.

Whilst FCAM had alleged that it was procedurally and substantively unfair that having had its Model Portfolios approved as medium risk by the FCA it should then be confronted by a FOS decision which criticised it for using one of those portfolios for a medium risk investor, the court was satisfied that the Ombudsman had not departed from the industry standard set by the FCA. There was no unfairness or breach of the European Convention on Human Rights. The Ombudsman had dealt comprehensively with the evidence and arguments addressed to him and had explained his reasons fully.

COMMENT

The grounds for bringing a judicial review are narrow. Whilst FOS should take regulators' standards into account, such standards will not necessarily be dispositive; the Ombudsman must consider what is fair and reasonable in "*all the circumstances of the case*". The crucial point here was the finding that a personal recommendation had been made. That brought the issue of suitability into play.

If suitability is an issue, investment managers must take heed of the FCA's Principles for Businesses and the Conduct of Business Source Rules. It will not be sufficient to simply evaluate a customer's general appetite for risk and then match that with a product of similar risk profile. There must be a deeper understanding of the customer's specific needs and objectives, their expertise and capacity for loss.

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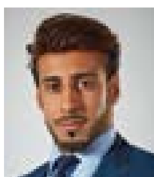

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