

International review

Keeping you in touch with international developments

Tide is turning against credit rating agencies
Page 1

The package deal: The decision in *Emptage v FSCS*
Page 4

FOS awards no longer “final”?
Page 6

Establishment of an Independent Insurance Authority in Hong Kong
Page 8

Australian Bank Fees Class Action
Page 10

Canada Considers Imposing Statutory Best Interest Duty on Investment Advice
Page 11

The Airocean case: materiality matters when it comes to director’s duties
Page 12

News
Page 13



Tide is turning against credit rating agencies

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Credit rating agencies (“CRAs”) have been criticised for some time for their role in contributing to the global financial crisis, especially for assigning ratings to sub-prime structured finance instruments which did not reflect their true risk, and a number of claims have been made globally against CRAs. In November 2012, the Federal Court of Australia delivered a world-first judgment by ordering a CRA to pay damages for investor losses.

The first civil lawsuit by the US federal government against a CRA followed in February 2013. In light of these developments, it is expected that more claims against CRAs will follow, but it is almost six years since the start of the credit crisis and investors are running out of time under the applicable limitation periods to make claims. We report on the worldwide trends in relation to the claims against CRAs:

Australia: landmark decision *Bathurst Regional Council v Local Government Financial Services Pty Ltd* (2012)

In the first known decision of its type in the common law world, the Federal Court of Australia held that a CRA owes a duty of care to potential investors. Standard & Poor’s (“S&P”) AAA rating of certain investment products was held to be misleading and deceptive and involved negligent misrepresentations to investors. The Court held that a reasonably competent ratings agency could not have rated the products AAA in the circumstances. S&P and ABN Amro, together with another entity, were ordered to pay A\$30 million in damages for losses caused to investors.

Background to the proceedings

S&P and ABN Amro were sued by investors for claims arising from the rating, sale and purchase of “Rembrandt notes”, a type of structured financial product known as constant proportion debt obligations (“CPDO”). The products were “grotesquely complicated” financial instruments that were designed by ABN Amro Bank NV in April 2006.

ABN Amro engaged S&P to rate the CPDOs and sought an AAA rating. The Court found that in developing the product, ABN Amro had effectively “gamed” the model it knew S&P would apply to rate the CPDO. It also found that in engaging S&P, ABN Amro pressed S&P to adopt its model inputs as the basis for the rating. For example, S&P had not calculated the actual average volatility of the Globboxx (a global debt index), instead it followed ABN Amro’s assertions. The actual average volatility should have been nearly double that asserted by ABN Amro.

S&P gave the CPDOs a rating of AAA and authorised ABN Amro to market the AAA rating to potential investors, which it did. The Local Government Financial Services (“LGFS”) (an authorised deposit taking institution for local councils in New South Wales) purchased A\$50 million of CPDO notes and sold approximately A\$16 million of CPDO notes to 13 local councils in New South Wales.

The volatility emanating from the global financial crisis caused sustained spread widening, which was an inherent risk or quality of the CPDO products. This caused S&P to downgrade its rating of the CPDOs from AAA to BBB+ in February 2008. The councils ultimately received back less than 10% of the principal amount they invested and commenced proceedings, with the backing of IMF (Australia) Ltd (“IMF”), a litigation funder.

The Court’s findings

In relation to the claims against S&P, the Court found, amongst other things, that:

- Potential investors believed that a rating by an agency such as S&P represented the best available independent evidence of the risk of loss on the investment. Investors expected S&P to reach its opinion as the result of independent and objective processes
- S&P’s AAA rating conveyed representations to a class of potential investors that:
 - in S&P’s opinion the ability of the notes to meet all financial obligations was “extremely strong”
 - S&P had reached its opinion based on reasonable grounds and as the result of the exercise of reasonable care
- S&P knew that neither of the above representations was true at the time it was made. Even though S&P’s rating was expressed to be an opinion, S&P’s state of knowledge meant that it was still capable of being misleading and negligent

- S&P’s AAA rating was misleading and deceptive under the *Corporations Act 2001*
- None of the disclaimers included in fine print by S&P erased the misleading nature of S&P’s conduct. For example, they did not make it clear that S&P’s rating was an opinion which did not have reasonable grounds and was not the result of reasonable care and skill – which would have been required
- S&P owed the class of investors a duty of care. The very purpose of ABN Amro obtaining the rating was for dissemination to potential investors so they could rely on S&P’s rating as S&P’s expert opinion as to the creditworthiness of the notes
- The investors were vulnerable and could not reasonably protect themselves from any lack of reasonable care by S&P in assigning the AAA rating
- S&P breached its duty of care to potential investors in assigning the AAA rating because S&P did not have a reasonable basis on which to rate the products as AAA. Its analysis was fundamentally flawed, unreasonable and irrational in numerous respects
- It did not matter that S&P could not have foreseen the global financial crisis because that was not the harm. The relevant class of harm was the cash-out of the notes caused by sustained spread widening. This class of harm was foreseeable; it was one of the two main anticipated risks inherent in the financial products

S&P has said that it intends to appeal the decision.

Potential implications of the decision

It was a combination of the specific circumstances in this case which led to the Court’s significant findings. These included:

- ABN Amro had been able to exercise real and substantial influence over S&P’s rating process. S&P representatives had been “sandbagged” by the ABN Amro representative and had simply “bulldozed” the CPDO rating through
- S&P adopted ABN Amro’s assertions in the rating process, without making important calculations independently. Several of these assertions were severely inaccurate or inadequate

While the Court found S&P liable under Australia’s misleading and deceptive conduct legislation, S&P was also held to have breached duties of care owed to the investors under common law principles of negligence which will be relevant to many other jurisdictions around the world.

Europe: claims in Germany and Italy but none yet in England

IMF has stated that it intends to approach investors in Europe (including in the UK, Netherlands, Germany and France) to discuss potential similar lawsuits over CPDOs. Approximately €2 billion worth of CPDOs are said to have been sold by ABN Amro (now a subsidiary of the Royal Bank of Scotland) and rated by S&P in Europe. They were known as Castle Finance or Chess notes.

Press reports indicate that, before the Australian judgment, about 60 cases had been filed globally against CRAs. Most were filed in the US but about a dozen cases against CRAs were reported to have been filed in Germany and Italy focussing on bonds and other products related to Lehman Bros. On 13 December 2012, Germany's Federal Court of Justice ruled that investors could sue S&P for failing to adequately reflect the deteriorating financial health of Lehman Bros in its rating assessment shortly before the bank became insolvent. Reuters report that this is the first time that a German court has admitted a case brought by retail investors against CRAs, potentially opening the door to further claims. Reuters also report that Italian prosecutors in southern Italy are seeking trial for seven current and former employees at S&P and Fitch over their downgrades of Italy, which could lead to the first European court case over sovereign rating cuts. The allegations are that the reports on Italy and its banking system by the agencies were inaccurate and leaked during market hours.

In England, there have not yet been any reports of claims being made against CRAs in relation to their role in the financial crisis. Investors face a number of difficulties in pursuing claims:

- The key hurdle will be for investors to prove that agencies owe them a duty of care when a rating is normally addressed to and paid for by the issuer of the bonds and where agencies do not have any relationship with potential investors, or even know their identity
- Circulars sent with any ratings have clearly worded disclaimers which the agencies will argue prevent a duty of care from arising or negate that duty. It is not known whether an English court would follow the approach of the Australian Court, which considered that S&P's disclaimers were ineffective as inadequate steps had been taken to bring them to the attention of investors
- Investors are running out of time to bring claims arising out of the credit crisis as, in the absence of fraud, investors' tort claims will be barred if brought more than six years after their loss is suffered

Following the financial crisis, EU regulation on CRAs was introduced to resolve the perceived issues surrounding the role of CRAs. Agencies have to be registered, ensure that ratings are not affected by any actual or potential conflict of interest and use methodologies which are rigorous and systematic. The European Securities and Markets Authority has the power to impose fines on agencies who commit infringements. Under the proposed CRA III Regulation which is expected to be adopted by the Council of the EU in first half of 2013, investors will be able to sue a CRA which, intentionally or with gross negligence, infringes the obligations set out the CRA Regulation (Regulation 1060/2009), thereby causing damage to investors.

US: lawsuits from investors and recent federal action

CRAs have hotly contested claims arising from the sub prime crisis which have been made by investors in the US. CRAs have argued that their role is equivalent to a restaurant or film critic and relied on the First Amendment which guarantees the right to free speech. Although some of the cases have survived initial motions to dismiss them, none have yet reached the trial stage. The federal courts have characterised the ratings as opinions as to the creditworthiness of a transaction, and have generally agreed that opinions are not actionable statements of fraud unless those opinions are not believed by the speaker at the time they are made.¹ CRAs appeared to be in a strong position as the Securities and Exchange Commission did not take any enforcement action after its investigations.

However, some recent district court decisions appear to assist investors in making claims. In *Abu Dhabi Commercial Bank v Morgan Stanley & Co*, the plaintiffs invested in a structured investment vehicle arranged and placed by Morgan Stanley and rated by Moody's and S&P. In August 2012, District Judge Shira Scheindlin dismissed the agencies' motion to dispose of fraud claims on a summary basis. Reconciling federal and New York state law, the court stated that ratings are neither objective statements of fact nor "mere puffery"; rather they are statements of opinion and assessment of the objective value of a financial instrument. According to District Judge Shira Scheindlin, "if a rating agency knowingly issues a rating that is either unsupported by reasoned analysis or without a factual foundation, it is stating a fact-based opinion that it does not believe to be true." The court found that the plaintiffs had presented sufficient evidence for a jury to infer that the agencies did not believe the ratings at the time they issued them and therefore made opinions that would be actionable statements of fraud. This case has not yet reached trial.

CRAs are also now under pressure as a result of the lawsuits commenced last month by federal government and a number of states. On 4 February 2013, the Department of Justice ("DoJ") filed a civil suit in a federal court in California alleging that, from 2004 to 2007, S&P engaged in a scheme to defraud investors in structured financial products known as Residential Mortgage-Backed Securities ("RMBS") and Collateralized Debt Obligations ("CDOs"). This civil lawsuit is the first significant action by the US federal government against a CRA. It appears that pre-action settlement talks with S&P broke down. The complaint alleges that S&P falsely represented that its ratings were objective, independent, and uninfluenced by S&P's relationships with investment banks when, in actuality, S&P's desire for increased revenue and market share led it to favour the interests of these banks over investors. S&P provided millions of pages of emails to the US government and the DoJ refers in its complaint to a

¹ See, for example, *Ohio Police & Fire Pension Fund v Standard & Poor's Financial Services LLC* 700 F.3d 829 (6th Cir, 2012); *Plumbers Union Local No 12 Pension Fund v Nomura Asset Acceptance Corp*, 632 F. 3d 762 (1st Cir.2011)

number of emails in which S&P analysts expressed concern about how securities were being rated and joked about the effect of the collapse of the housing market. One analyst in March 2007 even recorded a parody of the Talking Heads song "Burning Down the House." The DoJ alleges that S&P was so concerned with the possibility of losing market share and profits that it limited, "adjusted and delayed" updates to the ratings criteria and analytical models it used to assess the credit risks posed by RMBS and CDOs and knowingly disregarded the true extent of credit risks. In issuing the ratings, the complaint alleges that S&P deceived financial institutions into believing that S&P's ratings reflected its true current opinion regarding credit risks of CDOs, when in fact they did not. S&P denies the allegations.

The complaint seeks civil penalties under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) which allows the DoJ to file a civil lawsuit alleging criminal fraud against federally insured financial

institutions and to seek civil penalties up to the amount of the losses suffered as a result of the alleged violations. To date, the government has identified more than \$5 billion in losses suffered by federally insured financial institutions in connection with the failure of CDOs rated by S&P from March to October 2007.

Since the DoJ action, 16 states and the District of Columbia have also filed suits against S&P. The lawsuit brought by the Attorney General of the State of California refers to losses of US\$1 billion suffered by the California Public Employees Retirement System (the largest public pension fund in the US) and the California State Teachers Retirement System.

These lawsuits clearly have the potential of encouraging investors to make further claims against the rating agencies, but many claims in relation to ratings provided pre-credit crisis are likely to be time-barred.

The package deal: The decision in *Emptage v FSCS* and what it means for advisers

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In October 2012 the English High Court handed down judgment in *Emptage v Financial Services Compensation Scheme Ltd (2012)* which is likely to have implications for similar claims against investment advisers and mortgage brokers.

The case involved a judicial review of a compensation award given to Ms Emptage by the Financial Services Compensation Scheme Ltd ("FSCS"). Ms Emptage asked the court to review her FSCS award on the grounds that it did not adequately compensate her for the losses suffered due to negligent advice to take out an interest-only remortgage in order to invest in Spanish property. The FSCS attempted to distinguish between losses arising from regulated mortgage advice and unregulated investment advice regarding the Spanish property. The High Court found in favour of Ms Emptage, stating that the award given did not adequately compensate her.

Facts

Ms Emptage's claim arose from advice she received from an IFA in 2005 relating to her mortgage arrangements. At that time, Ms Emptage and her partner (who together had a combined income of £54,000) had a repayment mortgage with an outstanding balance of around £40,000 with 10 years remaining.

The IFA advised Ms Emptage to remortgage her property with an interest-only mortgage for £110,000 and use the £70,000 proceeds to invest in property in Spain. The IFA claimed that the rental income and capital appreciation of the Spanish property would satisfy the mortgage at the end of the term and also provide Ms Emptage with an additional £107,000, unless his calculations were "drastically incorrect".

Following the advice, Ms Emptage remortgaged her property and used the proceeds to invest in a yet-to-be-built Spanish property development. Subsequently, the Spanish property market collapsed and left Ms Emptage with a virtually worthless investment. As a result, Ms Emptage and her partner were left with a £110,000 interest-only mortgage with no means of paying for it.

The FSCS claim

The FSCS is the compensation fund of last resort for customers of FSA-regulated firms which are unable to satisfy claims against them. There are limits on the amount of compensation which the FSCS can pay out – the cap is £50,000 per person per firm in respect of investment and home finance business, but the limit is higher for deposits, being £85,000. The FSCS is required to pay "fair compensation" and, in respect of claims relating to bad or negligent advice, the FSCS generally seeks to return the claimant to the position they would have been in had the negligent or bad advice not been given.

Ms Emptage filed a claim for compensation with the FSCS in November 2009 as the IFA's business was insolvent and carried no professional indemnity insurance.

The FSCS at first rejected Ms Emptage's claim on the grounds that the loss resulted from investment advice she received with regard to the Spanish property. The FSA does not regulate investment in property and, so, this was not

'regulated' advice that was liable to be compensated by the FSCS. Following further correspondence, the FSCS changed its position, agreeing that improper mortgage advice had been given (interest-only mortgages are FSA-regulated) as the IFA had, in breach of the MCOB rules, failed to consider the affordability of the lump sum payment at redemption for Ms Emptage and the suitability of the repayment method using the Spanish property.

The FSCS award

On 10 December 2010, a Decision Letter was sent to Ms Emptage, awarding her £11,522.98. The award was calculated with reference to:

– The reduction in the original mortgage balance that would have occurred had Ms Emptage not switched mortgages

less

– The relevant amount that Ms Emptage would have paid to maintain that mortgage

plus

– The mortgage payments made on the new mortgage, any fees incurred and interest

The FSCS considered that in exercising its discretion it was only able to compensate for losses arising *directly* from the improper mortgage advice (which is a regulated activity) and not with regard to the losses arising from the purchase of the Spanish property (as property investment does not fall within the remit of FSA regulation). Ms Emptage sought judicial review of the decision.

The Court's analysis

The main issue for the court to decide was whether the FSCS complied with relevant statutory regulations and guidelines in calculating the award in respect of the IFA's negligent advice. The issue for the purposes of judicial review was whether the decision was wholly irrational and an improper exercise of discretion.

Analysing the decision in light of relevant legislation and case law,¹ the Court summed up the relevant principles and approach to be applied as follows:

- The FSCS has a broad discretion to compensate claimants with valid claims under the scheme only to the extent that it considers that the payment of compensation is essential to provide the claimant with fair compensation (COMP 12.4.7)
- It is for the FSCS to determine, in its discretion, which elements of the claim it considers essential in order to provide fair compensation and to exclude those elements that do not meet that requirement (*Ex parte Bowden*)

- Fair compensation means compensation that fairly compensates for the mischief and loss caused by the particular breach, requiring a two stage analysis:
 - (i) identification of the precise nature of the breach complained of; and
 - (ii) assessment of the actual losses directly flowing from the particular breach
- Fair compensation for negligent or bad advice designed to return a claimant so far as possible to the position the claimant would have been in had the breach not occurred means losses should be calculated in such a way as to restore the claimant so far as possible to the financial status quo (MAA/3)

The Court held that the FSCS had not approached the assessment of compensation correctly or in accordance with the principles set out above. The FSCS had failed to compensate Ms Emptage for the negligent mortgage advice and the award did not restore her to the position she would have been in had the negligent advice not occurred.

The essence of the claim had related to mortgage advice not investment advice. The key flaw was that the FSCS failed to view the IFA's negligent advice as an indivisible 'package' which included the investment advice as an essential element of the former because without the investment the remortgage was not feasible.

With regard to the issue of quantum, the Court stated that the proper amount of compensation if a mortgage is unsuitable because the borrower cannot afford it should be the obligation assumed which the borrower cannot afford. The Court held that properly analysed, the claim under MCOB 4.2.7R was for the IFA recommending a mortgage which was not suitable, and as affordability is an essential element of suitability the negligent advice as to suitability included the negligent advice as to affordability. The FSCS was in error in purporting to compensate on a basis that ignored the reason for that unsuitability. The Court therefore quashed the decision of the FSCS and ordered the FSCS to reconsider the question of compensation.

Commentary

Although the FSCS is appealing this decision to the Court of Appeal, (with the appeal due to be heard in May) this decision raises interesting issues regarding the assessment of complaints against, and the potential liability of, firms whose business involves the provision of advice in respect of both regulated and unregulated investments as part of the same transaction. While the case has clear implications for future FSCS compensation awards, it may well also have implications for the FOS, which assesses complaints on the basis of what is "fair and reasonable" and also determines monetary awards based on what it views as "fair compensation".

¹ The Financial Services and Markets Act 2000 ('FSMA'), SI 2001/544 and SI 2003/1475, Compensation Rules contained in the Financial Services Authority Handbook ('COMP'), MCOB and Policy MAA/3: Basic of compensation (as issued by the FSCS). The Court also considered *Ex parte Bowden* [1996] which involved a judicial review of compensation given under the Investors Compensation Scheme. The House of Lords held that the statutory rules and guidelines for the ICS allowed a broad discretion regarding which elements the ICS considers essential in order to provide fair compensation.

FOS awards no longer “final”?

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The English High Court has recently delivered a decision in *Clark v In Focus Asset Management & Tax Solutions Ltd (2012)*, which allows complainants who had previously accepted and been paid the statutory maximum award made by the Financial Ombudsman Service (“FOS”), to pursue a claim against their IFA for the balance of what they allege is their full loss caused by unsuitable investment advice.

The FOS Scheme

The FOS provides a free and independent dispute resolution service for customers of FSA-regulated firms. While detailed rules exist relating to the jurisdiction of the FOS, those who can use its services, the subject matter of complaints and the timeframe within which complaints should be referred, some of the key rules are as follows:

- In certain circumstances, the FOS may dismiss a complaint without consideration of its merits. This includes where the subject matter of the complaint has been the subject of court proceedings where there has been a decision on the merits; is currently the subject of current court proceedings (unless stayed); or would be more suitable to be dealt with by a court, arbitration or another complaints scheme
- The ombudsman is required to determine complaints by reference to what is, in his opinion, “fair and reasonable” in all the circumstances of the case. In considering this, the FOS will take into account relevant law and regulations, regulators’ rules, guidance and standards, codes of practice, and, where appropriate, what it considers to have been good industry practice at the relevant time
- If the complainant accepts an FOS determination within the specified time limit, the determination is “final and binding” on both the firm and the complainant. If the complainant rejects it (or makes no response, which is treated as a rejection), the determination is not binding on anyone. The firm has no ability to reject the determination – the only right of challenge available to it is on public law grounds by way of an application for judicial review
- Where a complaint is determined in favour of the complainant, the FOS may make a money award in a sum which it considers to be “fair compensation” for financial loss, up to a limit of £150,000 (prior to 1 January 2012 the limit was £100,000)
- Firms are required to comply with FOS money awards and, in the event of non-compliance, they are enforceable through the courts
- If the FOS considers that “fair compensation” requires the payment of a sum in excess of the maximum limit, the FOS can recommend that the firm pay the balance, but neither the FOS nor the complainants have any ability to compel the firm to do so

The facts

Mr & Mrs Clark made a complaint to the FOS in November 2008, alleging that In Focus Asset Management and Tax Solutions Limited (“In Focus”) had provided them with unsuitable investment advice in light of their risk profile. Mr & Mrs Clark had been advised by In Focus in 2001 and 2004 to invest in traded endowment policy plans on which they suffered loss alleged to be in excess of £500,000.

Following an investigation conducted by the FOS, a provisional decision was issued in November 2009. The complaint was upheld and the FOS stated that the Clarks’ compensation should be such as would put them back in the position they would have been in, although FOS could not direct In Focus to pay any more than £100,000. The decision stated that the Clarks “*may not be able to enforce a greater amount [than £100,000] in the courts. A court would make its own decision of whether to award the recommended greater amount above £100,000. However, I would recommend that [In Focus] pays the full amount in full and final settlement of this complaint*”. In Focus offered £100,000 in settlement, which the Clarks rejected.

The FOS then issued the final decision, in predominantly the same terms as the provisional decision, noting that if Mr and Mrs Clark accepted the award that they “*would be bound by the decision, which will be final*”.

The Clarks’ solicitor, on receipt of the decision, contacted the FOS to confirm the meaning of “*final and binding*” and asked: “*Would the complainants’ rights to pursue a civil claim through court proceedings for their additional loss (in negligence or otherwise) be prejudiced in any way by accepting the Final Decision and, if so, how?*” FOS responded stating that “*if the business did not pay the recommended balance and [the Clarks] decided to sue for the balance in court, the court would make its own decision on whether or not to award anything*”.

In February 2010, Mr and Mrs Clark accepted the award using the acceptance form provided by FOS, however they also inserted and countersigned the following statement: “*we reserve the right to pursue the matter further through the civil court*”. Later that month the FOS wrote to both parties confirming that the final decision was now binding and asked In Focus to settle the award. The Clarks confirmed that they had received two cheques amounting to £100,000, which were then paid into their bank account.

First instance

In June 2010, Mr & Mrs Clark issued proceedings in the County Court alleging breach of contract, breach of fiduciary and statutory duties and negligence. They sought their full alleged loss less the £100,000 already paid. In Focus applied to strike out the claim on the basis that Mr & Mrs Clark had accepted the FOS determination and the £100,000 payment in full and final settlement and the Court had no jurisdiction to entertain a claim for further sums.

In granting the strike out application, His Honour Judge Barratt QC considered the High Court decision of *Andrews v SBJ Benefit Consultants Ltd* [2010] EWHC 2875 (Ch). In summary, *Andrews* involved an individual who had issued a complaint after suffering losses estimated to be in excess of £400,000 following a transfer from an employee pension scheme to a personal pension scheme. The FOS upheld the complaint and awarded the maximum award of £100,000 with a recommendation that the firm in question pay the balance. The individual accepted the award and issued proceedings claiming damages for the balance. It was held that, as the FOS was a “tribunal”, its final determinations were “judgments” for the purposes of the doctrine of merger, the effect of which is to preclude the claimant from pursuing a recovery in the courts in relation to the same subject matter.

In *Clark*, the claim was struck out by Judge Barratt QC on the basis that *Andrews* was binding. As the issues in front of the court were the same as the issues put before the FOS, the doctrine of merger applied and the Clarks were therefore precluded from bringing a claim against In Focus for the balance of their alleged loss.

Appeal

Mr and Mrs Clark appealed the order to the High Court, and asked the Court to determine whether parties who had accepted a favourable determination of the FOS are subsequently able to bring a claim for damages for the balance of their alleged loss.

Cranston J found that they were. For various reasons, he took issue with the decision in *Andrews*. These reasons included that the FOS only makes recommendations which are not binding unless the complainant consents, such that the functions of the FOS differ from those of a typical tribunal. Cranston J also noted that “*the doctrine of merger turns on a cause of action being extinguished – it is merged in the judgment*”, therefore as the FOS deals with complaints, not causes of action, the doctrine is not (he said) applicable. Further to this, he noted that the FOS scheme had to be “*considered as a whole*” and that the term “final” referred to the end of the Ombudsman’s process, not the end of the resolution of the dispute.

Consequently, Cranston J held that the doctrine of merger did not apply to those who have accepted favourable determinations from FOS and, so, does not preclude those who have accepted the maximum award from claiming damages for an amount in excess of that award.

Comment

Unless and until a decision is handed down by the Court of Appeal clarifying whether parties who have accepted the maximum award from FOS can bring a claim for damages for the balance of their loss, the High Court decisions of *Clark* and *Andrews* represent contradicting authority. It is therefore to be welcomed that In Focus has lodged an application for permission to appeal to the Court of Appeal.

In the meantime, in response to the uncertain state of affairs to which Cranston J’s decision gives rise, the FOS announced that it had amended the wording on its website and in its final decisions to reflect that complainants may be able to pursue a claim in the courts for further damages in respect of complaints which exceed the current £150,000 maximum award.

According to the FOS’ annual review for 2011/2012 only 1% of cases last year involved the FOS recommending that a business pay compensation in excess of the maximum award, which suggests that only a limited amount of FOS decisions will be affected by this judgment. However, complaints concerning certain types of financial services and products (for example pensions and investment portfolio management) can often involve alleged losses way in excess of the £150,000 FOS cap and, were *Clark* to stand, it is possible that this would encourage more higher value claims to be referred to the FOS as a pre-cursor to litigation. Indeed, Cranston J did not think it would be inconsistent with the statutory aims of the FOS scheme for customers to refer complaints to the FOS with a view to using the money award to finance court proceedings for a greater amount. No doubt many will disagree with this view.

However, just because a complainant is successful before the FOS it does not automatically follow that they will be successful in an action before the courts. While the FOS is required to take into account “relevant law”, it was established by the Court of Appeal in *R (on the application of Heather Moor & Edgecomb Ltd) v Financial Ombudsman Service & Simon Lodge* (2008) that the Financial Services and Markets Act 2000 does not require the FOS to determine complaints in accordance with the law. Consequently, the court’s assessment of the claim may well differ from the FOS’s view of what is “fair and reasonable”, despite the common subject matter.

Nevertheless, until the position is clarified, FSA authorised firms (and their professional indemnity insurers) will need to exercise extra care when evaluating complaints which likely have a value in excess of £150,000.

Establishment of an Independent Insurance Authority in Hong Kong – New Wine in Old Wineskins?

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The Government has recently completed a three-month public consultation on the legislative proposals for the establishment of the Independent Insurance Authority (IIA). Subject to the views of the Legislative Council and the public, the IIA is expected to come into operation in the year 2015.

In this article, we highlight the proposed key legislative amendments to the Insurance Companies Ordinance (ICO) for the establishment of the IIA:

The Independence of the IIA

Under the legislative proposals, the IIA will be set up as a body corporate to take over the role of the existing government department (Office of the Commissioner of Insurance) and regulate the conduct of insurance intermediaries through a new statutory licensing regime. At present, insurance intermediaries are regulated under a self-regulatory regime administered by three Self-Regulatory Organisations. The proposed changes will bring in line with international practice that financial service regulators should be financially and operationally independent of the government, and modernize the regulatory infrastructure to strengthen protection of policyholders.

The IIA shall have a chairman and a chief executive officer. The respective responsibilities of these two new positions, however, have not been clearly defined. The governing board of the IIA would consist of at least six directors appointed by the Chief Executive from a cross-section of community, including a maximum of two members with knowledge of the insurance industry. No representative from the Government will be appointed to the board. Further, two statutory Industry Advisory Committees will be established, one on life insurance and the other on non-life insurance, to advise the governing board on issues relating to the insurance industry. Whilst keeping the autonomy of the IIA may be paramount, the proposed board composition has raised concerns that there is insufficient industry representation to properly manage the IIA.

Self-financed mechanism

The IIA will be self-financed with income streams from the following sources:

- (a) Licence fees from insurers: a fixed licence fee of HK\$300,000 for insurers and HK\$30,000 for captive insurers, and a variable licence fee of 0.0039% based on individual liabilities
- (b) Licence fees from insurance intermediaries: a fixed licence fee to be determined in the legislation after the expiry of the first five-year waiver period

- (c) User fees for providing specific service such as processing application for authorization or de-authorization of insurers, change of particulars of insurers and transfer of business of insurers
- (d) A levy of 0.1% on insurance premiums for all insurance policies, subject to certain caps and exemptions

The new fee basis will inevitably increase the costs of business for insurers and insurance intermediaries. It has also been suggested that the variable licence fee payable by insurers should be based on regulatory risk, rather than individual liabilities.

Statutory licensing regime for insurance intermediaries

The ICO will be amended to introduce a licensing regime to replace the existing self-regulatory regime. A person is required to obtain a licence with the IIA in order to carry on insurance intermediary activities (i.e. regulated activities) *in the course of that person's business, or employment, or for reward*. From the drafting of this provision, it is unclear whether the Government intends to exclude gratuitous advice by insurance intermediaries which may lead to subsequent procurement of insurance contracts. Further, the proposals also exempt professionals and trust companies including accountants, lawyers and actuaries giving regulated advice wholly incidental to their professional practice or discharge of their duties from the licensing requirement.

The proposed eligibility criteria for obtaining a licence will be similar to those of the existing regime. That is, the applicant must fulfil the 'fit and proper' requirements, pass the qualifying examinations, and be appointed by at least one authorized insurer or engaged by a licensed insurance agency or a licensed insurance broker company, as the case may be. Further, it is proposed that each authorised insurer or licensee is required to appoint a responsible officer for implementing internal controls and procedures for the purpose of complying with conduct requirements.

New conduct requirements of licensees

Under the proposed regime, the ICO will set out the broad principles of conduct requirements to be observed by insurance intermediaries. The broad principles, to a large extent, are modelled from the Code of Conduct for Persons

Licensed by or Registered with the Securities and Futures Commission. They require insurer intermediaries to, amongst others:

- Act honestly and fairly in the best interests of the policyholder or potential policyholder and with integrity
- Exercise a level of care, skill and diligence reasonably expected of them
- Make such disclosure of information as is necessary for the policyholder or potential policyholder to be sufficiently informed for the purpose of making any material decision
- Use best endeavours to avoid a conflict between the interests of the licensee and the interests of the policyholder or potential policyholder and, in the case of such a conflict, must disclose the conflict to the policyholder or potential policyholder

Breaches of the conduct requirements will be subject to disciplinary sanctions by the IIA, including reprimand, pecuniary penalty, suspension or revocation of licence.

The industry has expressed concerns that the new conduct requirements may interfere with an agent's common law duty to act in the best interests of, and with due skill, care and diligence towards the insurer. In particular, it is unclear whether an insurance agent is required to advise a potential policyholder in relation to the existence and terms of policies offered by other insurers in the market, and disclose confidential information such as commission rates, discounts and claims handling policies. It has also been suggested that breaches of the new conduct requirements may give rise to a claim for damages against insurance agents and insurers in tort and/or contract. In view of the potential liability faced by insurance agents and insurers, it may be appropriate to set out the new conduct requirements in a more specific manner, rather than leaving the ambiguity to be resolved in subsidiary legislation and guidelines issued by the IIA.

Investigative and disciplinary powers

The IIA will be vested with powers to initiate inspection and investigation, apply for a warrant, impose disciplinary sanctions against insurers and licensees, and prosecute offences summarily. These powers are similar to those of the Securities and Futures Commission although no reasons have been given in the consultation paper as to why such powers are necessary for the insurance industry.

Under the legislative proposals, the IIA will be empowered to exercise disciplinary power in any proven cases of misconduct and breach of the fit and proper requirements. Further, the IIA may suspend a licensee/responsible officer from carrying on a regulated activity for a specified period before a disciplinary decision is made. Where there is such a suspension, it is proposed that the IIA may publish

material facts relating to the case. It is an ongoing concern from the industry that the publication of material facts prior to the conclusion of the investigation may be unfair given the damage it may cause to the business of an insurer or its agent. A better alternative is to publish merely the fact of the suspension.

A Disciplinary Committee will also be established to assist the IIA in determining disciplinary sanctions. To ensure proper checks and balances, any disciplinary decision made by the IIA will be subject to review by the Insurance Appeals Tribunal.

Bancassurance

Under the legislative proposals, the IIA is the primary and lead regulator for all insurance intermediaries including banks. Nevertheless, the IIA and Hong Kong Monetary Authority (**HKMA**) will work closely on regulation in bancassurance. Further, it is proposed that the IIA can delegate to the HKMA specified functions such as investigation, inspection and suspension powers.

There are concerns from the industry that bank intermediaries being subject to both HKMA and the IIA may lead to discrepancy and unpredictability in enforcement as the two regulators may have different views and approach on insurance related issues. In any event, the IIA should retain its autonomy in its exercise of power and ensure there is consistency in the exercise of powers as between bank intermediaries and insurance intermediaries.

Looking forward

As transitional arrangements, existing insurance intermediaries will be deemed as licensees under the new regime for three years from the commencement of the Amendment Bill. License fees payable by insurance intermediaries will also be waived during the first five years of establishment.

The establishment of an IIA in Hong Kong will facilitate the effective implementation of international regulatory standards and the stable development of the insurance industry. In view of the enhanced investigative and supervisory powers given to the IIA, the insurance intermediaries will be subject to greater scrutiny. It is advisable that insurance intermediaries review their internal controls and risk management policies to ensure compliance with the new regulatory requirements. In general, the majority of the public supports the set up of the IIA despite the fact that there are still ambiguities and issues to be clarified. It is hoped that after the consultation exercise, the Government can further clarify the gaps in the legislative proposals to suit the need of the insurance industry and provide better protection to insurance policyholders.

Australian Bank Fees Class Action

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On 6 September 2012 the High Court of Australia in *Andrews v Australia and New Zealand Banking Group Limited (2012)* delivered a decision which has given the green light for consumers to proceed against Australia's banks in the largest ever class action in Australia.

The decision was handed down in relation to claims against the ANZ Bank challenging the legality of certain fees (known as exception fees) charged by ANZ over the past six years. A key question is whether the charges are penalties or whether they relate to services.

The proceedings are part of a wider class action in which separate proceedings raising similar claims have been commenced against 7 other Australian banks with the possibility that 4 further banks will be drawn in. The class actions have been launched on behalf of about 160,000 customers, with claims estimated at over \$200m. The class action is being funded by litigation funders IMF (Australia) Ltd.

The progress of the ANZ class action, which is being run as a test case for the proceedings against the other banks, is being watched with great interest by those in the legal, banking and insurance sectors in Australia.

Background

The applicants claim that ANZ's charging of the exception fees either amounts to breaches of contract or that the fees are penalties.

The disputed fees include honour fees, dishonour fees, non-payment fees, late payment fees and over-limit fees charged for retail and business deposit accounts and for consumer and commercial credit card accounts. At first instance in the Federal Court, Gordon J reached the following conclusions:

- The late payment fees were payable upon breach of contract and were therefore capable of being characterised as penalties
- The honour, dishonour, non-payment and over limit fees were not charged upon breach of contract and it was unnecessary to consider whether they were capable of being characterised as penalties. Instead, Gordon J held the fees were charged as a consequence of the decision of ANZ to afford or to decline the provision of further accommodation to the customer

The effect of the first instance decision was that a significant portion of the customers' claims could not proceed. The customers appealed this aspect of the decision.

High Court decision

The High Court unanimously allowed the appeal and found that the honour, dishonour, non-payment and over-limit fees were capable of being penalties. It also left open the question of whether the applicants should be entitled to challenge the finding that those fees were not payable upon breach of contract.

Importantly, the High Court confirmed that the scope of the penalty doctrine is not limited to breaches of contract in Australia. In doing so, it overturned previous NSW Court of Appeal authority which had held to the contrary.

The High Court overturned Gordon J's conclusion and held that even the existence of the following facts did not render the exception fees incapable of being characterised as penalties:

- The fees were not charged by ANZ upon breach by its customers
- The customers had no responsibility or obligation to avoid the occurrence of events upon which the fees were charged

Implications

It is still relatively early days in the class action proceedings.

While the High Court's decision will allow the consumers to continue with all their claims against ANZ, no determination was made by the Court as to whether the fees are in fact penalties. In addition, neither the High Court nor the earlier Federal Court decision considered the question of whether the fees were excessive.

The effect of the decision is that the proceedings have returned to the Federal Court for further hearing and determinations in relation to the ANZ proceedings.

Very little has happened to date in the proceedings against the other Australian banks, which have been stayed until at least June 2013 pending the ANZ proceedings. The outcome of the ANZ proceedings will not necessarily be determinative of the other class actions, which will still need to be resolved based on the relevant terms and conditions of the specific banking contracts.

For insurers, any judgment entered against the banks may raise interesting questions regarding the insurability at law of the amounts due to the customers as a consequence of the banks' overcharging.

Canada Considers Imposing Statutory Best Interest Duty on Investment Advice

Roderic McLauchlan, Partner, Toronto

Canada has had a series of high profile investment advisor scandals. It is perhaps no coincidence that the Canadian Securities Administrators (“CSA”) have launched a consultation in connection with their recommendation that a statutory “best interests” duty be imposed on advisors and dealers in Canada in connection with advice to their clients.

This is intended to bring Canada in line with similar statutory duties that exist in the United Kingdom and the EU, and which Australia is to implement later this year.

The proposal is that each advisor or dealer providing advice to retail clients with respect to investing, buying or selling securities or derivatives shall act in the best interests of the retail client.

This is an additional duty besides the obligation to exercise a degree of skill and care that a reasonably prudent person or company would exercise in the circumstances. It is also considered by the CSA, which is the national association of securities and investment regulators in Canada, to be more demanding than the duty imposed on registered advisors and dealers to deal “fairly, honestly and in good faith” with their clients under existing securities legislation in Canada.

As described by the CSA in its proposal, the statutory “best interests” duty is to heighten the existing obligation of good faith and fair dealing into a qualified fiduciary obligation.

In many other jurisdictions, the relationship between investment adviser and client has been characterized as fiduciary in nature. However, Canadian Courts, when dealing with claims between investment advisors, brokers and their clients, have been bedeviled by disputes as to whether or not the relationship is a fiduciary one or not. The courts apply an ad hoc analysis, leaving considerable uncertainty. The consequences are significant, as fiduciary relationships bring with them the full range of equitable remedies and potentially lower causation thresholds and more generous measures of damages.

The objectives of the CSA are to enhance investor protection and to harmonize the obligations across Canada. As the investment adviser and broker-dealer professions in Canada are effectively self-regulating through self-imposed regulatory bodies, the CSA has often taken the lead in these matters.

Many investor groups have been vocal about the poor record of recoveries by investors and the lack of framework in Canada. The higher duties imposed by such a ‘best interests’ duty would strengthen the basis of complaint. It would also bring the legal framework into line with the fact that polls of retail Canadian investors demonstrate that investors believe such obligations already exist.

Besides bringing the common law provinces in line, such a provision would have the affect of harmonizing the common law provinces with Quebec civil law jurisdiction, where it is recognized that the investment advisor relationship brings with it an obligation of loyalty that the courts consider to be akin to the fiduciary duty (*Laflamme v. Prudential-Bache Commodities Canada*).

The benefits of harmonization are clear but if it is enacted, and this is far from certain, there are both commercial and legal complications to be faced.

Concerns have been raised by the securities industry in Canada that greater costs will be imposed, that there will be a negative impact on investor access, and that it will have an uncertain affect on compensation practices. Notably, it is arguable that compensation structures based on commission are incompatible with a fiduciary duty, as the latter precludes profit-making from the opportunities of the client. Ultimately, fee-based compensation is more neutral and less prone to difficulties.

The CSA also recognizes that any such standard will have to be tailored to reflect the different business models. The statutory ‘best interests’ duty applicable for a fully discretionary stock broker will be different from the standard applicable to a mutual fund advisor or discount brokerage, who has significant restrictions on what they can sell and also have limitations on what advice, if any, they can provide. This will require significant guidance as to its application.

The Airocean case: materiality matters when it comes to director's duties

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In a landmark decision handed down by the Singapore High Court, an independent director's conviction for market misconduct was overturned. As a result of this case, company directors are no longer in the dark about their disclosure obligations and duties under the Securities and Futures Act. Melissa Russell and Victoria Macgregor of Clyde & Co LLP Singapore (with assistance from Clasis LLC) shed light on the requisite thresholds that need to be crossed in order to impute liability upon independent directors.

The background

The recent decision on appeal to the Singapore High Court in *Madhavan Peter v Public Prosecutor* [2012] SGHC 153, decided by Judge Chan Sek Keong, highlights Directors' and Officers' disclosure obligations and illustrates the possible serious consequences of failing to fulfil those duties.

Airocean Group Ltd was a holding company for a number of air-cargo logistics companies. Its four directors were Thomas Tay (Tay) as CEO, Chong Keng Ban (Chong) as COO, Ong Seow Yong (Ong) and Peter Madhavan (Madhavan).

In early September 2005, Tay was questioned by the Corrupt Practices Investigation Bureau (CPIB) in relation to a suspected bribe paid to secure business for two of Airocean's subsidiary companies. Tay was later arrested, released on bail and his passport was impounded. All of the directors knew of the CPIB investigation. In late September, Chong sold two million shares in Airocean.

The Straits Times published an article about CPIB's investigation of Tay in November 2005. This prompted the directors of Airocean to release an announcement, via SGXNET, in an attempt to clarify the newspaper article. However, the announcement mentioned only CPIB's investigation of Tay and did not mention the CPIB's investigation of the two Airocean subsidiaries. After receiving advice from the Singapore Exchange, Airocean released a further announcement, clarifying that three of its directors had been questioned by the CPIB about the alleged bribe. But this statement did not mention that the CPIB questioned the directors of two of Airocean's subsidiaries. On 5 December 2005, Airocean's share price fell by 17.4 percent.

Test of materiality

The Court considered the legal test of materiality under the Securities and Futures Act (SFA). The SFA prescribes the continuous disclosure obligations and also regulates insider trading. The Court held that:

- a) **Failure to disclose** (alleged breach of Rule 703(1)(b) of the Singapore Exchange Securities Trading Limited Manual read with s203(2) of SFA¹)

A company listed on the Singapore Exchange must disclose information which would be likely to *materially* affect the price or value of its shares. Intentional or recklessly withholding such information will constitute an offence of non-disclosure under the SFA. In relation to this offence, the Court decided that materiality depended upon whether the information was "**price sensitive information.**" The court looked at whether the information impacted the value of the shares. This was to be determined by expert evidence and actual evidence from the market and it had a high standard of proof.

- b) **Providing mis-leading information** (s199(c)(iii) read with s331(1) of SFA)

A Singapore company is prohibited from making any statement that is misleading in "*a material particular*" **and** its likely effect is to stabilise the company's share price². The Court held that the focus of this offence is '*on the price impact of false or misleading statements*'³. Again, the Court conceptualised information as material if it is "**price sensitive information.**"

- c) **Committing insider trading** (s218(a) of SFA)

¹ Chapter 289, 2002 Revised Edition

² s199 of SFA

³ per Chan Sek Keong CJ, paragraph 45

It is an offence for a person connected with a company to sell or buy shares in that company while in possession of information which is not generally available to the public but, if it were generally available:

- A reasonable person would expect such information to have a material effect on the company's share price
- The information would, or would be likely to, influence an investor's decision to buy or sell⁴

This is known as “**trade sensitive information**”.

Trade sensitive

In summary, the Court held that the information was “trade sensitive” but not “materially price sensitive”. As a result of the Court's decision, Madhavan, Chong and Ong were acquitted of misleading and non-disclosure offences and their sentences (including imprisonment up to 12 months and fines of SG\$180,000) (US\$147,263) were overturned. Chong's conviction on insider trading was upheld. Chong was disqualified from acting as a director for five years, while his custodial sentence was reduced to a fine of SG\$280,000 (US\$229,076.)

As the two different materiality tests show, information must meet a higher threshold for it to be “price” rather than “trade sensitive information”; information may influence an investor to buy or sell but it may not significantly affect the share price. The reason for the lower threshold in respect of “trade sensitive information” is that the level playing field of investors is only upset if investors, in possession of “trade sensitive information”, act upon it.

The Court's finding

In defence of the allegation that the directors acted recklessly in issuing the announcements, the directors said that they relied on legal advice but the Public Prosecutor argued such advice was flawed and should have been questioned. The Court held that directors were not reckless in failing to question their lawyer's advice unless it could be shown that the advice was manifestly absurd, irrational or wrong. In our view, the Court has attempted to redress the perceived onerous obligations that directors and officers owe under the SFA and other company legislation. Directors and officers should remain vigilant as we anticipate an increase in similar prosecutions/investigations by the CPIB.

This article was first published in Asian-MENA Counsel.

⁴ s203 of SFA read with s216 SFA

News

Deferred prosecution agreements (DPAs) shortly to be permitted in England and Wales

Whilst it has been possible to enter into a DPA in the US for some time, no such mechanism has existed within the UK. DPAs are now being introduced by means of provisions included in the Crime and Courts Bill currently passing through Parliament. Companies, partnerships and unincorporated associations will be able to enter into DPAs (but not individuals) in respect of a range of economic offences including for example some money laundering offences, certain Companies Act 2006 offences, Bribery Act offences and certain offences under the Financial Services and Markets Act 2000. A DPA is essentially an agreement that a prosecutor will lay, but not proceed with criminal charges against an organisation, in return for which the organisation agrees to comply with certain terms and conditions.

DPAs will be subject to judicial supervision, as the prosecutor must obtain a court declaration before the terms of a DPA are agreed that a DPA is likely to be in the interests of justice and its terms are fair, reasonable and proportionate, and a similar declaration must be obtained after the terms are agreed before it comes into force. The requirements that may be imposed on the company (or other body) under the DPA include: payment of a financial penalty, payment of compensation to victims of the alleged offence, donation of money to charity or a third party, disgorgement of profits, implementation of a compliance programme, co-operation in an investigation, and payment of the costs of the prosecutor.

The primary incentive for a company to enter into a DPA will be the avoidance of criminal prosecution however there will be potential for the financial penalty element to be reduced. The financial penalty must be broadly comparable to the fine that a court would have imposed following a guilty plea. There may also be scope for further reduction to recognise assistance provided with the investigation or prosecution, and DPAs are primarily intended to be for those who self-report and co-operate with investigations. A Code of Practice for Prosecutors on DPAs is to be produced by the Serious Fraud Office (SFO) and the Director of Public Prosecutions. Separately, the Sentencing Council is also to develop sentencing guidelines for those offences that are the subject of a DPA. The government has stated that the aim of the new regime is to enable prosecutors to secure tough penalties without the uncertainty and expense of a full criminal prosecution and trial. DPAs will be available for misconduct that is alleged to have taken place before the new DPA provisions come into effect.

Although a DPA is likely to be an attractive option, companies that discover wrongdoing will still want to consider carefully whether to enter into a DPA. Although a DPA provides comfort that a company will not be convicted of an offence and mitigation of potential penalties, it will be necessary for it to disclose sensitive information in relation to the wrongdoing to the SFO. There is no guarantee that the SFO will consider a DPA to be the appropriate way of dealing with the conduct, or that the court will then approve the DPA, although the guidelines being published in this regard should assist with determining the likely approach of the SFO/courts. How the system operates in relation to the first few DPAs will be watched with interest.

Piercing the corporate veil – UK Supreme Court judgment

The Supreme Court has recently given judgment on the issue of whether it is possible to pierce the corporate veil, so that a person controlling a company that has entered into a contract, can be held liable as a co-contracting party in *VTB v Nutritek*. Briefly, the facts of the case were that the claimant bank entered into a loan agreement with a Russian company RAP, under which RAP was loaned \$250 million to buy a number of dairy companies from another company, Nutritek. RAP subsequently defaulted on the loan. The claimant alleged that it was induced to enter into the loan agreements by misrepresentations made by Nutritek. The claimant alleged that Mr Malofeev was the ultimate owner and controller of Nutritek, and two other companies, Marcap BVI and Marcap Moscow, and that RAP was also controlled by Mr Malofeev via Marcap BVI. Therefore, the sale of the dairy companies from Nutritek to RAP was not an arms length transaction. The main issue in the case related to the appropriate jurisdiction, however the claimant also sought to amend its case to contend that Mr Malofeev, Marcap BVI and Marcap Moscow should be treated as jointly and severally liable with RAP for breaches of the loan agreements.

Lord Neuberger, giving the leading judgment on this issue, held that the claimant should not be able to include a claim of piercing the corporate veil. As this was the hearing of an interlocutory application, the Court declined to resolve the issue of whether, unless any statute expressly or implicitly implied otherwise, the court is ever entitled to pierce the corporate veil. However, Lord Neuberger proceeded on the assumption that the courts were entitled to do so in appropriate circumstances. It was held that in this case the claimant was seeking an extension to the circumstances in which it had traditionally been held that the veil could be pierced, meaning that the person controlling the company would be held liable as a co-

contracting party where none of the contracting parties had intended him to be. Such an extension would be contrary to principle and the extension was not needed to allow the claimant to seek redress from Mr Malofeev.

Judgment in Standard Life case on apportionment

In December last year, judgment was handed down in the matter of *Standard Life v ACE European*. The insured had operated a fund that suffered a one day 4.8% fall in value. It estimated that the majority of its customers would have claims against it, and subsequently made a payment into the fund to restore the value also making some additional payments to certain customers. The insured sought to recover under the Mitigation Costs cover section of its professional indemnity insurance cover. At first instance the court held that the payments were covered as they were “reasonably and necessarily incurred...in taking action to avoid...or to reduce a third party claim”. It was held that it did not matter that one motive in making the payment was to avoid or reduce reputational damage.

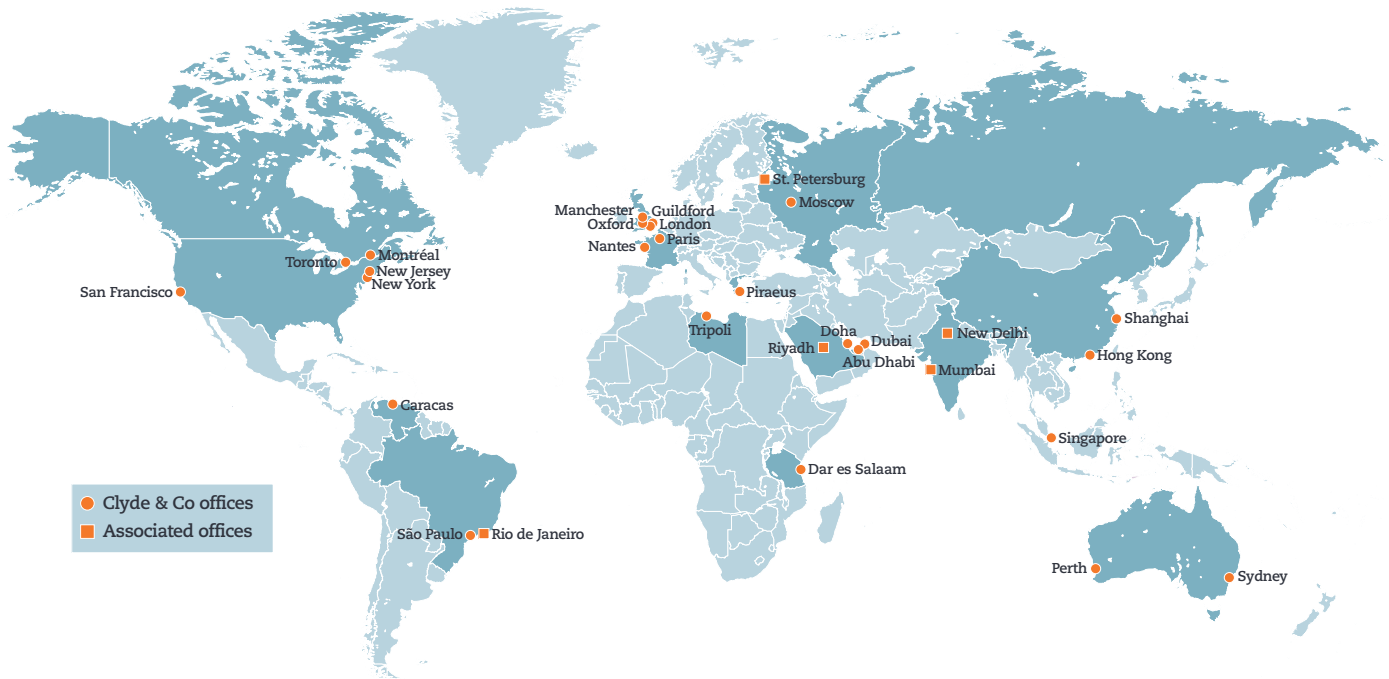
Before the Court of Appeal the issue was whether, if there are two equal and dominant purposes in the insured making the payment into the fund (one insured and the other uninsured), there should be an apportionment of the relevant mitigating costs. The argument in favour of apportionment was that mitigation cover was analogous to a “sue and labour” clause in a marine insurance policy. The Court of Appeal rejected the arguments for an apportionment on the basis that they were untenable as a matter of construction of the policy wording. This was enough to dispose of the appeal, but the Court nonetheless went on to consider apportionment in the context of liability insurance. The Court held that the adjustment of losses under marine policies proceeds on the assumption that the subject matter insured is fully covered by the insurance. Where there is underinsurance the apportionment is necessary in order to ensure that the insurers only contribute to the extent of their interest in the property. The Court found that the assumption was “inapposite and in any event unworkable” in the field of liability insurance to which the apportionment principle could not be transferred. Further, it would be “irrational and unprincipled” to attempt to introduce such a principle into liability insurance, where the extent of liabilities to be incurred is unknown when the policy is agreed.

UK FSA issues joint largest retail fine for mis-selling insurance products

The FSA has fined Card Protection Plan Ltd (CPP) £10.5 million for mis-selling insurance products. From 2005 – 2011 CPP sold 4.4 million card protection and identity protection insurance policies and renewed 18.7 million policies. This generated CPP gross profits of £354.5 million. The policies cost approximately £35 per annum and included features such as access to various monitoring tools and credit reports, and registration with a fraud detection service. The policies also provided cover for unauthorised transactions on lost debit and credit cards that occurred both before and after the customer had notified CPP that their cards had been lost or stolen. However, card holders would not usually be liable for more than the first £50 worth of unauthorised transactions before notification, and would not be liable for any unauthorised transactions after notification apart from in exceptional circumstances, and therefore this cover was not needed. The FSA’s investigation showed that CPP’s sales processes were focussed on sales and commercial objectives above treating customers fairly, and that sales agents were encouraged to be overly persistent in persuading potential customers to purchase products. When CPP became aware of significant concerns with its sales and documentation following FSA ARROW visits and compliance reports prepared by third parties it took insufficient action to deal with the issues. CPP estimates that the total cost of the investigation including the fine, redress payable to customers and the costs of the investigation will be £33.4 million.

CPP also agreed to provide an undertaking regarding an unfair contract term allowing it to take customers’ payments from another card covered by card protection in the event that the payment could not be taken from the original card.

Our global reach



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