Clyde&Co

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Foreword

The boundaries of financial regulation are constantly expanding and the question of what should come within the Financial Conduct Authority's (FCA) remit is currently under review, as we explore in the article on the FCA's perimeter. Another area of expansion is Fintech and the development and use of cryptocurrencies. Within a discussion about Facebook's Libra currency, our article addresses the potential of digital currencies and the challenges involved.

Continuing with a spotlight on financial regulation, we highlight two cases in recent times where individuals, who were subject to enforcement proceedings, have succeeded in recovering some of their costs from the FCA; a reminder that the FCA must demonstrate that it has reasonably brought each of its claims *and* be able to support them. We also provide an update on the FCA and Financial Ombudsman Service (FOS) complaints statistics, the business plans for the FCA, Prudential Regulation Authority (PRA) and the Pensions Regulator (TPR) and the Financial Reporting Council's new Stewardship Code.

On the global stage, class actions continue to be a significant exposure for financial institutions and their directors and officers. In addition to an article on the boundaries of U.S. securities actions against foreign companies, we also examine: important cases testing the UK's opt-out measures under the Consumer Rights Act 2015, the first Australian court decision in a securities class action and developments for collective redress happening across Europe and in Germany, in particular.

This Review also analyses the recent Supreme Court judgment in *Singularis v Daiwa* and provides a summary of the important cases impacting the FIDO space since our March 2019 Review and of what we can expect in the coming months.

The FCA perimeter

Author
Laura Cooke

There has been significant debate in recent months concerning the "perimeter" of the UK financial services regulator, the Financial Conduct Authority (FCA).

Put very briefly, the term "perimeter" is used to describe the scope of who and what the FCA regulates. The perimeter is predominantly set with reference to the provisions of the Financial Services and Markets Act 2000 and the Regulated Activities Order 2001 but there are a significant number of other pieces of primary and secondary legislation which come together to set the scope and powers of the FCA.

By way of illustration as to the complexity of the scope of FCA regulation, the current version of the FCA's Perimeter Guidance Manual ("PERG") runs to over 800 pages and increasing concern has been voiced that this complexity has given rise to uncertainty and ambiguity for consumers.

Further, the financial services industry is constantly developing and innovating and, given that the FCA is not a regulator which pre-approves new products and services, much of its perimeter work is, by necessity, responsive. As such, the perimeter is not static and the recent consultations on the need for and scope of regulation for crypto-assets and the peer-to-peer lending sector are illustrations of this point.

Another issue is those firms and individuals who operate outside, but close to, the boundary of FCA regulation sometimes with intent to exploit. Recent examples of consumer detriment in this regard include the promotion of non-standard, esoteric and high-risk investments by unregulated introducers to consumers. This has led not only to consumer detriment but also to significant exposures for IFAs and SIPP providers who have been involved with and/or accepted this business. The FCA does have certain powers which it can exercise against entities and individuals who it does not regulate, but these are more limited than those available in respect of those that it does regulate.

Further, while an entity can be FCA regulated for certain activities, that does not necessarily mean that all of its activities fall within the FCA's remit and, so, attract the statutory protections of the Financial Ombudsman Service and the Financial Services Compensation Scheme.

This differentiation may not be sufficiently clear to consumers, or they may not otherwise properly appreciate the implications.

In response to the heightened concerns about the scale of consumer detriment arising from activities on or around the FCA's perimeter, in June this year, the FCA published its first **Annual Perimeter Report**. Citing the three key challenges to the perimeter (being customer confusion over how they are protected, activities of firms outside the perimeter and swiftly evolving markets and business models), the FCA gave examples of actions it has and is taking to address issues identified at and beyond its perimeter with a view to improving consumer understanding of the FCA's role and the scope of regulatory protections.

In light of various events but most recently the collapse of the "mini-bond" issuer London Capital & Finance plc ("LC&F"), the House of Commons Treasury Select Committee has taken considerable interest in the FCA perimeter and, in a recent report published in July 2019 (**The Work of the Financial Conduct Authority: the Perimeter of Regulation**) the Committee made the following recommendations:

– Where regulated financial institutions undertake unregulated activity, the regulatory system should ensure that clear and explicit warnings are provided at that point, with the potential consequences of the lack of regulatory cover clearly explained, and with sanctions for firms that fail to do so

- The FCA should be given the power to formally recommend to the Treasury changes to the perimeter of its regulation, where that would enhance its ability to meet its objectives
- The FCA should not be, or feel, constrained from providing warnings on financial products that may cause consumer detriment and this should extend to activities beyond its perimeter and changes to primary legislation should be made to facilitate this
- The FCA should have greater powers to gather information from non-regulated entities to help it meet its objectives

In its **response** to the Report (published on 17 October), the FCA was supportive of the Committee's recommendations. While noting that rules are already in place requiring that firms do not imply an activity is regulated when it is not, the FCA did observe that the financial promotion regime does not require in all cases a proactive explanation or warning to consumers when a product or service is not regulated or the consequences of this. The FCA has, however, sought to clarify its expectations to firms in this regard by way of a **"Dear CEO Letter"** issued in January 2019.

As to the Committee's recommendation that the FCA be given the power to recommend changes to its perimeter, the FCA's view was that there could be a more structured and transparent approach for identifying and engaging with the Treasury on perimeter changes.

With regard to warnings on financial products, the FCA noted the extent of usage of existing powers to issue consumer alerts highlighting risks when it becomes aware of unauthorised activities that may cause significant consumer harm (521 warnings were issued in the prior year), coupled with its ScamSmart campaign. One key challenge identified by the FCA is the speed with which misleading financial promotions and scams can re-appear online under new guises or domains and as the FCA does not have the power to require a technology firm to block access to a website (absent seeking a court injunction), it is predominantly reliant on the cooperation of such firms to block websites promptly.

Finally, the FCA confirmed that it would give consideration as to how increased information gathering powers against unregulated entities might operate, the kind of information they would likely seek and how it would be able to take supervisory or enforcement action using this information.

However, the **Government's response** (published on 10 October) to the Committee's recommendations was somewhat more muted.

On the issue of increased consumer warnings, the Government confirmed that it was working with the FCA to consider what further steps may be taken to ensure consumers understand what regulatory protection they may or may not be entitled to when engaging with unregulated products. This topic also forms part of the independent review which is taking place into the circumstances surrounding the collapse of LC&F, to include whether the FCA discharged its functions in respect of LC&F in a manner which enabled it to effectively fulfil its statutory objectives.

The Government rejected the Committee's suggestion that the FCA should be given the power to recommend to the Treasury changes to the perimeter on the basis that the current arrangements are satisfactory and, in any event, it is for the Government to consult and propose any changes to the perimeter to Parliament.

Addressing one of the key challenges for all regulators (i.e. financial and other resources), the Government noted that introducing the additional powers as against unregulated entities suggested by the Committee would represent a significant change to the FCA's remit, significantly add to its supervisory responsibilities and have considerable resource implications which may have the unintended effect of reducing the FCA's ability to supervise authorised firms. Despite voicing these concerns, the Government committed to further discussions with the FCA on this proposal.

While there are a few action points arising from the Committee's perimeter recommendations, the next substantive event in the continuing discussion about the scope of the FCA's powers and responsibilities in respect of entities operating on or outside its perimeter will be the outcome of the independent review into the collapse of LC&F. This review, which was commissioned in May 2019 and is headed by Dame Elizabeth Gloster, is expected to report on its findings within a year.

Business plans of the FCA, PRA and TPR

Author
Kirsten Shoraka

Whilst the UK finalises preparations to leave the European Union, the FCA has made it clear that it will not allow Brexit to deter from its consumer-focussed priorities in 2019/20 and it set out some key factors for regulation in a post-Brexit UK.

The Business Plan outlines four ongoing cross-sector priorities, namely (1) firms' culture and governance, including extending the Senior Managers and Certification Regime to all firms; (2) fair treatment of firms' existing customers through monitoring firms' practices, including the information they give prospective and current customers; (3) developing operational resilience, which will play a vital role in protecting the UK's financial system; and (4) combating financial crime and improving anti-money laundering practices by enhancing the use of technology and data, as well as engaging with multiple agencies and government bodies.

The Prudential Regulation Authority's ("PRA") strategic goals for 2019/20 are in a similar vein, relating to:

1. Monitoring and embedding structural reforms to banks, keeping implementation of the risk margin under Solvency II under review and starting an evaluation of the effectiveness of the Senior Managers and Certification Regime ("SMCR") and remuneration policies for banks and insurers and for corporate governance at board level.
2. Adapting to market changes and horizon scanning: this will not only relate to Brexit but also to financial risks arising from climate change and the authorisation of new firms in the UK.
3. Financial resilience, i.e. ensuring that firms are adequately capitalised and have sufficient liquidity.
4. Establishing 'operational resilience' in its prudential framework by the end of 2020, to which end the PRA plans to publish a consultation paper in the second half of 2019, setting out its proposed policy.
5. Continuing its work with the BoE's resolution directorate to ensure firms develop capabilities to wind down their trading and derivatives businesses in an orderly manner and collaborate with international regulators to ensure a co-ordinated and effective approach.
6. Assessing the competition implications of its policies and checking for any unintended distortions to competition. This will include refining the framework to facilitate the issuance of insurance-linked securities through insurance special purpose vehicles in the UK.

The Pension Regulator's ("TPR") plan for 2019 – 2022 outlines a more proactive and targeted approach, which will see hundreds more pension schemes contacted in the coming year.

Communications clarifying duties and the TPR's expectations will be sent to defined benefit (DB) schemes, newly authorised master trusts, defined contribution (DC) schemes and new employers with auto-enrolment responsibilities.

Further, the TPR will be regulating compliance, with the CMA Market Investigation on Investment Consultants requiring new duties for trustees in their relationships with investment consultants and fiduciary managers.

The TPR will also continue to work actively with the FCA and the Money and Pensions Service ("MAPS") on DB to DC transfers to ensure that they work effectively for those who want to transfer but also enable savers to understand the risks involved and the options available to them.

As the past year has seen the TPR's first prosecution for fraud (including custodial sentences) and a number of high-profile matters such as Southern Water agreeing to pay GBP 50 million into its pension scheme, the TPR has shown that it will not shy away from holding to account those who fail to comply with the required standards of pension legislation. The new Business Plan demonstrates that the TPR will continue to make full use of its regulatory powers and firms should expect that the TPR will be stepping up its enforcement and supervision activity. Against this background, insurers have to consider the insurability of fines for breaches of the Pensions Act 2004 or of costs from the appointment of a Skilled Person undertaking an investigation of pension schemes.

In conclusion, the goals and targets set out in the business plans of the three regulators illustrate the expectation that firms promote a culture which benefits consumers and prevents harm from markets, together with a good corporate culture within firms. As both the FCA and TPR aim to increase regulatory activity, this has implications for coverage considerations in relation to investigation costs and regulatory fines.

Costs orders against the Financial Conduct Authority

Author
Laura Cooke

Regulatory investigations and investigation costs are a significant source of indemnity claims for FI and D&O insurers. Whilst rarely used, there is a mechanism available which allows the subject of an investigation to seek their costs back from the regulator in certain circumstances. In this article we take a look at two cases (both concerning individuals) where a proportion of costs incurred were successfully recovered from the UK financial regulator, the Financial Conduct Authority (FCA).

Upper Tribunal appeals

The Upper Tribunal Tax and Chancery Chamber (the "Tribunal") hears a variety of appeals, including appeals against certain decisions made by the FCA, covering a wide range of disciplinary and regulatory matters, such as authorisation and permissions, penalties for market abuse and disciplinary sanctions. Appeals from Tribunal decisions can be made to the Court of Appeal on a point of law only.

In proceedings before the Tribunal, the normal practice is for parties to bear their own costs on the basis that the Tribunal's power to make costs orders is limited by the Tribunal Procedure (Upper Tribunal) Rules 2008/2698 (the "2008 Rules"), rule 10. This prescribes that the Upper Tribunal may not make an order in respect of costs or expenses except in certain situations. In relation to financial services cases the relevant provisions are rules 10(3)(d)-(f), which provide that a costs order can be made:

(d) *if the Upper Tribunal considers that a party or its representative has acted unreasonably in bringing, defending or conducting the proceedings;*

(e) *if, in a financial services case, the Upper Tribunal considers that the decision in respect of which the reference was made was unreasonable; or*

(f) *if, in a financial sanctions case, the Upper Tribunal considers that the decision to impose or uphold a monetary penalty in respect of which the appeal was made was unreasonable.*

These powers are rarely exercised by the Tribunal in financial services cases (the majority of applications made under rule 10 are against the Revenue and Customs Commissioners). However, in the last few years there have been two cases which provide a valuable insight into the situations where the Tribunal has been willing to make such an award in a financial services case and serve as a warning to the FCA going forward.

Angela Burns v The Financial Conduct Authority [2017] EWCA Civ 2140

Ms Burns was appointed as a non-executive director of two UK mutual societies. Upon investigation, the FSA (as it was then) found that Ms Burns was in breach of her fiduciary position, had failed to disclose conflicts of interest and had acted to further her own commercial interests. The FSA imposed a financial penalty and made an order prohibiting her from performing any function in relation to any regulated activity.

Ms Burns denied the allegations and made a reference to the Tribunal for the case to be reviewed. In December 2014, the Tribunal upheld four misconduct findings and agreed that she was not a fit and proper person to exercise the functions of a non-executive director. In May 2015 Ms Burns made an application for an order against the FCA for the payment of her legal costs which amounted to GBP 1,885,820.90 (GBP 1,494,562.32 was claimed on behalf of insurers who instructed solicitors and counsel on her behalf pursuant to a D&O policy).

Despite the findings against Ms Burns, the Tribunal exercised its discretion under rule 10(3)(d) of the 2008 Rules to order the FCA (as it by then had become) to pay costs of GBP 100,000 plus VAT to Ms Burns on the basis that the FCA had acted unreasonably in pursuing an allegation that she had made a demand for corrupt payments. Ms Burns appealed to the Court of Appeal on the basis of the misconduct findings and the FCA appealed against the costs award.

The Court of Appeal upheld the Tribunal's findings regarding Ms Burns' misconduct. It also upheld the Tribunal's costs order. Upon reviewing the evidence, it was clear that the FCA's Regulatory Decisions Committee (RDC) had accepted Ms Burns' evidence that the email in question, which could have been interpreted as a demand for a corrupt payment, was not a demand for a corrupt payment and was in fact just "poorly worded". After Ms Burns made the reference to the Tribunal, the FCA's statement of case contained no allegation that the email constituted a corrupt payment demand. However, following the receipt of further evidence unconnected to the email in question, the FCA doubted Ms Burns' general credibility and sought to amend its statement of case to reintroduce the allegation. Ms Burns argued that the FCA had been unreasonable in pursuing the allegation on a number of grounds, which the FCA sought to contest in a variety of ways, none to the satisfaction of the Tribunal. The Tribunal stated:

"*The Authority needed to consider whether the additional evidence contained something which showed, implied or pointed to any intention to seek corrupt payment in return for misuse of influence as a non-exec director. It did not contain any such material. Even though there were wider concerns in certain other respects about Ms Burns' integrity and the credibility of her evidence, these were not capable of providing a sound basis for rejecting the conclusion reached by the RDC and reading the email in a way that would have flouted common-sense.*"

The unreasonableness of the FCA therefore, the Tribunal held, "*increased the gravity of the proceedings and increased Ms Burns legal costs*", thereby justifying the imposition of the costs order.

The Court of Appeal, whilst accepting the FCA's argument that the FCA is entitled to plead any allegation which has a real prospect of success and lies within the scope of the facts and matters considered by the RDC, stated that the FCA must, nonetheless, have a proper basis for making any allegation and have suitable evidence, especially when the allegation was as serious as a demand for corrupt payments.

The FCA had contended that the Tribunal had wrongly applied a gloss to the statutory test and directed itself that the FCA required a cogent basis for differing from the position taken by the FCA's RDC. The Court of Appeal disagreed:

"*We do not understand [the Tribunal] to have been purporting to lay down any new rule of general application but merely to have been making a parenthetical observation that, the more serious the allegation, the more cogent the evidence must be to overcome the inherent improbability that it occurred. Where, as here, the allegation is of a particularly serious nature, the FCA must well know that it will require evidence of commensurate cogency to make it good. It should consider with great care whether it is appropriate to advance such an allegation, and particularly so in circumstances where it has been considered and rejected by the RDC.*"

As such, the Court of Appeal was entirely satisfied that the Tribunal had made no error in arriving at its conclusion.

Alistair Rae Burns v The Financial Conduct Authority [2019] UKUT 19 (TCC)

Mr Burns was a director of a financial advice company, TMI, which specialised in the giving of advice to retail customers on transfers into Self Invested Personal Pension Schemes ("SIPPs"). Upon establishing himself as a SIPP operator in 2012, Mr Burns told the FCA that TMI did not provide advice on the underlying investments. In 2015, the RDC issued a warning notice to Mr Burns regarding the lack of advice given on underlying investments and also in relation to undisclosed conflicts of interest and Mr Burns argued to the RDC that the FCA was aware of the issue regarding advice in 2012 and that, in any event, it was time-barred in relation to that issue under section 66(4) of the Financial Services and Markets Act 2000, which provides that the FCA may not take action after 3 years from when they become aware of the misconduct (the "Advice Limitation Issue"). The RDC's Decision Notice was ultimately made on a slightly different basis: that Mr Burns' personal recommendation process did not in practice comply with the FCA's regulatory requirements and that Mr Burns had failed to ensure that TMI fairly managed and clearly disclosed Mr Burns' personal conflicts of interest and the conflicts of interest relating to other individuals at TMI i.e. side-stepping the Advice Limitation Issue. The RDC fined him GBP 233,600 and prohibited him from performing any senior management or significant influence function in relation to any regulated activity.

Mr Burns made a reference to the Tribunal in 2016 in which he repeated his submissions and Statements of Case were issued by both sides. Following an internal investigation in 2017, the FCA conceded that the Advice Limitation Issue was time-barred and therefore sought to amend its Statement of Case to reflect that it was now only pursuing the conflict of interest point and sought a reduced financial penalty of GBP 116,830.

The Tribunal, in its decision of 31 July 2018, upheld the RDC's finding in relation to the conflict of interest point but considered a penalty of GBP 60,000 appropriate. It further upheld the prohibitions on Mr Burns' activities.

In August 2018, Mr Burns applied for a costs order. His original application was for costs in excess of GBP 130,000 but he later submitted a revised costs order for GBP 58,283.30. He based his application on:

- Rule 10(3)(e), on the basis that the RDC's Decision Notice was unreasonable. Mr Burns contended that the FCA had information in its possession in July 2015 which should have led to it concluding that it was time-barred from bringing an action in relation to failing to give advice. He said that this information was withheld from him and when settlement talks were in progress he would have settled the case, rendering the RDC and Tribunal hearings unnecessary. Further, that the RDC and FCA colluded to side-step the Advice Limitation Issue and reformulate the Decision Notice
- Rule 10(3)(d), on the basis that the FCA conceded the Advice Limitation Issue unreasonably late

In relation to the application under rule 10(3)(e), the Tribunal found that there was no collusion between the FCA and the RDC but that the RDC had "*failed to consider why, if the Authority did have knowledge that TMI did not advise on the underlying investments, that knowledge was not in itself sufficient for the Authority to be regarded as having knowledge of the "particular misconduct" that the Authority was relying on, namely the failure to take reasonable steps to ensure that the Personal Recommendations Process was compliant.*" This resulted in a "*significant gap in the RDC's reasoning*" and its reason for not addressing the Advice Limitation Issue was therefore unreasonable and Mr Burns was entitled to costs.

In relation to the application under rule 10(3)(d), the Tribunal held that the FCA acted unreasonably in the conduct of the proceedings by not addressing the Advice Limitation Issue in its Statement of Case. The FCA had many opportunities to fully examine the point at various stages of its investigation and the proceedings and, when they eventually did, they concluded that the point should be conceded. If they had taken one of the earlier opportunities, the point would have been conceded far earlier. Mr Burns was, therefore, entitled to costs.

However, despite these successes for Mr Burns, the amount of costs actually awarded (GBP 4,400) was a fraction of what Mr Burns had sought as the Tribunal found that Mr Burns wanted to contest other points that had been found against him in order not to receive any financial penalty and so it was not the case that he would definitely have settled at an earlier stage or that the FCA's late concession was the reason the hearings went ahead. The costs awarded therefore reflected the period between the Statement of Case in September 2016 and the FCA's concession in July 2017 and related only to the findings of unreasonableness regarding the Advice Limitation Issue.

Comment

These two cases will serve as a reminder to the FCA that care must be taken in meeting the appropriate evidential standards of each and every aspect of an enforcement case and the reasonableness of its approach may be open to consideration from a costs perspective should the matter be referred to the Tribunal. Indeed, the Tribunal in the Alistair Burns case concluded that it was appropriate for it to order a limited costs order in the circumstance as "*To do so will send out an important message to the Authority that, even in circumstances of what is found to be serious misconduct on the part of the applicant, which I accept is the position here, it is imperative that all subjects of investigation and enforcement proceedings should be treated fairly and reasonably. There have been a number of significant instances in this case where I have found that the Authority has fallen below the standards that should reasonably be expected of it.*"

Further, and as a consequence of the FCA having appealed the costs order made by the Tribunal in the Angela Burns case, the Tribunal now has a Court of Appeal authority for an adverse costs award against the FCA, even in situations where there is clear misconduct on the part of the regulated person in question and where the FCA has in fact won on its substantive points. We may, as a result, see the Tribunal becoming more willing to exercise its discretion under rule 10(3) to make costs orders against the FCA. This will, of course, depend on the specific circumstances of the case.

Complaints statistics

Author
Kirsten Shoraka

FCA

The FCA published its complaints figures for regulated firms for the first half of 2019 in October 2019. The statistics show that complaints increased by 9.7%, rising from 3.91m in the second half of 2018 to 4.29m in the first half of 2019.

PPI continued to lead the way, making up 49% of all complaints. However, excluding PPI, total complaints decreased from 2.32m to 2.18m during the period, which marks the lowest volume of complaints since new reporting rules came into effect in 2016.

Excluding PPI complaints, the most complained about products remain current accounts (14% of reported complaints), credit cards (8%) and motor and transport insurance (6%). However, all of these are down from the previous period.

FOS

The Financial Ombudsman Service's ("FOS") first quarter statistics for 2019/20 show 136,681 new enquiries and 70,304 complaints, out of which 12,538 complaints were passed to an ombudsman for a final decision; on average, 30% of the complaints were resolved. Again, PPI continued to be the most complained about product (31,005 new complaints), followed by a significant amount of complaints relating to consumer credit, especially high-cost lending.

In the areas of Banking and Credit, Mortgages and Home Finance, General Insurance, PPI, Investments, Life & Pensions and Decumulations, the top five business groups complained about were Lloyds, Barclays, RBS, HSBC and Santander, making up a total of 77,540 complaints.

Since 1 April 2019 the FOS has been able to consider complaints about claims management companies (CMCs). Between April and June 2019 the FOS received 262 enquiries and 117 new cases relating to PPI CMCs, 17 of which were referred to an ombudsman; 43% of the complaints were upheld.

Comment

These complaints figures reflect the current landscape of consumer finance and firms' performance in handling consumers' dissatisfaction in the UK. From a regulatory perspective, the overall decrease in complaints can only be interpreted as a positive development, showing that firms continue to focus on ensuring their customers are well served and that complaints are dealt with quickly and effectively.

The Revision to the Stewardship Code

In October 2019, the Financial Reporting Council (FRC) published the 2020 Stewardship Code, which takes effect for reporting years beginning on or after 1 January 2020. It is not obligatory to sign up to this Code but the FRC will publically list who has signed up to it and who has not.

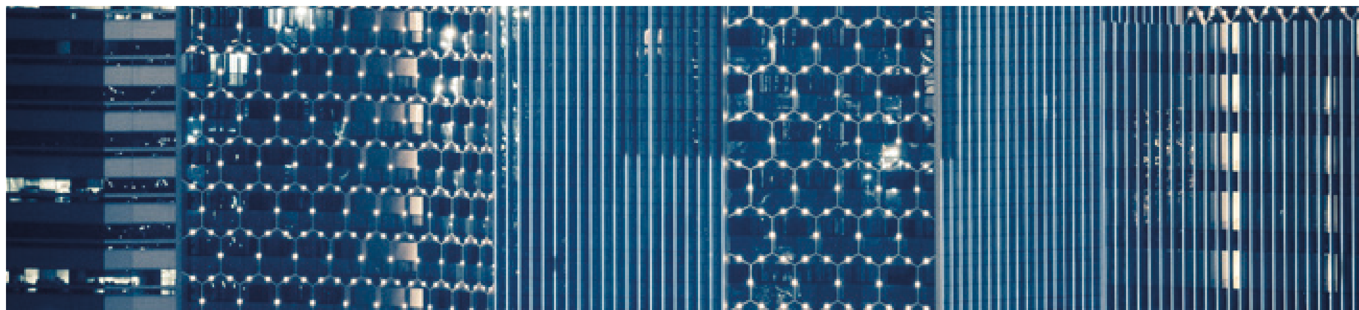
In the FRC's press release, it stated that "*the new Code substantially raises expectations for how money is invested on behalf of UK savers and pensioners*" and, despite the Kingman Review being critical of the effectiveness and usefulness of the 2012 Stewardship Code, the FRC claims that the new Code "*directly addresses the issues raised by Sir John Kingman's independent review of the FRC in respect of the previous Code.*"

The 2020 Code introduces a definition of "stewardship": "*responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society*". The Code consists of 12 "apply and explain" principles for asset managers and asset owners and 6 "apply and explain" principles for service providers. The previous Code applied only to asset managers.

The principles are to be reported on in an annual Stewardship Report (Report), which must contain details of all of the stewardship activities undertaken in the previous 12 months and of the outcomes of those activities in that time. The Report must also explain the investment strategy and culture of the signatory and show how this has been reflected in its governance.

Signatories are expected to take into account environmental, social and governance factors in their running of their businesses and to ensure that their investment decisions are in accordance with their clients' needs. Signatories should have regard to the UK Corporate Governance Code and other governance codes, to directors' duties, to capital structure, risk, strategy and performance, to diversity, remuneration and workforce interests, to audit quality and to compliance with covenants and contracts.

For asset managers in particular, the new Code comes against the backdrop of a growing consensus that they should be taking such matters into consideration or potentially face claims if, as a result of failing properly to consider such matters, losses have accrued to their clients. For example, asset managers could face claims if they had purchased stocks without fully considering the risks to their portfolios of a changing climate or if they had held onto assets for too long and, as a result, climate change risks had brought about sharp price corrections. Thus, building consideration of such matters into everyday decision-making and reporting on those decisions might limit such exposures.



Facebook's Libra: watershed moment for digital currencies?[1]

Authors
Lee Bacon and Karen Boto

Over the past few years the rise of "Fintech" (financial technology) has had a profound impact across the globe.

The exponential growth of the Fintech sector has largely been fuelled by the rapid rate at which new technology is evolving but also by the strong consumer appetite for innovation in all aspects of financial services.

Some of the most advanced examples of Fintech innovation can be found within the payments and money remittance space. The development and use of cryptocurrencies and blockchain is often the segment of Fintech that attracts the most headlines. This is particularly so after some of the largest tech giants have recently sought to enter the scene.

Here we address the potential for digital currencies, such as Facebook's newly proposed Libra coin, to facilitate cheaper and faster cross-border money transfers. We also address the challenges that Libra and other digital currencies are likely to face before they begin to make a more widespread impact.

The Libra coin

Facebook's plan to launch Libra, a new global digital currency built on an open-source blockchain, with a payment system embedded into its messaging services, poses the significant and immediate question of how deeply Libra and other digital currencies like it might transform the traditional financial services and payments industry.

If realised, Facebook's vision could mean the disintermediation of banks and other payment providers by Libra, through enabling instant, near-free international money transfers for Facebook's 2.4bn users from their mobile phones. Aside from cross-border payments, the widespread use of e-money like Libra could have broader implications for online commerce. The creation of Calibra, the payment service which Facebook aims to integrate into its messaging service, could be used for micropayments between customers, potentially bringing a new way for users to interact with digital content and make digital purchases.

When Facebook first announced its plans to launch Libra earlier this summer it was reportedly being backed by over 27 partners, including payments companies, e-commerce groups and venture capital companies, such as Visa, MasterCard, PayPal, eBay, Lyft and Spotify.

It was intended that these companies would together form the independent consortium, the Libra Association, which would govern the network and also provide the financial capital to kick-start the project.

It was proposed that Libra would be backed by a pool of currencies and assets around the world, with a view to providing a stable and safe store of value, effectively setting it apart from other cryptocurrencies like Bitcoin, Ripple or Ethereum, known for their price volatility.

Whether Facebook will achieve its audacious plans to launch its own digital currency remains to be seen. Over the past month the mission has gone awry. At least seven high profile partners have dramatically withdrawn from the project, including PayPal, eBay, Visa and MasterCard, citing regulatory uncertainty.

The departure of these high-profile financial firms and mainstream companies may cause damage to the project's credibility or, at the very least, delay the launch.

1 The substance of the article was first discussed in the Jusletter IT Journal and has been updated accordingly (https://jusletter-it.weblaw.ch/en/issues/2019/26-September-2019/facebook-s-libra--wa_1ce3575e35.html__ONCE&login=false).

The challenges

The main challenges for Facebook and any other companies entering into this space are seen as two-fold: regulation and adoption. Libra continues to cause a storm of inquiries and warnings from regulators in the U.S., as well as in the UK and Europe.

Aside from the regulatory and procedural issues faced by Facebook in setting up a network to move money around the world, including anti-money laundering checks, Libra may have wide-reaching implications for the structure of the financial services system.

Regulators and bankers alike are worried about the harmful potential of the Libra coin:

- Will Libra be used as a vehicle for money laundering?
- Is Libra a threat to global financial stability?
- Is Libra open to data privacy abuse?
- Will Libra strip nations of control of their monetary policy?

These concerns, amongst others, led to regulators in the G7 nations creating a working group to examine the risks of such currencies to the financial system.

Consequently, earlier this month, the G7 group warned that digital currencies, such as Libra, "pose challenges for competition and anti-trust policies" and should not be allowed to launch until all of the legal, regulatory and oversight challenges and risks are adequately addressed.

In the U.S., there have also been hearings by the Senate Banking Committee to understand how the currency works. Mark Zuckerberg appeared before the U.S. House of Representatives recently and faced some tough questions over many things, including data privacy.

What is eminently clear is that Facebook and the Libra Association will need to work closely with regulators across the globe if they wish to overcome the many regulatory concerns.

In addition, Libra faces the perpetual challenge that other cryptocurrencies face: namely, the adoption of blockchain and cryptocurrencies at scale to make a practical business case for their mainstream use. In particular, there is the difficulty of convincing merchants to agree to accept payment in the form of a digital coin whose value would fluctuate against the local currency of the assets used to back it.

That said, overcoming this hurdle could potentially signal a new era in which digital currencies become the predominant medium of exchange.

Cross-border payments and remittances

Decentralisation in financial services through technology-enabled innovation is not a new phenomenon, nor is the idea that distributed ledger technology is capable of transforming many facets of finance, such as retail and wholesale payments, trade finance, capital markets, lending and insurance.

The impact on financial services is likely to be particularly hard-felt in the payments industry, given the potential application of blockchain technology to the settlement of interbank payments and remittances.

This is particularly so given the inefficiencies, slow speed and high cost of the current banking system.

If counterparties were to exchange digital currencies rather than fiat currencies, that is, without having to go through a central regulating body like a bank, payments could be made and settled in a matter of minutes, if not seconds, via blockchain. Moreover, the distributed nature of blockchain would mean that a digital record of payments would exist that is both transparent and immutable.

Some initiatives that leverage distributed ledger technology, of course, already exist. Ripple, for instance, connects financial institutions and payment providers via their own global payments network and enable transactions using fiat currency or Ripple's own XRP cryptocurrency.

Similarly, central banks and other financial institutions that have previously lagged behind the curve are showing signs of increasing blockchain adoption and a readiness to engage with the new era of digital currencies. For example, thirteen of the world's biggest banks are preparing to launch digital versions of major global currencies in 2020.

Despite the upsurge of blockchain-based payments solutions, there remain significant barriers to adoption at scale. One issue is that the transparent nature of blockchain means there are limitations to anonymity in scenarios where sensitive or private data is involved. In response, several companies are exploring the "tokenization" of sensitive data to preserve anonymity.

Another challenge is the inevitable friction caused by the conversion of crypto assets and fiat currencies, particularly given the inherent volatility of cryptocurrencies.

This is, however, where Libra is perhaps different and could (if successfully launched) raise the credibility of cryptocurrencies. The proposal is to create a digital currency that is fully backed by a reserve of real-world assets which would effectively minimise volatility, although would not entirely eliminate it, given that the value of Libra would inevitably fluctuate as the value of the underlying assets moved.

The future of cryptocurrencies

Despite Facebook's recent set-back, Libra still draws support for its potential to revolutionise finance if it can satisfy the regulatory and other concerns being raised.

It has been widely acknowledged that Libra represents a significant step forward in the process of extending financial inclusion and reducing payments' friction, which have been the aim of many entrepreneurial minds for decades.

We must wait to see whether Libra becomes the global currency and de facto money transfer standard that it aspires to be and, importantly, what final form it takes when it is ultimately launched next year, if it is launched at all.

Notwithstanding this, Libra has already succeeded in focussing the minds of policymakers and regulators around the globe and boosting awareness and the adoption and development of cryptocurrencies and security tokens more broadly. This may still serve as a watershed moment for digital currencies.

Insurers should carefully watch this space to see whether Libra does become the digital currency that brings cryptocurrencies to the masses.

As we discussed in our previous article (**Cryptocurrencies - to insure or not to insure?**), insurance demands are only likely to increase as the crypto and blockchain markets continue to mature. It will be interesting to see whether insurers' appetites to write crypto-related risks expand as and when the industry and regulation become more stable.

The rise of consumer-driven collective proceedings

Author
Laura Tye

2015 saw the enactment of the Consumer Rights Act (the "Act"), a piece of legislation which, in 142 pages, replaced the Sale of Goods Act 1979, Unfair Terms in Consumer Contracts Regulations 1999 and the Supply of Goods and Services Act 1982, as well as amending other existing legislation, with the aim of simplifying and strengthening consumer rights. Of particular interest to financial lines insurers, however, is Schedule 8: Private Actions in Competition Law, which introduced changes to the Competition Act 1998 ("CA98").

While the introduction of the Act has not resulted in a deluge of claims against financial institutions, those that have been brought are potentially significant. We focus on two major cases: *Walter Hugh Merricks CBE v MasterCard Incorporated and Others* (1266/7/7/16) and *Michael O'Higgins FX Class Representative Limited v Barclays Bank PLC and Others* (1329/7/7/19).

Collective proceedings regime

The amendments brought in by the Act saw, amongst other things, the introduction of an "opt-out" collective redress procedure for competition law claims before the Competition Appeal Tribunal (the "CAT").

Once a class representative has filed the claim on behalf of the class "*raising the same, similar or related issues of fact or law*", the CAT will consider whether the claim is suitable to be dealt with on a collective basis, taking into account the cost, size and nature of the class. The CAT will have significant control over the scope and focus of the collective proceedings, including who should be included. It will also be for the CAT to decide whether the collective proceedings should be on an opt-in or an opt-out basis.

The availability of the opt-out regime is in contrast to the general position with other types of collective proceedings available in the Courts of England and Wales, such as group litigation orders, which operate on an opt-in basis.

Merricks v MasterCard

In September 2016, the former Financial Ombudsman, Walter Merricks, sought to bring a GBP 14bn class action on behalf of 46 million customers before the CAT. This was prompted by MasterCard having been found by the EU Commission to have acted in breach of competition law by setting multilateral interchange fees which were charged between banks for transactions involving the use of a 'MasterCard' branded card. Through the transactional structure in place, these fees, in varying degrees and over a number of years, were ultimately "passed on" to the consumer (i.e. the customers of merchants that accept MasterCard).

Mr Merricks therefore brought collective proceedings on an opt-out basis, seeking an aggregate award of damages for all individuals who, between 22 May 1992 and 21 June 2008, purchased goods or services from businesses that accepted MasterCard.

Merricks v MasterCard has had quite a tumultuous time before the CAT to date. First, Mr Merricks had to convince the CAT that his case was suitable for collective proceedings in order to obtain a Collective Proceedings Order ("CPO"). The CAT was not persuaded for two reasons: (1) a lack of data to determine the level of "pass-on" to consumers; and (2) an absence of plausible means of calculating the individual loss suffered by claimants. The CAT also refused Mr. Merricks permission to appeal their decision to refuse the CPO on the basis that the legislation provided no route to appeal. Mr. Merricks therefore took his fight to the Court of Appeal.

Mr. Merricks had an initial victory when the Court of Appeal agreed with him that it does have jurisdiction to hear an appeal in relation to a CPO determination (at least in respect of an aggregate damages claim), rather than requiring Judicial Review.

When the substantive appeal came before the Court of Appeal in February 2019, Mr. Merricks was again victorious. The Court of Appeal considered that the CAT had erred in law in its approach and had "*demanded too much of the proposed representative at the certification stage*". The Court of Appeal considered that the CAT had exposed the application for certification to too vigorous a process whereas, in the Court of Appeal's view, "*the proposed representative should not… be required to demonstrate more than that he has a real prospect of success*".

As such, the CAT's order refusing certification was set aside and the application was remitted to the CAT for re-hearing. MasterCard has, however, appealed the decision to the Supreme Court.

O'Higgins v Barclays et al

A couple of months after the Court of Appeal's ruling in *MasterCard*, the CAT was presented with a new application for an opt-out CPO, this time from Michael O'Higgins, former chairman of The Pensions Regulator.

Mr O'Higgins, with legal support from the UK outpost of the US plaintiff firm, Scott + Scott, and financial backing from Therium Capital, is pursuing a number of banks, alleging that they unlawfully manipulated the foreign exchange market between 2007 and 2013 in violation of competition laws.

In a similar vein to *MasterCard*, Mr O'Higgins' claim stems from a May 2019 European Commission ruling in which the banks were found guilty of anti-competitive behaviour for their roles in foreign exchange trading cartels and were handed fines in excess of EUR 1bn. Precise quantum has not yet been specified but the claim appears to seek hundreds of millions of pounds for those that have been affected by the cartels' manipulation, including pension funds, asset managers, hedge funds and corporates.

Scott + Scott also spearheaded a class action in the US against 15 banks for their role in foreign exchange manipulation. That action was settled last year, resulting in over USD 2.3bn in settlements.

It will be interesting to see how Mr O'Higgins' application for a CPO fares before the CAT following the Court of Appeal's recent guidance in *MasterCard* and its comments that the CAT had demanded too much at the certification stage.

What next?

As noted earlier, *Merricks v MasterCard* will be heading to the Supreme Court before the end of the year. It is hoped that the Supreme Court will bring some much-needed clarity to the legal test for the certification of claims as eligible for inclusion in collective proceedings and resolve the correct approach to questions regarding the distribution of an aggregate award when a party is applying for a CPO.

Collective redress in Germany

Author
Henning Schaloske

Traditionally, collective actions have not been part of the civil law litigation landscape. However, the landscape for collective redress in Europe has evolved over the last few years and collective action mechanisms have become more available throughout the region.

While the international financial crisis and the connected individual losses can be regarded as a starting point for the increased demand for collective actions in Europe, other factors have contributed to the establishment and the design of such collective redress mechanisms.

In Germany, the most prominent is the "Dieselgate" scandal. In September 2015, the United States Environmental Protection Agency found that Volkswagen had intentionally programmed diesel engines to activate emissions controls only during laboratory emissions testing. A (German) consumer lobby has been pressing for the availability of collective redress. In addition, plaintiff firms have geared up, and new firms (particularly from the U.S.) have entered the market together with litigation funders. As lawyers in Germany may, in general and subject to narrow exceptions, not operate under a contingent fee basis, litigation funding (or third-party funding) has become an increasingly popular way for plaintiffs and their law firms to obtain the money they need to pursue claims. Litigation funding has not been commonly used across Europe, but this is beginning to change as international litigation funders are entering the market and new funders are setting up shop throughout Europe. Another driving force for the establishment of collective redress mechanisms has been the introduction of the new European data protection regime on 25 May 2018, when the General Data Protection Regulation (GDPR) took effect across EU Member States. Following this, individual data subjects may bring claims against companies and their directors and officers in the event of a data protection breach. The European collective redress mechanism is specifically drafted to apply, inter alia, to claims under GDPR.

Against this backdrop, there has been a rising call for collective redress mechanisms in Germany and across Europe. However, a major concern in many jurisdictions has been to avoid a mass litigation business model for a plaintiffs' bar of the sort that can be found in the U.S. Legislators in Europe, and especially in Germany, bearing this concern in mind, have drafted the available collective redress mechanisms accordingly so as to preclude a perceived risk of misuse.

Collective redress in Germany

In Germany, for the most part, two collective actions are currently available, one mechanism allowing for collective shareholder actions and another for collective consumer claims.

Collective shareholder actions

In 2004, 17,000 individuals filed a suit against Deutsche Telekom, the former monopolistic provider of telecommunications services. The company's share price had fallen significantly. The Frankfurt Regional Court ("Landgericht") was overrun when plaintiffs claimed damages for what they considered to be a misleading description in a Telekom prospectus. The Capital Markets Model Case Act (KapMuG) was introduced by the legislature shortly thereafter in response. KapMuG gives investors a form of class action as it allows parties who choose to take part in the model proceedings to receive a preliminary ruling on legal or factual questions that are significant beyond their individual cases.

Each party must file a lawsuit in its own name to benefit from the outcome of the proceedings. If at least 10 plaintiffs apply for proceedings under the KapMuG, they will be referred to the competent Higher Regional Court ("Oberlandesgericht"), which will then appoint a model plaintiff and one or more model defendants. If the court in the model proceedings finds misconduct, other investors can invoke this finding in their own cases. Shareholders who have not yet filed a complaint with the District Court are able to participate in the model proceedings by simply registering the claims in a register within six months, as long as their original case is not time-barred.

In the current VW investor case related to the "Dieselgate" scandal, the Higher Regional Court (Braunschweig) has been asked to admit a class action under KapMuG to determine whether the company informed the capital market too late about the manipulated software. Hearings began in September 2018 with the German investment firm Deka Investment GmbH acting as the appointed model claimant.

Consumer class actions

In light of the disadvantageous position of German car owners affected by the manipulated diesel software as compared to those in other countries, the German "Bundestag" revisited a draft for collective class actions which had been dormant for several years and passed the "Law on Introduction of a Class Action for Civil Declaratory Judgment" ("Gesetz zur Einführung einer zivilprozessualen Musterfeststellungsklage"), which took effect on 1 November 2018.

It allows qualified bodies, such as consumer associations, to request a declaratory judgment to determine central claim-relevant conditions for the benefit of at least ten affected consumers. The law requires qualified institutions to have at least 350 members and to have been registered for at least four years (though not with the sole intention of serving as a qualified institution for model declaratory actions).

The class action for declaratory judgment is litigated exclusively between the association and the responding party. However, any consumer has the opportunity to register their claims with the Federal Office of Justice ("Bundesamt für Justiz") without the need for an attorney, and thus to suspend the limitation period. Any decision in the class action for declaratory judgment then creates a binding effect for the registered consumers for any subsequent actions brought by them.

Should the association and the defendant decide to settle, such settlement has to be approved by the court before it becomes binding. Since the model decision is limited to the basis of the claim, consumers have to initiate separate individual proceedings regarding their individual claim (dealing with the amount of damages, for example).

In the notes on the draft legislation, the Federal Government assumed that roughly 450 class actions for declaratory judgment would be submitted annually and it forecasted a success rate of about 50 percent. To date, only five model proceedings have been commenced.

The first proceedings which were initiated were against Mercedes Benz Bank AG, based on alleged unclear wording of revocation clauses in consumers' car loan contracts. The Higher Regional Court Stuttgart ("Oberlandesgericht") dismissed the claim as inadmissible. The litigation of consumer interests may only play a subordinate role in the daily practice of the institution to be regarded as a qualified institution and this requirement was not fulfilled by the association representing the class, according to the deciding court.

The second model declaratory action filed is the one against Volkswagen AG, connected to the "Dieselgate" allegations. More than 400,000 German car owners have signed up to this landmark model declaratory action so far. Hearings in the Higher Regional Court Braunschweig started at the end of September 2019. The court found the model declaratory proceeding to be admissible but suggested that the plaintiffs may be limited to claims made under tort law and could have difficulties proving actual losses.

Further model declaratory proceedings have been initiated against a rating agency for misleading ratings, a residential apartment complex owner for raised rent and a local German bank for incorrect interest adaptation in consumers' savings accounts.

Despite the relatively slow start, a significant increase in the number of proceedings is expected in the future and consumer protection associations have been announcing that they intend to pursue lawsuits in various fields.

The EU's approach to collective redress

On an EU-level, the European Commission has drafted a directive on collective redress under its "New Deal for Consumers". The Commission's press release when presenting the draft stated that "Recent cross-border consumer cases, such as the 'Dieselgate' scandal which affected consumers all over the EU, have confirmed that European consumer law should be strengthened." In addition to consumer protection, a number of other areas of law are also supposed to be subject to this new mechanism, including data protection, financial services, travel and tourism, energy, telecommunications, environment and health. The EU Parliament adopted the Commission's proposal in March 2019. The proposal plans to establish collective rights for consumers. It only allows "qualified entities" (designated by the Member States or even created ad hoc for a specific action) to bring representative actions. These associations must be properly established, not act for profit and have a legitimate interest in ensuring compliance with EU law in order to be regarded as a "qualified entity". The entities will be required to disclose their financial capacity and the source of their funding to the courts. In particular, law firms are not eligible to be qualified entities so as to prevent a plaintiff industry developing.

The proposal provides a variety of measures for which qualified entities may apply. In addition to declaratory decisions, the available measures also entail injunctions and redress orders, especially calling for reimbursement, monetary compensation, price reduction, repair, replacement, contract termination and prohibitions on a trader's practice.

The draft EU proposal goes beyond the German model as the associations may, subject to certain requirements, claim for damages directly (though punitive damages are not available). In contrast, in Germany, the Model Declaratory Proceedings are limited to the ascertainment of facts in order to create a binding effect for subsequent individual proceedings in which the amount of damages to be payable to the respective consumer is determined.

The European proposal leaves it to the Member States to establish opt-in or opt-out mechanisms for redress orders. Regarding injunction orders, the proposal foresees an opt-out mechanism. The proposal also aims for an EU-wide reach for collective actions initiated in any one Member State:

- Within the same Member State, the final decision of the deciding court will create a binding effect and be considered as irrefutable evidence that an infringement occurred;
- For actions relating to the same matter but brought in other Member States, these findings would create a rebuttable presumption that an infringement had occurred

EU Whistle-blower Directive

Author
Kirsten Shoraka

The harm caused by tax avoidance, money laundering, corruption or the misuse of data is substantial, yet 85% of respondents to the European Commission's 2017 public consultation expressed the view that workers very rarely report concerns about wrongdoing due to the legal and financial consequences they might face. To address this, the European Union is introducing far-reaching rules for potential whistle-blowers who might be discouraged from reporting their concerns or suspicions for fear of retaliation. It was passed in April 2019 and is expected to be adopted shortly.

Currently, the protection afforded to whistle-blowers differs greatly among Member States, with only ten EU Members having laws that provide for such protection. With the new Directive , the EU aims to set new European-wide standards. The new law will establish safe channels for reporting both within an organisation and to public authorities. It will also protect whistle-blowers against dismissal, demotion and other forms of retaliation. In addition, national authorities are required to inform citizens and provide training for public authorities on how to deal with whistle-blowers under the new legislation.

Areas covered by the Directive are:

- Public procurement
- Financial services, the prevention of money laundering and terrorist financing
- Product safety
- Transport safety
- Protection of the environment
- Nuclear safety
- Food and feed safety, and animal health and welfare
- Public health
- Consumer protection
- Protection of privacy and personal data, and security of network and information systems
- Breaches or avoidance of corporate tax

In the UK, the Public Interest Disclosure Act 1998 ("PIDA") already provides protection for whistle-blowers from dismissal or detriment as a result of reporting a "protected disclosure", though it does not require workplaces to encourage whistleblowing. In addition, in the financial services arena, the FCA introduced, in 2017, new self-reporting and whistleblowing rules which encourage employees to speak up and challenge poor practice or unlawful behaviour within their business. UK branches of PRA-regulated banks are expected to have in place a strong framework to facilitate whistleblowing by employees, primarily ensuring that all concerns reported are property investigated with no personal repercussions.

In an interesting case handed down in October 2019, *Gilham v Ministry of Justice* [2019] UKSC 44, the Supreme Court expanded the whistle-blower protection to the judiciary, following a claim made by a district judge against the Ministry of Justice for detriment following her expressing her concerns over public sector cuts in the justice system. The Supreme Court held that the PIDA protection applied to her and to other non-contractual office holders; if she was not granted the protection that employees enjoyed then this treatment would be incompatible with the European Convention of Human Rights Articles 10 and 14. The judgment arguably allows other non-contractual workers, such as company directors, to benefit from the PIDA protection.

Much of the content of the Directive is already contained in the existing UK whistleblowing frameworks but there are some areas where the Directive goes further, such as the requirement for companies that have 50 or more employees to set up internal and external reporting structures or for Member States to provide free access to independent advice. We shall have to see whether the UK government will adopt the full Directive into domestic law following Brexit.

If so, FIs and D&Os might face an increase in regulatory investigations and civil actions relating to alleged wrongdoing, leading to further notifications to insurers. Such scrutiny may lead to further action by regulators into a firm's systems, controls and corporate governance.

Will *Toshiba* "open the floodgates" to U.S. securities litigation against foreign companies?

Authors
Edward Kirk and Anne Knipper

Shareholders are filing record numbers of securities class actions against non-U.S. issuers, despite the U.S. Supreme Court's 2010 ruling in *Morrison v. National Australia Bank*[1] limiting the extraterritorial reach of the Securities and Exchange Act of 1934 (the "Exchange Act"). Many of those actions involve American Depository Receipts ("ADRs") and courts have found that under *Morrison*, U.S. securities laws may apply to ADRs traded on a domestic exchange or sponsored by the company.

A recent ruling by the Court of Appeals for the Ninth Circuit (the "Ninth Circuit") in *Stoyas v. Toshiba Corp., et al.*[2] has created some uncertainty regarding the applicability of U.S. securities laws to unsponsored ADRs.

The Application of Morrison to ADRs

In *Morrison*, the U.S. Supreme Court held that Section 10(b) of the Exchange Act applies only to (1) "transactions in securities listed on a U.S. exchange" ("Prong 1"), or (2) "domestic transactions in other securities" ("Prong 2"). *Morrison* stated that this test should focus on domestic purchases and sales.

Following *Morrison*, investors in ADRs continued to file an increasing number of securities class actions against non-U.S. issuers. In each of the past two years, the number of securities class actions against foreign companies was double the 1997-2017 annual average of 24.[3]

There are two basic types of ADRs: (i) sponsored ADRs issued on behalf of a foreign company; and (ii) unsponsored ADRs issued by depositary banks without the involvement, participation or consent of the foreign company whose stock underlies the ADR.

Courts applying *Morrison* to securities class actions involving ADRs have consistently found that under Prong 1, the U.S. securities laws apply to ADRs listed on a U.S. registered exchange. Prong 1 does not apply to ADRs listed on over-the-counter ("OTC") markets as they are not listed on a registered securities exchange.

Prong 2 may apply to ADRs where a foreign issuer sponsored or otherwise took affirmative steps to make its ADRs available to U.S. investors.[4]

The Second Circuit's Application of Morrison's "Domestic Transaction" Test

The Court of Appeals for the Second Circuit (the "Second Circuit") was the first federal appellate court to analyze what constitutes a "domestic transaction in other securities" under Prong 2 of *Morrison*.

In *Absolute Activist Master Fund Ltd v. Ficeto*[5], the Second Circuit found that Prong 2 of *Morrison* applies where (1) the parties "incurred irrevocable liability" to purchase or sell a security in the U.S., or (2) title was transferred in the U.S. *Absolute Activist* held that Cayman Island hedge funds that purchased penny stocks in U.S. companies not traded on a U.S. exchange failed to sufficiently allege that they incurred irrevocable liability in the U.S. to "take and pay for a security" or "deliver a security", or "that title to the shares were transferred within the [U.S.]"

1 561 U.S. 247, 130 S. Ct. 2869 (2010).
2 896 F.3d 933 (9th Cir. 2018).
3 Securities Class Action Filings - 2018 Year in Review, Cornerstone Research.
4 See e.g., in re Volkswagen "Clean Diesel" Marketing, Sales Practices, and Product Liability Litigation, 2017 WL 66281 (N.D. Cal. Jan. 4, 2017); Vancouver Alumni Asset Holdings Inc., et al. v. Daimler AG, et al., 2017 WL 2378369 (C.D. Cal. May 31, 2017).
5 677 F. 3d 60 (2d Cir. 2012).

Two years after *Absolute Activist*, the Second Circuit revisited Prong 2 of *Morrison* in *Parkcentral Global Hub Ltd. v. Porsche Auto Holdings*[6]. *Parkcentral* applied *Morrison* in the context of swap agreements linked to shares of a foreign company traded on a foreign exchange. Although the swaps were purchased in the U.S., this alone was not sufficient under *Morrison*. The court reasoned that while a domestic transaction is necessary, it alone is not sufficient as *Morrison* did not hold that the securities laws apply to *any* domestic transaction. Further, applying U.S. securities laws whenever a transaction is predicated on a domestic transaction "*regardless of the foreignness of the facts constituting the defendants' alleged violation, would seriously undermine Morrison's insistence that Section 10(b) has no extraterritorial application.*" The swaps were essentially transactions conducted on foreign exchanges and not domestic transactions, and therefore they did not merit the protection of U.S. securities laws.[7]

The Ninth Circuit's Application of Morrison to Unsponsored ADRs in Toshiba

Whether U.S. securities laws apply to a foreign company's *unsponsored* ADRs was examined by a U.S. District Court in California in *Stoyas v. Toshiba Corp*[8]. The District Court dismissed the complaint against Toshiba with prejudice, finding that Prongs 1 and 2 of *Morrison* did not apply because the ADRs traded on an OTC market and there were no allegations that Toshiba committed any affirmative act related to the purchase or sale of the securities in the U.S.

On July 17, 2018, the Ninth Circuit reversed the District Court and allowed the plaintiff an opportunity to re-plead sufficient facts to establish that they purchased the unsponsored ADRs in a domestic transaction. The Ninth Circuit adopted the Second Circuit's irrevocable liability test established in *Absolute Activist*, but rejected its carve-out of "predominantly foreign" securities fraud claims from Section 10(b) under *Parkcentral*. While the plaintiffs alleged that the ADRs were purchased by investors and sold by depositary institutions in the U.S., the complaint did not specifically allege where the parties incurred irrevocable liability. Therefore, the Ninth Circuit held that the plaintiffs did not sufficiently allege a domestic violation of the Exchange Act, but allowed the plaintiffs to re-plead, noting that there were a number of factual connections to the U.S. and *"an amended complaint could almost certainly allege sufficient facts to establish that [the investor] purchased its Toshiba ADRs in a domestic transaction."*

The Ninth Circuit rejected the defendants' argument that because the plaintiffs did not allege any connection between Toshiba and the ADR transactions, *Morrison* precluded the Exchange Act claims. The court reasoned that *"this would turn Morrison and Section 10(b) on their heads: because we are to examine the location of the transaction, it does not matter that a foreign entity was not engaged in the transaction."* Instead, *"[f]or the Exchange Act to apply, there must be a domestic transaction: that Toshiba may ultimately be found not liable for causing the loss in value to the ADRs does not mean that the Act is inapplicable to the transaction."*

In rejecting *Parkcentral*, the Ninth Circuit found that carving out "predominantly foreign" securities claims disregarded Section 10(b)'s application to *"the purchase or sale of any security registered on a national securities exchange or any security not so registered."* Moreover, *Morrison* held that the foreign location of the alleged deceptive conduct was irrelevant regarding the applicability of the Exchange Act, *"given Section 10(b)'s exclusive focus on transactions."* Accordingly, the Ninth Circuit focused solely on the location of the securities transaction, rather than where the alleged deceptive conduct took place, to determine whether the Exchange Act applied under Prong 2 of *Morrison*.

Importantly, the Ninth Circuit explained that *Morrison* merely determines transactions *"to which the Exchange Act can theoretically apply"*, and while applicability is necessary, it is not sufficient to state an Exchange Act claim. Specifically, Section 10(b) makes it unlawful "to use or employ, in connection with, the purchase or sale" of a security "any manipulative or deceptive device or contrivance." A plaintiff must show "a connection between the misrepresentation or omission and the purchase or sale of a security" to establish a claim under Section 10(b). For the fraud to be in connection with the purchase or sale of any security, it must "touch" the sale, or be done to induce the purchase of the securities at issue.

Following the Ninth Circuit's ruling, Toshiba petitioned

6 763 F.3d 198 (2d Cir. 2014); see also City of Pontiac Policemen's and Firemen's Retirement System, et al. v. UBS AG, et al., 752 F.3d 173 (2d Cir. 2014) (rejecting plaintiffs' dual listing theory and finding placement of buy orders in U.S. insufficient under Prong 2 of Morrison).

7 The Second Circuit recently reaffirmed Parkcentral in Prime Int'l Trading, Ltd. v. BP P.L.C., 937 F.3d 94, 106 (2d Cir. Aug. 29, 2019).

8 191 F. Supp.3d 1080 (C.D. Cal. 2016).

the U.S. Supreme Court regarding whether a domestic transaction is sufficient for the Exchange Act to apply, even when a case is foreign in other respects. Toshiba argued that there is a split of authority regarding *Morrison* in view of the Ninth Circuit's rejection of the Second Circuit's holding in *Parkcentral*, and the *Toshiba* decision opens up the Ninth Circuit as a new forum against any issuer in the world. On June 24, 2019, the U.S. Supreme Court denied without explanation Toshiba's petition. The plaintiffs later filed a Second Amended Complaint. On September 19, 2019, Toshiba filed another motion to dismiss, arguing that plaintiffs again failed to allege that the company induced them to purchase the ADRs or had an involvement in the unsponsored ADRs. This motion has not yet been heard, but will be closely watched.

Comment

Some commentators have raised concerns that the Ninth Circuit's ruling in *Toshiba* will "open the floodgates" to securities class actions against foreign companies with unsponsored ADRs in the U.S. However, even if plaintiffs can sufficiently allege facts allowing the application of the Exchange Act under Prong 2 of *Morrison* to unsponsored ADRs, they also must plead and prove a connection between the misrepresentations or omissions and the purchase or sale of the ADRs to establish liability under Section 10(b). This will be a high hurdle for plaintiffs to overcome where a foreign issuer took no affirmative act related to the purchase or sale of the ADRs in the U.S., and so ultimately, *Toshiba* may not substantially increase the exposure of foreign companies whose securities back unsponsored ADRs.

The securities hype: first of its kind, but not the last

Authors
Janette McLennan and Claire Schekeloff

Australia has had a class action regime since 1992. Despite all of the claims activity in the time since with around 120 actions commenced, no securities class action has proceeded to judgment in Australia. That changed recently, with judgment being delivered in the Myer shareholder class action.[1]

Whilst the Court found that Myer had breached its continuous disclosure obligations by failing to disclose to the market that it was not likely to reach its forecasted net profit, and had engaged in misleading or deceptive conduct, it was not accepted that the Applicant and Group Members had suffered any loss. This is because the market price of Myer's shares at the time these contraventions occurred already factored in an impact well south of what had been forecast.

This decision is undeniably relevant to ASX-listed companies and their directors and officers, shareholders, litigation funders and insurers. However the decision illustrates that these cases are so fact specific in determining:

- firstly, threshold liability questions, being whether there is any information that was material to investors that was not disclosed to the market, and if there was whether any exceptions to disclosure under the listing rules apply; and
- secondly, that expert evidence on loss and quantum will continue to be a central battleground on which these cases are fought beyond the threshold liability questions.

Background facts

The facts of this case are typical of most shareholder claims involving forecasting. Central to the case was a forecast made by the then CEO as to the retailer's expected net profit after tax (NPAT) in FY2015. The representation allegedly disclosed to the market that Myer expected to achieve NPAT in FY15 in excess of AUD98.5m. When Myer issued a subsequent release to the ASX, the NPAT it disclosed was significantly less when compared to the forecast made nearly six months beforehand.

The shareholders alleged that Myer:

- contravened its continuous disclosure obligations under the Corporations Act 2001 (Cth) (the Act);
- contravened the ASX Listing Rules (Listing Rules) in failing to advise the ASX of information which was likely to have a material impact on the value of Myer's shares; and
- engaged in misleading or deceptive conduct.

Myer shareholders claimed that they lost money as a result of those contraventions. Myer denied all allegations made against it.

Decision on contravention

The class succeeded on the part of its case concerning continuous disclosure. His Honour Justice Beach found that there should have been disclosure as to the likely FY15 NPAT under Listing Rule 3.1 and section 674 of the Act on a number of occasions. Further, by not having so corrected at each of these points in time, Myer engaged in misleading or deceptive conduct in contravention of section 1041H of the Act. This is a timely reminder that when a company makes a forecast it has an ongoing obligation to monitor that forecast and change it if, at any time, it is no longer valid.

Myer deployed a defence under Listing Rule 3.1A which provides for a number of exceptions to disclosure. However, that defence was not available to the retailer because a "reasonable person" would have expected the information to be disclosed by Myer to correct or prevent a false market in its securities.

1 *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* [2019] FCA 1747

Causation and quantum

As to whether the shareholders established that such conduct caused loss and damage, and if so, how much, Justice Beach found that the shareholders did not suffer any loss by reason of the contraventions. This was because the market had already factored in an NPAT well below the forecast by the time the contraventions occurred. In addition to expert evidence, contemporaneous evidence sourced from market analyst reports was important, as analysts had already factored in and come to an expectation that Myer was not going to perform as well as it did in FY2014. For that reason, even if a corrective statement had been made it was likely to have had no or no material effect on the market.

Despite the no loss finding, Justice Beach dealt with two important issues in his judgment. These were:

- Firstly, whether causation needs to be demonstrated on a direct (individual reliance) or indirect (market) causation basis i.e. whether a shareholder needs to have been aware of a misrepresentation and relied upon it to recover any loss. Justice Beach accepted indirect or market-based causation theory. This is consistent with some other first instance decisions of Australian courts outside of the class action space which suggested that market based causation is available.[2]
- Secondly, what the appropriate loss methodology is in these types of claims with his Honour commenting on the use of event studies. These measure the effect of a specific "event" (such as a market announcement) on the price of a company's shares which are valuable tools in assessing materiality and share price inflation.

What next?

It remains to be seen if an appeal will be filed. Whilst the Myer securities class action was the first to proceed to judgment in Australia, our prediction is that it will not be the last. Notwithstanding that this is a first instance decision, some jurisprudence in such an active part of the commercial litigation market is welcome given shareholder claims have dominated class actions in the past decade. But until there is a body of case law, including authoritative statements from appeal courts and the High Court, we expect uncertainty to continue on central questions in these claims relating to such matters as causation and loss.

2 For example, see Edelman J in Caason Investments Pty Ltd v Cao (2015) 236 FCR 322 at [145] to [182] and Brereton J in Re HIH Insurance Limited (in liq) (2016) 335 ALR 320.

Supreme Court confirms financial institution is in breach of its *Quincecare* duty

Author
James Cooper

On 30 October 2019, the Supreme Court handed down its judgment in *Singularis v Daiwa* [2019] UKSC 50, unanimously dismissing Daiwa's appeal. It upheld the High Court judgment that Daiwa (the "Bank") owed a duty (the "*Quincecare* duty") to Singularis (the "Company") not to execute an order if it had been put on inquiry that it was an attempt to misappropriate funds of the customer, and that the Bank had breached this duty.

Despite being a short judgment, the Supreme Court provides useful analysis of the law of attribution and "lays to rest" the controversial judgment in *Stone & Rolls Ltd v Moore Stephens* [2009] UKHL 39.

Facts and issues

The Company was wholly owned by Mr Al Sanea, a high net-worth individual, to manage his personal assets. Mr Al Sanea was a director of the Company, along with six other individuals, who were largely inactive. Separately, Mr Al Sanea also owned a substantial business group, the Saad group.

In April 2007, the Bank entered into a stock-lending agreement with the Company, pursuant to which the Company made equity investments. The Bank held the Company's funds in its client account.

During the first half of 2009, the Company sold a number of significant shareholdings and the proceeds were placed into the client account. Throughout June and July 2009, the Bank received several requests from Mr Al Sanea to pay monies totalling USD 204m from the Company's client account to Saad group companies. Largely, these instructions were authorised without further enquiry by the Bank, despite the Bank being aware of the financial difficulties of Mr Al Sanea and the Saad Group and of other suspicious factors.

On 24 July 2009, the Cayman Courts issued a worldwide freezing order over the assets of the Saad group. The Company ultimately went into liquidation and the liquidators brought a claim against the Bank for repayment of the USD 204m, claiming dishonest assistance and breach of the *Quincecare* duty.

At first instance, the dishonest assistance claim was dismissed, since the Bank's employees had not acted dishonestly. However, the breach of the *Quincecare* duty claim was upheld, subject to a 25% reduction for contributory negligence by Mr Al Sanea and the inactive directors.

The Bank appealed against this finding but the Court of Appeal dismissed its appeal. The Bank further appealed to the Supreme Court and the issues to be decided were as follows: whether the fraud of Mr Al Sanea could be attributed to the Company, and, if so, whether the claim was thereby defeated due to: (i) illegality; (ii) lack of causation; or (iii) a countervailing claim in deceit against the Company.

Supreme Court judgment

Lady Hale, giving the only substantive judgment, stated that it was "*incontrovertible*" that the Bank had breached the *Quincecare* duty of care that it had owed to the Company, approving the judge's findings of fact in this regard.

The issue for the Supreme Court, therefore, was whether any of the Bank's defences, noted above, could defeat the claim. Whilst attribution was key to the defences succeeding, the Supreme Court agreed with the judge that all of the Bank's defences would fail, whether or not Mr Al Sanea's fraud was attributed to the Company.

Taking each in turn:

Illegality

The legal doctrine, *ex turpi causa non oritur action* (the illegality defence), prevents a claimant from pursuing a claim if it arises from or is founded upon the illegality of the claimant. In this case, in order for the defence to have succeeded, the fraudulent activities of Mr Al Sanea would have needed to have been attributed to the Company. However, irrespective of any finding of attribution, the defence would fail for the following reasons (approving the judge's findings):

- Directors are subject to fiduciary duties to their companies in order to protect their companies from any wrongful activity by them. These duties would not be enhanced by preventing the company's recovery of money which had been wrongfully removed from its account. Further, "*although the purpose of protecting the bank would be enhanced by denial of the claim, that purpose was achieved by ensuring that the bank was only liable to repay the money if the Quincecare duty was breached*". Thus, that purpose would be undermined if the bank were able to deny the claim due to illegality in a case where the circumstances are such that the duty arises due to the illegal actions
- Financial institutions play a part in combatting financial crime and it would not be in the public interest to allow a bank to escape liability for failing to detect a crime by pushing blame on to the employees of its customer
- It would be unfair and disproportionate to allow the defence to succeed: the appropriate response would be to discount the liability on the basis of contributory negligence

Causation

The Bank asserted that the Company inflicted the harm on itself and, thus, any breach of the Bank's duty did not cause the loss. The Supreme Court rejected this: "*the purpose of the Quincecare duty is to protect a bank's customers from the harm caused by people for whom the customer is, one way or another responsible…the fraudulent instruction to Daiwa gave rise to the duty of care which the bank breaches, thus causing the loss.*"

The Bank's claim in deceit against the Company

The Bank further sought to argue that it had paid out the monies because of the Company's own deceit and, therefore, that it had a claim against the Company for any loss suffered from its exposure to the Company's claim, thus cancelling out the Company's claim for breach of the *Quincecare* duty. This was also rejected, as the Supreme Court agreed with the judge's finding that the exposure arose from the Bank's breach of the duty, not from Mr Al Sanea's misrepresentations.

Attribution

The Supreme Court held that Mr Al Sanea's fraud could not be attributed to the Company and helpfully considered the line of authorities on the point.

The starting point is that companies have a separate legal identity (*Saloman v Saloman and Co Ltd* [1897] AC 22) though they necessarily operate through individuals. The law presumes that the acts and state of mind of a company's directors and agents can be attributed to the company if those individuals act in accordance with the Articles of Association by the application of the law of agency. In *Bilta (UK) Ltd v Nazir (No 2)* [2015] UKSC 23 the Supreme Court held that, where a company has been the victim of wrongdoing by its directors or of which its directors had notice, then the wrongdoing, or knowledge, of the directors could not be attributed to the company.

The Bank, however, sought to rely on the decision of *Stone & Rolls Ltd v Moore Stephens* [2009] UKHL 39 to found attribution on the basis that the Company was, in effect, a "one-man company", as Mr Al Sanea was the sole shareholder and the Company's other directors were largely inactive.

In *Stone & Rolls*, the auditors, Moore Stephens, successfully relied on the illegality defence to bar a claim from their client company, Stone & Rolls Limited (Stone & Rolls). The controlling shareholder of Stone & Rolls, Mr. Stojevic, used it to deliberately carry out a scheme to defraud banks and then to pay away monies to himself or other of his companies. As a result, Stone & Rolls became insolvent and entered into liquidation. Stone & Rolls brought a claim against Moore Stephens for failing to detect that its transactions were fraudulent and for delay in stopping the continuing fraud. The House of Lords, by a 3:2 majority, held that Moore Stephens was entitled to rely on the illegality defence to strike out the claim by Stone & Rolls.

In summary, the House of Lords was of the view that Mr. Stojevic was the only shareholder, the sole director and the controlling mind of the company and, hence, Stone & Rolls was vested with the knowledge of the fraudulent scheme. Although Moore Stephens owed a duty of care to its client company and its shareholders, Stone & Rolls was precluded from suing its auditors in order to take advantage of and obtain benefit from its own fraud.

However, this decision has been subject to much debate, including by the Supreme Court in *Bilta*, in which Lord Neuberger copied Lord Denning's phrase from an earlier case that *Stone & Rolls* should be put *"on one side in a pile and marked "not to be looked at again""*.

However, there was some support within the judgment that the illegality defence was available where there were no innocent directors or shareholders, which the Supreme Court in *Singularis* said had been "*unfortunately*" treated as an established rule of law whatever the context and purpose of the attribution in question. In *Singularis*, the Supreme Court held that this was not the correct approach. Whilst agreeing with the High Court that the Company was not a "one-man company", like in *Stone & Rolls*, as it had other reputable directors on the board and there was nothing to suggest that they had been aware of or complicit in Mr Al Sanea's fraud, Lady Hale stated that,

"…the judge was correct also to say that "there is no principle of law that in any proceedings where the company is suing a third party for breach of a duty owed to it by that third party, the fraudulent conduct of a director is to be attributed to the company if it is a one-man company". In her view, what emerged from Bilta was that "the answer to any question whether to attribute the knowledge of the fraudulent director to the company is always to be found in consideration of the context and the purpose for which the attribution is relevant" (para 182). I agree and, if that is the guiding principle, then Stone & Rolls can finally be laid to rest".

Therefore, looking at the issue of attribution in the context of the Bank's breach of the *Quincecare* duty in this case, attributing the fraud of Mr Al Sanea to the Company would have the effect of stripping the duty of any value, as breach of the duty would cease to have a consequence. Therefore, the Supreme Court held that there was no attribution to the Company.

Comment

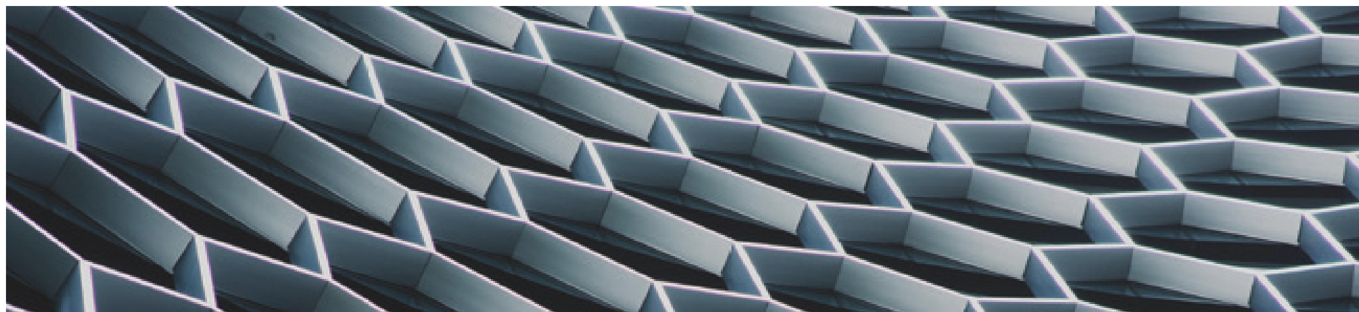
The *Quincecare* duty that financial institutions owe to their customers is there for good reason: to protect a bank's customer from itself where circumstances put the bank on inquiry that there may be fraud on the account. On causation, the losses, the Court held, arose from the Bank failing to protect the customer, not from the illegal actions of Mr Al Sanea.

Further, when considering the illegality defence, the Supreme Court expressly confirmed that the illegality of the director (whether attributed to the Company or not) would not provide the Bank with an illegality defence when the exceptional circumstances of the fraudulent instruction to the bank is the very thing which gives rise to the *Quincecare* duty. As the Supreme Court confirmed, there are also good public policy reasons for preventing financial institutions from escaping their liability in these circumstances, due to the part they are required to play in identifying and preventing financial crime.

The Supreme Court's decision provides welcome clarification as to how attribution should be considered: namely, by looking at the context and the purpose for which the attribution is relevant. It was highly relevant that the question was being asked in the context of the *Quincecare* duty: to attribute Mr Al Sanea's fraudulent conduct to the company would "*denude the duty of any value in cases where it is most needed*".

The Supreme Court's limiting of the decision in *Stone & Rolls* to its facts also closes down debate surrounding this case and confirms that it is not a rule that conduct can be attributed to companies which are one-man companies; it will depend on the facts of the case.

The *Quincecare* duty has now been given Supreme Court approval and the case demonstrates that it will be very difficult for a financial institution to defend itself against such a claim. The decision should serve as a warning to all financial institutions that, where a customer is known to be in serious financial difficulty or there are circumstances in which it could reasonably be said that the bank has been "put on inquiry", financial institutions will want to consider carefully any unusual payment instructions received from a director (even if they are accustomed to dealing with that individual) and to ensure that those on the front line of their operations are alert to the need for caution.



Case summaries

There have been a number of interesting decisions in the FIDO liability space since our last Review in March 2019. Below are brief summaries of these cases and an overview of what we can expect in the months to come.

Financial institutions

Mis-selling

Cases alleging the mis-selling of swaps continue to be brought by claimants. In *Marme Inversiones v Natwest Markets plc and others* [2019] EWHC 366, the Court rejected the claimant's claim for damages and for rescission of the swaps and held that the Defendants were entitled to declarations that they had acted lawfully.

The claimant entered into a loan with the defendant banks, with interest referencing EURIBOR. Hedging agreements were entered into and the claimants suffered huge losses. In its claim, the claimant alleged that the defendants had impliedly made untrue representations which were that they had not sought to manipulate EURIBOR, had no reason to believe that other banks were seeking to do so and had not conducted themselves in such a way as to undermine the integrity of EURIBOR. These misrepresentations were alleged to have arisen from the first defendant's conduct in proposing and using EURIBOR for the swaps; the rest of the defendants were said to have acted on an agency basis.

Representations required clear words or conduct; silence or mere assumption was not usually enough and the Courts would not often seek to imply a representation which was "vague, uncertain, imprecise or elastic". In fact, the broader and more complex the alleged representations, the more active and specific the conduct had to be to give rise to the implication.

In this case, the Court found, factually, that the claimant was not able to point to any clear words or conduct and, thus, the representations had not been made. Despite not having to decide the issue, the Court stated that had the representations been made, they would have been false but also that had they been made, the claimant had not relied on them; that the claimant had given no thought to EURIBOR or whether it was being manipulated at the time and that there was no evidence that the claimant would have acted differently if it had known.

However, applying *Property Alliance Group Ltd v Royal Bank of Scotland Plc* [2018] EWCA Civ 355, the Court held that there had been a limited representation that the defendant itself was not manipulating EURIBOR. The Court also endorsed (as the Court had done in *PAG*) the so-called "helpful test" in *Geest v Fyffes* [1999] 1 All ER (Comm) 672, namely that the existence of an implied representation can be tested by whether a reasonable representee would naturally assume that the true state of facts did not exist and that, if it did, he would necessarily have been informed of it.

If the representations had been made and relied upon, rescission would nonetheless have been unavailable as the claimant had previously affirmed the swaps. Damages also would have been unavailable as the claimant could provide no evidence that it could have agreed different terms with the banks if it had been aware of EURIBOR issues.

***Quincecare* duty**

In 1992 there was a case called *Barclays Bank Plc v Quincecare* [1992] 4 All ER 363 which established that a bank will be liable to its customer for damages in negligence if it makes a payment in circumstances where it had reasonable grounds for believing that the instruction to make the payment was an attempt to misappropriate the funds of its customer. This duty became known as the "*Quincecare* duty".

In our last Review, we reported on the case of *Federal Republic of Nigeria v JP Morgan Chase Bank* [2019] All ER (D) 156, in which the *Quincecare* duty was in issue. In a judgment handed down by the High Court in February 2019, the claimant survived an application for reverse summary judgment after the court concluded that the bank had failed to establish that the claimant's claim had no realistic prospect of success. Another question that arose was whether the *Quincecare* duty applied to depository accounts as well as current accounts and the court found that it did.

Briefly, the facts of the case are as follows: the claimant sought to recover USD 875m which had been paid out of a depositary account at the defendant bank by the defendant, pursuant to instructions from authorised persons on the account. The claimant asserted that the payments were made in breach of the *Quincecare* duty as the bank had been put on inquiry that fraud was taking place on the account and the bank itself had filed suspicious activity reports in relation to the account.

The bank appealed and the Court of Appeal held that the judge had not erred in refusing to grant reverse summary judgment against the claimant.

Looking at the grounds of appeal:

- The ambit and nature of the *Quincecare* duty – The judge had not erred when he had described the duty as a duty not to make a payment in accordance with a suspicious instruction: what the bank should do when put on inquiry was fact dependent and it was not useful to ascribe differing layers of importance to parts of the duty. When the issue came to trial, it would be for the judge to determine what the bank should have done in the circumstances
- The judge's approach to the interpretation of the terms of the depository agreement - The judge had not erred in his approach to the construction of the agreement
- The proper interpretation of particular terms in the agreement - there was nothing in the terms of the depository agreement between the parties which entitled the bank to summary judgment. The entire agreement clause did not prevent the *Quincecare* duty from arising. Further, the bank's *Quincecare* duty was not excluded by the terms of the depository agreement; exclusion clauses are to be construed narrowly and read in the context of the relevant section of the agreement taken as a whole and there was nothing to suggest that the exclusion was meant to exclude the *Quincecare* duty

The appeal was dismissed and the issue of whether breach of the *Quincecare* duty had caused the customer's loss was to go to trial.

Parent company liability

In *Vedanta Resources PLC and another v Lungowe* [2019] 3 All ER 1013, the Supreme Court found that although England was not the 'proper place' in which to bring the claim, the English courts should still take jurisdiction over the claim because substantial justice for the claimants was not obtainable in Zambia.

The case concerned 1,826 Zambian residents who commenced proceedings in England for alleged loss and personal injury arising from environmental damage caused by a copper mine ("KCM") in Zambia. Vedanta Resources, an English-domiciled company is the parent company of KCM. Relying on the ECJ decision of *Owusu v Jackson* [2005] 2 WLR 942, proceedings were commenced against the parent company and its Zambian subsidiary in England. Both Vedanta and KCM challenged jurisdiction.

The court held the following:

- Article 4.1 of the Recast Brussels Regulation confers a right on any claimant (regardless of their domicile) to sue an English-domiciled defendant in England irrespective of connecting factors to other jurisdictions. There was no abuse of EU law in relying on Article 4 to establish jurisdiction over Vedanta as anchor defendant for the purpose of attracting the English courts' jurisdiction over the claim against KCM, "the real target of the claim"; any implied exception to the effect of article 4.1 must be construed narrowly and EU case law also suggests that the abuse of law doctrine is limited to situations where EU law is invoked collusively to subvert other EU provisions
- There was a real, triable issue against Vedanta, namely whether the parent company had sufficiently intervened in the management of the mine owned by KCM such that it assumed a duty of care to the claimants and, thus, established statutory liability under applicable Zambian environmental, mining and health laws. As such, Vedanta's claims that the lower courts had failed to analyse the issue were rejected
- On the point of whether the English courts were the "proper place", the high likelihood of claims being continued against anchor defendants in England as conclusively indicating that England was the "proper place" was not the correct approach. Nor was the risk of

irreconcilable judgments a decisive factor in favour of England as the proper place for the claim. The judge had, therefore, made an error in circumstances where Vedanta had by the time of the hearing offered to submit to the Zambian jurisdiction in order that the whole case could be tried there. While an offer to submit does not preclude a claim in England against Vedanta alone, it has the effect that there would be a risk of irreconcilable judgments due to the claimants' choice to exercise their article 4 right, rather than due to Zambia's unavailability as a forum for all of the claims

- There was a risk of denial of substantial justice if the case against KCM remained to be tried in Zambia due to lack of funding and specialised legal teams. This concept of substantial justice formed the critical part of the proper place assessment

Whilst this judgment is purely about jurisdiction, commercially it is nonetheless significant and will no doubt increase forum shopping and the number of claims in the English courts against UK parent companies in relation to their overseas subsidiaries. This will particularly be the case in countries where local legal resources are considered insufficient to enable substantial justice.

Insurers might want to review jurisdiction clauses with an eye on the potential liability of parent companies for their subsidiaries abroad, considering that group litigation claims could potentially incur significant awards and costs.

Directors

Personal liability

In *Antuzis & Ors v DJ Houghton Ltd* [2019] EWHC 843 (QB) the Court held that the directors of the company were personally liable for breaches of statute and contract by the company in not paying minimum wage, holiday pay or overtime to agricultural workers. The general principle is that directors will not be liable for the torts of the company committed at their direction if they acted in good faith (*Said v Butt* [1920] 3 K.B. 497). The conduct that is relevant is the conduct in relation to the director's duties towards the company not the third party. Specifically, here, the duty in question was the section 172 Companies Act 2006 ("CA 2006") duty to promote the success of the company.

In this case the company was 100% owned by the two directors and they were not acting in good faith as they knowingly behaved in such a way as to damage the company's reputation by causing the company to breach its contractual obligations to the claimants. They, therefore, could be held personally liable.

Liability for unlawful dividends

In *Burnden Holdings (UK) Limited (in liquidation) v Fielding* [2019] EWHC 1566 the Court was tasked with determining whether the directors of an insolvent company had breached their duties in relation to a distribution of specie by the company and the grant of security in their favour in relation to a loan made to the company. The case was brought by liquidators and all of the claims failed.

The facts are complicated but the case serves as a useful reminder of directors' duties in relation to dividends. Directors are to be treated as if they were trustees in relation to the company's funds. If they knew the facts that constituted an unlawful dividend, they are liable as if for breach of trust, irrespective of whether they knew that the dividend was unlawful. Directors will not be held to be personally liable if they took all reasonable care to ensure that there were sufficient profits from which to make a dividend, even if it transpires later that this was not the case. In doing so, the court confirmed that directors may make use of and trust the advice of qualified advisers.

Fraudulent trading

In a claim for fraudulent trading against directors under section 213 Insolvency Act 1986, the court can declare that "any persons" who were knowingly parties to the carrying on of the business with the intent to defraud creditors, or for any fraudulent purpose, should make a contribution to the company's assets.

Fraudulent trading claims are only available if the company's business has been carried on dishonestly with the intent to defraud. Actual dishonesty involving real moral blame is needed (*Re Patrick and Lyon Ltd* [1933] Ch. 786). This is an objective test, and the court will recognise that persons may undertake risky transactions with the intention of saving companies. It is only where such risks are taken dishonestly that liability will arise (*R v Grantham* [1984] 3 All ER 166).

The high standard of proof required to demonstrate dishonesty means that these types of claims are rarely brought in practice. 2019, however, saw a successful claim brought for fraudulent trading in the case of *Pantiles Investments Ltd (in liquidation) and another v Winckler* [2019] EWHC 1298 (Ch).

Briefly:

- Ms Winckler set up a company to purchase a property from Mr Goldbart (on Mr Goldbart's advice), having unsuccessfully tried to get a mortgage. The purchase was funded by loans, including unsecured loans from companies connected to Mr Goldbart
- Thereafter, Ms Winckler rented the property back to Mr Goldbart and his wife for amounts that were less than the interest payments on the loans
- Mr Goldbart was later declared bankrupt and then Ms Winckler sold the property and distributed the profits to people connected with Mr Goldbart

Mr Goldbart's trustee in bankruptcy claimed that the property had been transferred to the company at an undervalue and that the subsequent sale and distribution of the proceeds of sale by the company were part of a scheme to defraud Mr Goldbart's creditors.

Having obtained a declaration that the shares in Ms Winckler's company were held on trust for Mr Goldbart (and, as such, for the trustee), the company was wound up in 2015 on the petition of HMRC and the claimant was appointed as liquidator.

The liquidator asserted that Ms Winckler had knowingly been a party to the carrying on of the company's business with the intent to defraud Mr Goldbart's creditors (s. 213). Furthermore, the liquidator asserted that, under s. 212, she had been in breach of her duties as a director and was guilty of misfeasance. The liquidator sought a contribution to the company's assets equal to the deficiency to the creditors from Ms Winckler.

The court agreed with the liquidator, finding that Ms Winckler did appreciate the nature and effect of the documents that she had signed on behalf of the company and that they lacked commercial reality. She had known the effect of her actions and had facilitated the scheme, thereby rendering the company insolvent, as it was unable to pay the tax that she knew would fall due. As such, she had acted dishonestly, but, even when viewed objectively, she would nonetheless be in breach of her duties to the company under sections 172 CA 2006 (to promote the success of the Company) and 173 CA 2006 (to exercise independent judgment). Contribution from Ms Winckler is to be assessed in a separate hearing.

Cases to watch

We are still anticipating the long-awaited judgment in *Russell Adams v Carey Pensions EWHC* (Ch), which alleges negligence and breach of the FCA's COBs rules against a SIPP administrator in relation to the suitability of storepod investments held within the SIPP wrapper. This case is expected to have significant wider implications for the industry. Another SIPP provider, Berkeley Burke, fell into administration and on 4 October 2019 its administrators confirmed that it will not be appealing the court ruling which ordered the company to pay GBP 1m to people affected by unregulated investments.

Another outstanding judgment is in relation to the Lloyds shareholder action regarding the acquisition of HBOS at the height of the financial crisis, which the shareholders say they were misled into approving.

In relation to collective actions, the Tesco shareholder group action is progressing through the UK courts (having recently survived a strike-out application) and shareholder group actions against Metro Bank and Petrofac are still being mooted.

Contributors

Lee Bacon
Partner, London
+44 20 7876 4410
lee.bacon@clydeco.com

Karen Boto
Legal Director
+44 20 7876 4211
karen.boto@clydeco.com

Laura Cooke
Partner, London
+44 20 7876 6387
laura.cooke@clydeco.com

James Cooper
Partner, London
+44 20 7876 6388
james.cooper@clydeco.com

Edward Kirk
Partner, New York
+1 212 710 3960
edward.kirk@clydeco.us

Janette McLennan
Partner, Syndey
+61 2 9210 4456
janette.mclennan@clydeco.com

Dr Henning Schaloske
Partner, Dusseldorf
+49 211 8822 8801
henning.schaloske@clydeco.com

Laura Tye
Legal Director
+44 (0) 20 7876 6287
laura.chicken@clydeco.com

440

Partners

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4,000

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