BANKING LITIGATION

General Editors

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SWEET & MAXWELL

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Foreword by Lord Millett

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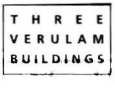

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FOREWORD

Those who bought the first edition of this book will have eagerly awaited the publication of the second; those in the financial services industry who did not should make haste to buy it. Written for professionals in the banking financial and investment management sectors, as well as for lawyers who advise them, its great and distinctive merit is that it is written from the practitioner's point of view. This, coupled with the fact that the authors have first-hand experience of the kind of claims which are made against investment managers and other providers of financial services, gives it great practical value.

The law and the financial market do not stand still. The courts have been busy in the six years which have passed since the first edition; so have the regulators. A new edition was urgently needed. But the authors have not been content merely to bring the work up to date. They have added three new chapters dealing with the giving of financial and investment advice and the different financial products that may be offered for sale; the potential liability for infringement of the regulatory regime which was introduced by the Financial Services and Management Act 2000; and the kind of claims which may be brought for the mismanagement of pension and other investment funds.

So long as financial services, investment advice, and the management of investment funds, are provided by professional practitioners, legal claims will be brought against them; and so long as the potentiality for such claims remains there will be a need for a work such as this, written for and from the perspective of those who provide such services.

Lord Millett

PREFACE

It is now some six years since the first edition of this work was launched on an unsuspecting public. What we said about the book in the Preface to the first edition was:

> "What the book does is look at the banking industry in the United Kingdom, identify the areas of significant development, and set down those developments, the issues which arise in consequence and, where appropriate, advise as to how bankers might respond. It is not a step by step practical guide to the conduct of a particular piece of litigation. Rather it identifies contemporary issues, seeks to contribute to the continuing debate on such issues and tenders guidance for the future."

It was this approach which we had hoped would enable the book to find a niche in the market, and anecdotal evidence since has suggested to us that the work has perhaps "filled a gap" in publications in relation to banking litigation, in that bankers and legal practitioners in many instances keep a copy of the book close to hand for immediate reference. This appeared to be confirmed when Sweet & Maxwell approached us with a request that we consider producing a second edition.

Of course, we were flattered by this; and fascinated to discover that not only had the book sold well in the United Kingdom, but that it had achieved a following in many other common law jurisdictions, particularly current members of the Commonwealth.

There were two other factors which persuaded us that we should proceed with a second edition: firstly that there had been sufficient developments in the relevant areas since production of the first edition to justify an "update"; and secondly the most obvious demonstration that this work had entered the consciousness of the profession—the citing of the work as an authority. In the Privy Council decision in *National Commercial Bank (Jamaica) Ltd v Hew* Lord Millett cited a section of the chapter on "Advice by Banks to Customers" in support of the proposition that banks do not generally owe a duty to advise on the wisdom of commercial projects for which they are lending money.

This we found both pleasing and disturbing. Pleasing for obvious reasons. Disturbing because of our previous understanding that no work was ever treated as an authority until the authors/editors had not only retired from practice but actually "shuffled off this mortal coil"! Both of us still felt, and feel, very much alive.

Although we speak of an "update" in fact that is not an accurate description of this edition. Not only have we brought the existing chapters, on their different topics, up to date (by reference to significant developments in those

areas since the publication of the first edition), but we have incorporated three new substantive chapters. These three additional topics are, respectively: Financial Services and Investment Advice; Potential Liabilities under the Financial Services and Markets Act 2000 (FSMA 2000); and Investment Management. All of these topics are areas where we feel that comments are required; particularly of course in relation to FSMA 2000, which has come into effect, and substantially changed the Regulatory Regime, since the publication of the first edition. We will return to these three new chapters later, by way of comment.

So what is it that has happened, in relation to the areas covered by the original topics, that has required substantial updating? We set out below a very brief summary of those points, although of course such a summary is no substitute for referring to the substantive text itself.

Chapter 1

In relation to the liability of banks as constructive trustees there have been significant developments in respect of both knowing receipt and dishonest assistance. In *BCCI (Overseas) Ltd v Akinele* the Court of Appeal rejected the categorisation of knowledge as expounded in Baden in favour of a single test: unconscionability. In relation to dishonest assistance following on from the House of Lords in Tan, the test as to dishonesty has been further developed and explained in *Twinsectra Ltd v Yardley*. A combined objective and subjective test has been adopted.

As regards the statutory regime controlling money laundering, matters have moved on with the introduction of Pt 7 of the Proceeds of Crime Act 2002, the Money Laundering Regulations 2003 and the Terrorism Act 2000. The courts have taken the opportunity, in those cases that have before them giving rise to money laundering issues, to provide useful guidance for banks, as illustrated by *C v S (Money Laundering: Discovery of Documents), Governor of the Bank of Scotland v A Ltd*, and *Squirrel Ltd v National Westminster Bank Plc*.

Chapter 2

In relation to a bank's duty to advise a customer, a passage at para.2–07 of the First Edition was cited with approval by the Privy Council in *National Commercial Bank (Jamaica) Ltd v Hew* (see the earlier reference).

2002 saw the introduction of the Business Banking Code applicable to business customers.

Statutory recognition has been given to the practice of using Chinese Walls, by banks and other institutions, by s.147 of the Financial Services Markets Act 2000.

The practice of banks giving references has been affected by: (a) the Court of Appeal's decision in *Turner v Royal Bank of Scotland*; and (b) The Business Banking Code. In the former case the court held that there was no implied term that the customer had impliedly consented to the giving of a banker's

reference. Added to this, a term of the Business Banking Code provides that a bank will not give a banker's reference without the permission of its customer.

In relation to the Data Protection Act 1998, the Court of Appeal, in *Durant v FSA,* has adopted a narrow interpretation on the meaning and effect of s.7, which has significantly limited the scope of what information can be obtained from an institution such as a bank.

Marevas are now a thing of the past, having been replaced with the user friendly language introduced by the CPR of freezing injunctions. More significantly the courts have increased the responsibilities for banks which have notice of a freezing order. In *Commissioner of Customs & Excise v Barclays Bank*, the Court of Appeal, overturning the decision of Colman J., held that banks owe a duty of care to the claimant who has obtained a freezing order to ensure that sums of monies are preserved. Permission to appeal has been granted by the House of Lords, so that we will have to wait and see whether this development stands.

Increasingly banks have adopted mediation or other means of dispute resolution as an alternative to litigation. This has been encouraged with the introduction of the CPR, and there has been a series of cases in which the courts have encouraged mediation, whether by an order or penalising a party in costs for refusing to contemplate ADR. The last section of Chapter 2 addresses this developing area.

Chapter 3

Whilst there has been a considerable decline in the number of claims brought by banks which give rise to the defence of undue influence, the law has not stood still. *Barclays Bank v O'Brien* was intended to settle this area of law once and for all, but this proved to be anything but the case. Chapter 3 examines how matters have developed post-O'Brien and then considers the House of Lords decision in *Bank of Scotland v Etridge (No.2)*, where outstanding issues were considered, particularly the involvement of solicitors.

The issue of insurance of credit risks, considered in Chapter 3, has been affected by the Contracts (Rights of Third Parties) Act 1999. However, it has not been property but the financing of the film industry that has given rise to recent litigation in relation to the insurance of credit risks, exemplified by the decision of the Court of Appeal in *HIH Casualty and General Insurance Ltd v New Hampshire Insurance Co.* The case illustrates the difficulty faced in interpreting exclusion clauses, and the importance of drafting them carefully.

Chapter 4

Since the last edition, the Contracts (Rights of Third Parties) Act 1999 has been passed which has altered the doctrine of privity of contract; this has had an impact on syndicated lending and indirect participation, which is considered in this chapter.

Chapter 5

Since the last edition, when the repercussions of the Maxwell affair were still reverberating in the courts, there has been little in the way of fresh litigation. The dematerialisation of shareholdings has however continued apace, with 85 per cent of UK shares now being held electronically. The opportunity has also been taken to expand the section explaining how investments are held.

Chapter 6

In relation to letters of credit, issues as to what constitute original documents have continued to be litigated in the courts. The decisions in *Glencore International AG* v *Bank of China and Kreditbank Antwerp v Midland Bank* sent ripples of unease through the banking community. Following a worldwide consultation process the ICC issued a policy statement on July 12, 1999, aimed at resolving ambiguities. Following its publication, the Commercial Court considered it appropriate to apply that ICC policy statement in *Credit Industriel v China Merchants Bank.*

The view expressed in the last edition, that a bank could rely upon the fraud exception in relation to a letter of credit, even though it did not know of the fraud at the time of rejection but only at the date of the trial, has since been subject to judicial scrutiny in *Balfour Beatty Civil Engineering v Technical & Guarantee Co Ltd, Solo industries Ltd v Canara Bank* and *Mahonia Ltd v JP Morgan Chase Bank.* The *Mahonia* case also raised the issue as to whether illegality can ever be a defence to a bank sued on a letter of credit.

Chapter 7

In relation to electronic banking, unsurprisingly for such an embryonic area, the principal areas of development have been regulatory and legislative. These developments include the Electronic Communications Act 2000 and the Electronic Signatures Regulations 2002, the Electronic Commerce (EC Directive) Regulations 2002 which deal with the conduct of business via the internet, and the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 which implemented a European-wide solution to the legal risks inherent in payment systems in the event of a participant's insolvency.

The decision in *Tayeb v HSBC* has determined an important point as to when a payment via CHAPS becomes final, bringing certainty to an area of commercial activity where certainty is vital.

Chapter 8

The introduction of the Civil Procedure Rules (the "CPR") since the last edition has introduced a number of changes in relation to the rules relating to disclosure. The most notable ones for banks are, first, the availability of pre-action disclosure in certain circumstances, and secondly non-party disclosure orders which overlap with, but extend beyond, the type of documents that can be obtained under the Bankers Book Evidence Act.

Additionally, the Freedom of Information Act 2000 may have implications for banks, where they have provided information to public bodies such as the Financial Services Authority or the DTI.

However, the most significant recent developments in relation to disclosure and banks have occurred in the context of legal professional privilege, in the series of decisions in *Three Rivers District Council v Governor and Company of the Bank of England.*

Chapter 9

This is the first of the completely new chapters. It addresses the topic of Financial Services and Investment Advice. The structure of the chapter is that it firstly identifies how the various providers of financial services, previously regulated under separate regulatory regimes (largely dependent on the industry from which they came), *e.g.* banks, stockbrokers, insurance brokers, insurers, are now regulated by one regulatory body—the Financial Services Authority ("FSA"). It also addresses how the new regime applies to different types of institution. Secondly, it identifies the types of investment products that might be sold and, against that background, then addresses the important issue of the remedies available for any breach by the supplier of products of the duties owed by him. In this context important recent cases such as *Larussa-Chigi v CSFB, Brandis Brokers v Black, Clarion v National Provident Institution* and *Valse Holdings v Merrill Lynch* are discussed and explained.

This is an area of increasing importance to banks and others, as many such claims are now brought. The "hands on" experience of the authors in the areas they address are apparent.

Chapter 10

This is the chapter on the regulatory regime under the Financial Services and Management Act 2000 ("FSMA"). It is obviously of vital importance to people operating in the banking world in London. Bankers, having previously been used to operating within the regime provided for by the Banking Act, now have to take on board a whole new regime.

The chapter does not attempt to deal in fine detail with the intricate provisions of FSMA. Rather, it addresses the structure and major regulatory obligations imposed by FSMA in the context of potential liability for infringement. What it constitutes is a straightforward guide to the Act in a user friendly and non-intimidatory manner.

The areas of liability addressed are criminal, civil, regulatory, and finally the potential for complaints to the Financial Ombudsman Service. Liabilities in the criminal and civil context are primarily addressed in the context of the two broad prohibitions contained in FSMA, namely the general prohibition in s.19 and the financial promotion prohibition in s.21; but in the civil context the authors also deal with the effect of s.27 on contracts entered into in breach of the general prohibition, the restitutionary powers provided for by ss.382–384

(which enable the FSA or the Secretary of State to bring proceedings); and also the general right of action given to individuals by s.150 of FSMA—which is similar to the powers contained in s.62 of the 1986 Act. The chapter also demonstrates the application of that predecessor section in the cases of *ANZ* v *Cattan* and *Morgan Stanley v Puglisi*.

The chapter then comments briefly on the regulatory sanctions available and finally outlines in some detail the Ombudsman scheme and how it operates.

Hopefully bankers and others operating in this area will find the chapter useful as a shorthand guide to the most significant provisions of FSMA, and how liability may arise. It is not of course a substitute for the more detailed works which address the fine detail of FSMA.

Chapter 11

Finally, this chapter addresses the topic of Investment Management and analyses this from the perspective of the claims that may be brought for alleged mismanagement of funds.

Commencing with an identification of the various different services offered, whether advisory or discretionary, and with particular emphasis on pension fund management, the analysis proceeds to examine the types of claim that may be brought (whether for breach of contract, tort, misrepresentation or negligent misstatement) and potential defences.

It is apparent from the analysis that the authors have first hand experience of such claims, particularly in relation to pension funds. For example, up-to-date authorities are quoted on such topics as pre-action disclosure, technical damage issues, such as the date when the loss, if any, falls to be calculated, the relevance of "bench marking" etc.

As the authors emphasise this area of investment management services has seen a substantial increase in the number of cases being brought. Those concerned with this topic, whether potential claimant or defendant, will benefit greatly from a close reading of the contents of this chapter.

So that is what we have done, and we hope that it meets with approval. We said in the first edition that we very much hoped that readers of the book would find it of great benefit, both at the level of providing information and in terms of tendering practical advice, and we repeat that expression of hope. The law is stated as at January 1, 2005, although efforts have been made to update the published text since that date. Since the publication of the first edition, the new Civil Procedure Rules have come into effect. To the extent that practice has changed in consequence this is recorded in the updated text.

Many people have contributed to this book, and whilst the majority of them are recorded at the beginning, there are some whose names do not appear. We would like to take this opportunity of thanking them for their assistance. First, we thank Roger Jones, at Lloyds Bank Plc, for the time he spent reading and commenting on the chapter on International Banking. Secondly, we thank

Alan Hawley, of Media and Technology Group Direct, for his comments in relation to electronic banking. The book has also enjoyed considerable support and encouragement from many senior figures at both 3 Verulam Buildings and Richards Butler. However, the most significant contribution to the production of this edition has undoubtedly been that made by Emma Chown. She fulfilled the same function here as in relation to the first edition in co-ordinating and chasing the many contributors to the book and ensuring, in a polite but firm manner, that none of us fell too far behind our deadlines. It is as true of this edition as it was of the first that, without her efforts, it quite simply could not, and would not, have been written.

We are flattered that Lord Millett has been good enough to write the Foreword to this edition. We are also very grateful to the team at Sweet & Maxwell, namely Sarah Watt, Jasmin Naim and, in the early stages, Roxanne Selby for all their encouragement, support and patience. We have very much enjoyed working with them.

David Warne
Nicholas Elliott QC
July 2005

TABLE OF CASES