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Welcome to the Q1 2016 edition of our Banking Disputes Quarterly, designed to keep you up to date with the latest news and legal developments and to inform you about future developments that may affect your practice.

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ON THE HORIZON

"Women in finance charter" aims to address gender imbalance in the financial services sector

By Sarah Day (Partner) and Paula Johnson (Senior Professional Support Lawyer)

A number of leading banks, including Lloyds Banking Group, Barclays, HSBC and The Royal Bank of Scotland, have pledged to tackle gender imbalance in the UK financial services sector by signing up to a new voluntary charter. The Women in Finance Charter (**Charter**) was launched by HM Treasury following recommendations made by Jayne-Anne Gadhia, Chief Executive of Virgin Money, who recently carried out a review into the representation of women in the financial services sector (**Review**). The aim of the Charter is to increase the number of women in senior leadership positions. Firms which sign up to the Charter commit to implementing the recommendations set out in the Review.

The Review reveals that financial services firms employ more women than men but only a few women progress beyond middle management levels, leaving most of the top jobs in the hands of men. At entry level 66 per cent of recruits are female but this drops to 33 per cent at middle management level and to 18 per cent at senior management level. On average women make up 23 per cent of boards in the financial services sector but their representation on executive committees amounts to only 14 per cent, while 25 per cent of the companies sampled had no women at all on their executive committee and nearly 17 per cent had no women on their board. Where women do sit on executive committees they tend to be in corporate support functions such as human resources, communications, legal and compliance, marketing, treasury, audit, policy and public affairs rather than business-facing (profit and loss) roles.

Whilst the sector has the highest pay in the UK it also has the widest gender pay gap, which currently stands at 39.5 per cent.

The Review recognises that meaningful change in gender equality is only likely to happen if businesses start to measure it. What gets measured gets done. To that end, recognising that each business will have its own priorities and requirements, the Review makes three overarching recommendations:

1. Reporting – firms should set their own internal targets, against which they should publicly report progress;
2. Executive accountability – there should be an executive responsible for improving gender diversity at all levels of the organisation and in all business units;
3. Remuneration – executive bonuses should be explicitly tied to achieving the internal targets which firms have set. It would be up to individual institutions to determine how they do this.

The government strongly believes that these recommendations will be key to driving change. Each firm signing up to the Charter will be expected to set out its approach to each of these three recommendations and report on progress against targets either in its Annual Report and Accounts or in a prominent and signposted place on its website.

Firms have been asked to sign up to the Charter on a voluntary basis. After three months HM Treasury intends to publish a list of signatories. If large sections of

the industry do not engage with the recommendations then government may need to examine whether a more prescriptive approach is required.

Aside from the main recommendations, the Review also identified other positive actions which could be taken to improve inclusion in the workplace. These key enablers include:

- investing in supportive people managers;
- providing technology to support flexible working;
- ensuring pay structures are transparent; and
- implementing good flexible working policies.

The big question is whether the Review and the Charter will succeed in bringing about change. Signing the Charter is entirely voluntary and the proposals do not have the force of law. Cynics may argue that even if firms do sign up to the Charter they may set themselves unambitious targets in order to ensure that they are achievable and do not have an adverse impact on board bonuses. On the other hand many high profile diversity groups and many senior women are against legally binding quotas as it is felt that they misfire and do not lead to a genuine acceptance of diversity in leadership.

International banks may be reluctant to sign up if this means that they have to commit to introducing practices in this jurisdiction which they do not want to implement elsewhere.

The fact that a number of leading banks have already signed the Charter is however encouraging. Institutions which have not yet signed up run the risk of being named and shamed in the press and this could prove a powerful incentive. Investors may also play a part in lobbying firms to consider more women at board level. According to the Daily Telegraph, big investors, such as Aviva and L&G, have already been quietly lobbying on this front.

The Review is just one part of the government's overall commitment to tackling gender inequality in the workplace. Recently the government committed to addressing gender pay gap through requiring every company with more than 250 employees to publish the difference between the average pay of their male and female employees. Sir Philip Hampton, the Chair of GlaxoSmithKline, was also recently appointed to lead an independent review on increasing representation of women in the Executive level of FTSE 350 companies.

It seems that the tide is turning. It will be interesting to see how many banks and financial services firms sign up to the Charter over the next three months and what positive steps they take to increase the number of women in senior positions.

Greater power, greater responsibility? The "legal function" and the senior managers regime

By Tony Katz (Partner) and Sam Bodle (Trainee)

Coming into force on 7 March 2016, the Senior Managers Regime (**SMR**) swept aside the 'Approved Persons Regime' by creating a responsibility and "accountability framework" within banks building societies and credit unions (**Institutions**) that was better suited to their committee-based decision making and matrix structures.

However, the run up to implementation has exposed a number of challenges and uncertainties regarding the SMR's application to corporate governance practice and the role of the legal function. Most notably Institutions have been questioning whether General Counsel (**GC**) are included within the regime, and what effect such an inclusion would have on GCs.

FCA Consultation

On 27 January 2016 the FCA announced its decision to consult on the pros and cons of including the GC role within the SMR. Although a GC's responsibilities are not expressly included in the list of 17 Senior Management Functions ("SMF") under the regime, there is some uncertainty as to whether they are caught by the final, 'catch-all' provision of this definition, which applies the SMR to any person: "*allocated overall responsibility for one of the firm's business activities, business areas or management functions*".

A person with "*overall responsibility*" is someone with "*ultimate responsibility under the governing body, for managing or supervising a function; with direct responsibility for reporting to the governing body and putting matters for decision to it*".

Whilst the GC is not included in the guidance's list of an Institution's main "business activities" and "business areas", this list is not exhaustive. Furthermore, the FCA has confirmed that GCs are *not* excluded from it, and that any comments previously made by the FCA to the contrary were aimed purely at individuals giving discrete legal advice to the board, rather than at the wider GC role.

Is the GC an SMF?

It is pretty clear that a GC has "overall responsibility" for the legal department, it is unclear as to whether this qualifies them as a SMF. There is a suggestion that it should not qualify, as a legal department is arguably ancillary to the main services, business areas and activities undertaken by Institutions. Additionally, often a GC in a large organisation such as an Institution does not have an active executive decision-making role, in that they instead shape and inform strategy indirectly through legal advice. In this case it is questionable whether they should take responsibility for the impact of Institutions' decisions that might result in an Institution's failure, and which are outside the remit of their purely legal expertise. Would it be right to blame a GC for a failure to appreciate the non-legal related risks inherent in CMBSs in 2008?

What would be the effect of SMF status for a GC?

The response of most Institutions thus far has been to treat GCs as not being SMFs, where the GC's responsibilities are limited to the legal function (but where the GC has additional responsibilities clearly this may impact the conclusion). However, the question arises as to what impact the application of the SMR to GCs would really have?

Under the SMR the principal obligations falling on Senior Managers are:

1. Compliance with defined responsibilities (both (i) role specific responsibilities, and (ii) prescribed responsibilities under the SMR, e.g. ensuring an Institution's compliance with the SMR);
2. FCA/PRA pre-approval of an SM's appointment, based on "fitness and propriety" for the post;
3. Compliance with the Conduct Rules.

Starting with point two above, the test for fitness and propriety is broken down into questions of an individual's: (i) honesty, integrity and reputation; (ii) competence and capability; and (iii) financial soundness. However, each of these requirements is already imposed to a significant degree by the SRA Code of Conduct (**Code**). For instance mandatory Principles 2, 3 and Outcomes 1.16, 5.1-5.5 variously require a solicitor to act honestly and with integrity, Principles 4, 5 and Outcomes 1.4 and 1.5 go to standard of service, and Principles 8 and 10, together with the Account Rules ensure financial responsibility.

In the same vein, it is questionable whether the Conduct Rules, referred to at point three above, would impose new behaviours which aren't already covered by the Code and case law. For instance, in addition to the requirement to act with integrity (see above), the need to act with due skill care and diligence is covered by the duty of care owed by a solicitor to a client at common law. The requirement to be open and co-operative with the FCA and PRA is a natural extension of mandatory principle 7 and Chapter 10 of the Code, and the requirements to ensure effective control of the business and compliance with relevant regulation are covered by Principles 7 and 8, and in particular Outcomes 7.5 and 7.2. Obviously, however, the biggest worry for GCs will justifiably be the possible exposure to sanctions for breaching the SMR, including: public censure by the FCA, a ban from particular functions within regulated firms, an unlimited fine and criminal liability.

Concern has also been voiced in the legal community about the effect on privilege of the Conduct Rules' requirement for "appropriate disclosure" to the FCA or PRA. It is hard to imagine that this rule will apply over and above privilege, given the existing protections under s. 413 FSMA 2000 protecting privileged documents from disclosure to regulators, as well as the long established authority that privilege is a fundamental tenet of the administration of justice. However, this does not solve the potential issues relating to waiver of privilege, for example when a GC wishes to rely on a document but cannot, as it is privileged in favour of the Institution.

The extension of the SMR to the legal function may also have an adverse impact for Institutions, for by defining liability through a GC's awareness of a given risk, they may well be disincentivised to ask necessary questions and investigate matters for fear that any consequent awareness may subsequently be held against them. Equally the extension may lead to increased pressure on legal department budgets, due to the requirement that delegation by a GC be responsible, appropriate and effective, which could prompt a shift in recruitment towards more experienced lawyers, or an increased desire to obtain external advice.

This extension would also pose practical challenges in terms of implementation in relation to point one above, in that the question of defining the role of a GC in such a way as to be able to hold them individually responsible would by no means be easy. For a GC's role is defined through contributions to multiple other departments and supporting SMFs: the role is collaborative in such a way as to arguably obviate any notion that they alone should be held responsible for any one of their acts. Careful thought will therefore need to be given as to the precise definition of the legal function if the extension goes ahead.

Conclusion

The argument can be invoked on both sides of the debate over extending the SMR to GCs that the effect of such an extension would be less a matter of new regulatory obligations and more one of increased accountability for a GC's existing responsibilities. On the one hand the lack of multiple new and onerous obligations, set against the benefits of increased transparency and accountability may justify the extension. However equally, it raises the question as to why the SMR should tread ground already covered by the SRA Regulation, which already takes account of those with "management responsibilities" and those without, and which is arguably better placed to regulate lawyers.

The FCA has yet to announce anything other than an intention to consult, and so we therefore need to wait for the next step of publishing a full consultation timetable.

RECENT DEVELOPMENTS & CASES

Transfers to the financial list: factors to consider

By Jamie Curle (Partner) and Camilla Macpherson (Senior Lead Professional Support Lawyer)

The Financial List has been operating since October 2015 and is now becoming well-established. In *Property Alliance Group Limited v Royal Bank of Scotland Plc* [2016] EWHC 207 (Ch), the Court considered whether to order the transfer of existing proceedings into the Financial List. The application for a transfer was brought by The Royal Bank of Scotland Limited (**RBS**) and opposed by Property Alliance Group Limited (**PAG**). PAG has brought various claims against RBS in these proceedings. The key allegations relate to the mis-selling of interest rate swaps and the fixing of LIBOR rates.

What disputes are eligible for the Financial List?

Claims suitable for the Financial List are:

- claims worth £50 million or more and relating to loans, project finance, banking transactions, derivatives and complex financial products, financial benchmarks, capital or currency controls, bank guarantees, bonds, debt securities, private equity deals, hedge fund disputes, sovereign debt, or clearing or settlement; or
- claims which require particular expertise in the financial markets or raise issues of general importance to the financial markets. Financial markets include the fixed income markets, the equity markets, the derivatives markets, the loan markets, the foreign currency markets and the commodities markets.

Click here to read our earlier article which contains more information on the Financial List.

PAG accepted that its claims fell within the definition of a Financial List claim. However, it argued that this did not mean the case must be transferred, especially in circumstances where there was already a judge docketed to the case who had delivered a number of judgments (mostly in relation to disclosure and privilege). In addition, the hearing was only a few months away.

Ten significant factors

The judge listed the following factors as being relevant to deciding a contested application for a transfer to the Financial List:

1. The extent to which the case concerned matters of market significance, rather than matters relevant only to the specific case and parties.
2. The relative importance of the issues of market significance.
3. Whether the case had already been assigned to a judge.
4. Whether, if the case were to be transferred to the Financial List, the judge would have to be changed.
5. How long proceedings had been underway.

6. Whether the assigned judge had already conducted hearings and delivered judgments in the proceedings.
7. Whether the judge's familiarity with the case would enable their pre-reading to be more efficient than if a new judge were to be appointed.
8. Proximity of the trial date.
9. Whether the timetable would be disrupted by a transfer to the Financial List.
10. Whether assigning a Financial List judge would disrupt other proceedings underway in other lists, for example because that judge would no longer be able to conduct those proceedings.

He concluded that this was an appropriate case to be transferred, even though it would involve a change of judge. The fact that some of the allegations were relevant to other participants in the market, the judgment would impact on cases currently underway and the case might be viewed as a lead case in relation to LIBOR allegations were all relevant issues.

Comment

It should be fairly unusual for an application to transfer a claim into the Financial List to be opposed. The financial markets expertise of the judges of the Financial List will generally appeal to both sides in a dispute. Where there is opposition (for example because there are tactical considerations at play), this case provides useful guidance on how the Court will reach a decision. That said, not every case which meets the criteria of the Financial List needs to be transferred or started there. A high value but straightforward loan dispute, for example, probably does not require particular financial market expertise.

Applications to transfer to the Financial List should be made as early as is feasible. The Courts will not want to jeopardise a fixed trial date and will also want the same judge to conduct both the pre-trial review and the trial itself. If an application is being made at a later stage, assurances that the trial date will still be met are likely to give comfort to the judge considering the case.

Swaps mis-selling claims – public law claim dismissed

By Hugh Evans (Partner), Adam Ibrahim (Partner) and Nina Benson (Senior Associate)

Customers of banks who consider they have been mis-sold an interest rate hedging product (**IRHP/Swap**) have explored various avenues for remedies. A recent judgment discourages them from pursuing public law claims.

In February 2016 the Divisional Court (Elias LJ and Mitting J) dismissed an application for judicial review in *R* (*on the application of Holmcroft Properties Limited*) *v KPMG LLP* [2016] EWHC 323. The customer (**Holmcroft**) had submitted a swap mis-selling complaint to Barclays Bank PLC (**Barclays**). This had progressed through Barclays' past business review and redress scheme (**Review Scheme**). Holmcroft was disappointed to be offered no compensation for consequential loss. It was time-barred from bringing a private law claim against Barclays. Instead, Holmcroft attempted to overturn the Review Scheme outcome by bringing a public law claim against KPMG LLP (**KPMG**), the skilled person and independent reviewer appointed by Barclays for its Review Scheme. Why did the court reject Holmcroft's claim?

Review Scheme framework

Public law claims are typically brought against public bodies. KPMG is a private body. To establish that KPMG should be subject to public law duties, it was necessary for Holmcroft to satisfy the court that KPMG's Review Scheme role had a sufficient "public law" flavour.

Briefly, the Review Scheme was set up pursuant to:

- an undertaking given by Barclays to the financial services regulator (**FCA**);
- a subsequent FCA requirement notice (issued under section 66 of the Financial Services and Markets Act 2000) requiring Barclays to provide a report prepared by a skilled person, appointed or approved by the FCA; and
- a letter of engagement (a contract) between Barclays and KPMG, entered into pursuant to the undertaking and in anticipation of the requirement notice.

KPMG reviewed Barclays' Review Scheme outcomes and offers before they were communicated to customers. Following such review, Barclays' redress offer in response to Holmcroft's complaint was confirmed by KPMG to be appropriate, fair and reasonable.

Holmcroft's public law (judicial review) claim sought to overturn KPMG's confirmation of the Review Scheme outcome.

Key elements of the judgment

In dismissing Holmcroft's claim, the court adopted a 2-stage approach.

1. **Question 1**: Is KPMG amenable to judicial review? (Did KPMG owe Holmcroft any public law duties?) **Decision 1**: No. KPMG's Review Scheme role, as independent reviewer and skilled person, is **not** amenable to judicial review.
2. Question 2: **If the answer to Question 1 had been "Yes":**
   - **Question 2(a)**: What public law duties would have been owed? **Decision 2(a)**: Narrow procedural fairness duties only.
   - **Question 2(b)**: Could there have been any breach? **Decision 2(b)**: No. Barclays' review and redress arrangements had operated in a way that was fair to Holmcroft. (Holmcroft claimed, in particular, that Barclays should have disclosed its **full** records for Holmcroft to allow it to make properly informed representations on consequential loss. The court disagreed.) Holmcroft had been given sufficient information in the Barclays' review letters, communicating the redress offer and reasons for it, to enable Holmcroft to made representations contesting that offer. The review steps taken by Barclays meant that there could be no material breach by KPMG of any public law duty of procedural fairness.

Reasons – Amenability/no public law duties

Why was the court satisfied that KPMG did not owe a customer such as Holmcroft any public law duties?

The court identified some aspects suggesting KPMG might be amenable to judicial review (concluding, for example, that "*KPMG was "woven into" the regulatory function*"). These aspects are outweighed, however, by the numerous reasons provided for the court's decision that KPMG is not so amenable and owes Holmcroft no public law duties.

- The Review Scheme is essentially voluntary. The FCA could not have compelled Barclays to engage KPMG in its Review Scheme role. As vital as KPMG's role is in individual cases, it could not have been imposed on Barclays by the FCA in the exercise of its regulatory powers.
- The source of KPMG's powers is **contractual**. (Such contracts are matters of private law.) Whilst not determinative, this is important. Barclays, not the FCA, appointed KPMG. The FCA only approved that appointment, and KPMG has no relationship with customers "*at all*".
- In reviewing offers, KPMG is **assisting** in achievement of public law objectives. That is not enough to subject KPMG to judicial review.
- There are **limits** to the FCA's regulatory role. Had there been no willing skilled person, the FCA has no regulatory obligation to carry out KPMG's role. ("*Indeed, it is highly unlikely that [the FCA] would have had the resources to act in that way…*")
- Barclays' Review Scheme arrangements did **not prevent** the FCA from taking a more active role in individual cases. (The judgment alludes to the possibility of the FCA itself being liable to judicial review but observes, "*we do not underestimate the difficulty of establishing a breach in any particular case.*")

Futility and alternatives

The often limited nature of any judicial review remedy also seems to have influenced the court. Any public law "victory" may readily prove fruitless. Generally, even if successful, a judicial review claim will only result in the challenged decision being set aside. A customer may remain disappointed by any further decision made to replace it. (The court stated, "*There would be no damages against KPMG absent a civil cause of action. The only relief would be to set aside the approval of the unfair offer and Barclays would have to consider again.*")

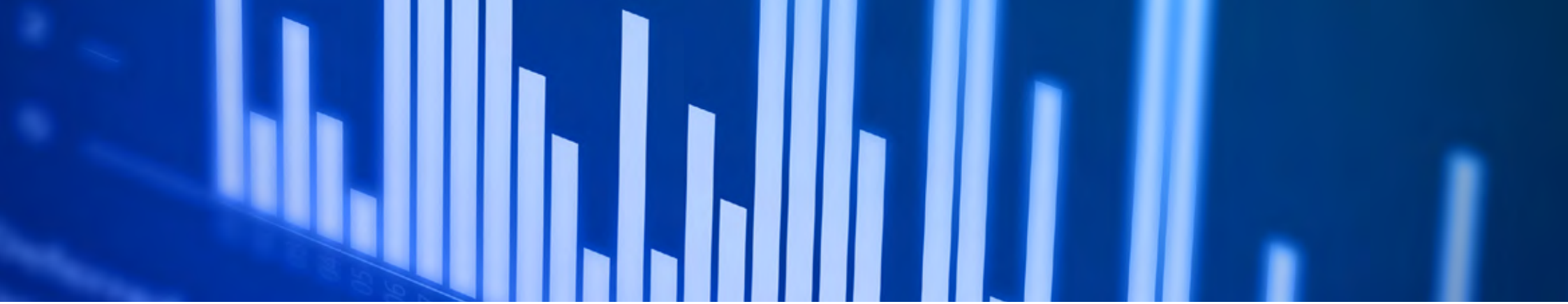
Related to this, the court speculated on the availability of alternative remedies through private law rights of action. The court stated that, if these existed, "*they would certainly be more appropriate remedies to pursue*".

Adequacy of disclosure – information and reasons

Why was the court satisfied that, in any event, Holmcroft had been given sufficient information in Barclays' decision letters?

Even had KPMG been under a public law duty, on the issue of procedural fairness, the court decided that it was enough that Barclays had given Holmcroft **the gist** of its reasons for the offer made and the material on which it was based.

The court stated, "*We do not accept that there is any obligation to provide the full records available to the bank, or even those records on which the bank has relied. It is enough that the bank **fairly summarises** the reasons why it*



reached the decision in circumstances where the customer has had reasonable opportunity, and is sufficiently informed, to be able to respond to, and if appropriate take issue with, those reasons." (emphasis added)

What next?

Holmcroft's application was dismissed and permission to appeal was refused. Holmcroft has since renewed its application for permission to appeal to the Court of Appeal. Notwithstanding that renewed application, the current position remains that the court has rejected this public law challenge to the Review Scheme outcome. The judgment must make sobering reading for Holmcroft and other customers who had sought to follow Holmcroft's lead in bringing public law claims.

Customers who may have harboured doubts about the banks' review scheme arrangements may have noted one conclusion in particular. Following a detailed review of the way in which the Review Scheme arrangements worked for Holmcroft, the court stated that: "*The redress exercise appears to have been conducted in a conspicuously scrupulous way.*"

Financial disputes and arbitration: update on prime finance

By Paul Hopman (Partner) and Wouter de Clerck (Senior Associate), DLA Piper Amsterdam

The Panel of Recognised International Market Experts in Finance (**PRIME Finance**) and the Permanent Court of Arbitration (**PCA**) recently announced that they have joined forces and that the PCA has been authorised to administer all arbitrations under the under the PRIME Finance Arbitration Rules. This development should add depth and credibility to the administration of PRIME Finance arbitrations. The arbitrations may take place anywhere in the world and may be facilitated by the PCA's host country agreements with a number of its member states. This should ensure that parties to complex financial transactions have easier access to arbitration and mediation to resolve their disputes.

PRIME Finance was set up in 2012 with the objective of providing arbitration and mediation services, expert opinions and judicial training and education in the area of complex financial transactions. A key advantage that PRIME offers is its panel of expert arbitrators, all of whom have specialist knowledge and extensive experience in the financial services field.

As we reported previously, in 2013 ISDA decided to include a model arbitration clause in its ISDA Arbitration Guide 2013 which specifically deals with PRIME Finance institutional arbitration rules (click here to view our earlier article on this point). Derivative disputes in particular are likely to benefit from this new agreement between the PCA and PRIME Finance.

The PCA is an intergovernmental institution, established by treaty in 1899 to facilitate arbitration and other forms of dispute resolution between states. More recently, the PCA is probably best known for the administrative support it provides in inter-state and investor-state arbitration proceedings which are often seated in The Hague, a notable highlight being the US$50 billion Yukos award issued by a tribunal in July 2014.

Following the designation of the Secretary-General of the PCA as appointing authority under the PRIME Finance Arbitration Rules, the PCA and PRIME Finance have now chosen to co-operate more closely, with the PCA

administering all arbitrations under the under the PRIME Finance Arbitration Rules. Whilst PRIME Finance thus chooses to "de-institutionalise" its arbitration rules not five years after having gone to the market as a new arbitration institution, nevertheless the advantages of intensified co-operation with the PCA may outweigh any disadvantages, since PRIME Finance and parties using its arbitration rules will benefit from the administrative experience and expertise of the PCA.

Of note in this regard is a "publication clause" in the PRIME Finance rules, which permits PRIME Finance to include in its publications excerpts of an arbitral award or an order, and to publish either in their entirety, in anonymised form if no party objects to publication within one month after receipt of the award. This rather unique feature of the PRIME Finance rules coincides with a recent drive for transparency in international arbitration, and may render PRIME Finance arbitration more attractive to financial institutions previously put off arbitration by the lack of precedent value of arbitral tribunal decisions in relation to similar claims.

Precedent value is particularly relevant to the adjudication of multi-party or mass claims, which can be of particular relevance to financial institutions (see, for example, the recent surge of claims in the UK, the Netherlands and other countries in connection with sales of derivatives and other complex financial products to mid-sized and small businesses). However, there is no simple solution that would allow for arbitration to be more widely-used in relation to such claims, given the contractual nature of arbitration and the fundamental requirement that all parties must agree to attribute exclusive jurisdiction to the arbitral tribunal. This is one reason why financial institutions have not yet adopted arbitration as a dispute resolution mechanism as enthusiastically as parties in other business sectors.

However, there are successful examples of mass claim tribunals – such as the Iran-US Claims Tribunal, seated in The Hague, which is deciding claims by nationals of one state against the other arising from debts, contracts, expropriations or other measures affecting property rights. Such proceedings suggest that arbitration could be extended to mass claims in the strictly commercial context (albeit that some sort of government intervention would appear to be required for the process to work). Moreover, with an increasingly international client base and, consequently, a need to enforce decisions on a global level, arbitration and its global enforcement regime under the New York Convention retain a strong attraction as a preferred dispute resolution mechanism in connection with derivative contracts and other complex financial products. With the solid backing of the PCA, PRIME Finance and its arbitration rules now appears to be even better placed to seek to take advantage of these trends.

English court interprets undefined terms in securitisation documents

By Jeremy Andrews (Partner) and Maria Scott (Associate)

An earlier version of this article first appeared in the February 2016 issue of Butterworths' Journal of International Banking and Financial Law.

In the recent decision of *CBRE Loan Servicing Limited v Gemini (Eclipse 2006-3) Plc* [2015] EWHC 2769 (Ch), Henderson J interpreted the terms "principal" and "interest" in a noteholder dispute resulting from a

securitisation structure involving multiple agreements. The Court considered the context of the overall scheme, applying commercial common sense to determine the most appropriate interpretation.

The securitisation related to a bank loan advanced to a number of Guernsey-registered limited partnerships in August 2006 (**Loan**), who used the funds to refinance a portfolio of commercial properties in the UK. In November 2006, Gemini (Eclipse 2006-3) Plc (**Issuer**) purchased the Loan, funding the purchase by issuing secured floating-rate notes, divided into 5 classes from A to E (**Notes**), ranking in that order of priority. The rental income from the properties would be used to pay the interest due under the Loan, which would in turn be used to pay the interest due under the Notes.

Following the financial crisis, the value of the underlying properties fell dramatically and the interest due under the Loan was no longer paid in full by the borrowers, constituting Events of Default. In August 2012 the Loan was accelerated so that the whole amount became due. CBRE Loan Servicing Limited (**CBRE**), the Master Servicer of the Loan, then entered into a supplemental hedging agreement with Barclays Bank Plc. Barclays agreed not to terminate certain interest rate hedging transactions provided that a programme for disposal of the properties was implemented to enable a gradual termination of the hedging transactions.

As a result, CBRE as Master Servicer received monies from three different sources: a) rental income from the rented properties; b) proceeds of the sale of those properties sold in accordance with the programme for disposal; and c) premiums paid for the surrender of leases.

The question for the Court was whether each of these receipts constituted "principal" or "interest" under the Loan documentation, neither of which term was defined. Whilst it was in the economic interests of the Class A Noteholders for the receipts to be characterised as "principal", characterising the receipts as "interest" would benefit the holders of Class B to E Notes ("Junior Noteholders").

The Court found, in favour of the Class A Noteholders, that:

a) Rental payments were to be characterised as interest (which the Class A Noteholders did not dispute);

b) Sale proceeds should be characterised as principal, because they represent the realised capital of a property which stands as security for the Loan; and

c) Surrender premiums should be characterised as principal, assuming that the premium paid represents the capitalised value to the landlord of the remaining term of the lease.

In coming to its conclusion, the Court referred to the familiar principles of contractual interpretation laid down by the majority of the House of Lords in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 and the Supreme Court in *Rainy Sky v Kookmin Bank* [2011] UKSC 50, as well as the statements of principle by Lords Mance and Collins in *Re Sigma Finance Corp* [2010] 1 All ER 571.

It noted that the way that the relevant provisions in the Loan documentation were drafted indicated that the Master Servicer's allocation of the receipts was intended to be a "*relatively routine matter which can be performed without undue difficulty or delay*". The very fact that the terms "principal" and "interest" had not been expressly defined suggested that their identification did not require

any "*legal sophistication, but merely the application of commercial common sense*." On that basis, the Court found that the receipts should be characterised depending on their source and the role they play in the context of the Loan and its security, having viewed the issue as a matter of commercial common sense.

The Court then went on to "*test*" its decision by considering its consequences in the context of the overall structure of the transaction documents, finding that treating sale proceeds and surrender premiums as principal was in line with what the parties might reasonably be expected to have contemplated when the securitisation was put in place. The decision was consistent with:

- The treatment of the proceeds of sale under the Loan before it was in default; and
- The subordination of the Junior Noteholders to the Class A Noteholders.

The Class A Noteholders accepted that the rental income should be treated as interest, meaning that the Junior Noteholders would not be left without any income whatsoever. Any shortfall was caused not by a mischaracterisation of the funds, but by the financial crisis.

The decision emphasises the need to consider carefully the interaction of contractual provisions in complex financial structures involving multiple individual documents. Whilst the Court will endeavour to examine the relevant provisions against the context of the entire structure in order to identify the interpretation that makes the most commercial common sense, banks should be vigilant when putting such structures in place. Seemingly innocuous terms used in everyday commerce may nevertheless need to be expressly defined in order to avoid unintended and/or costly consequences.

Borrowers defending claims on grounds of misrepresentation who seek rescission must repay outstanding principal as a condition to defending the claim

By Hugh Evans (Partner) and Tom Longstaff (Associate)

In March 2016 the Court of Appeal handed down its decision in the case of *Deutsche Bank AG and others v Unitech Global Ltd and another* [2016] EWCA Civ 119, in which it was ordered that to continue with its defence – which included allegations of LIBOR manipulation – the defendant must make a payment of $120 million into court.

This is a useful decision for banks where a claim is brought against a customer for an outstanding debt and a defence is filed which seeks to introduce wide-ranging allegations which, if successful, would give rise to a right to rescind the loan agreement. The decision demonstrates that courts have the power to take a robust approach and require an interim payment or a payment into court to be made where it is inevitable that a defendant will have some liability to the bank regardless of the outcome of the proceedings.

Background

The procedural history of the case can be summarised as follows:

The two claims

Two actions are brought by Deutsche Bank (**Bank**) against Unitech Global Limited (**UGL**) and Unitech Limited (**Unitech**):

- the first action involves the Bank and eight other lenders (collectively, the **Lenders**) in a claim against Unitech and UGL. This action relates to a credit facility agreement (**Agreement**) made with UGL for the sum of $150 million, in respect of which Unitech acted as parent company guarantor;

- in the second action, the Bank claims $11 million from Unitech under a guarantee of UGL's obligations in respect of an interest rate swap that was entered into as part of the Agreement and was referenced to LIBOR (**Swap**). Unitech's defence to the second action includes allegations of misrepresentation (in respect of LIBOR) and breach of duty.

Earlier decisions

At an earlier hearing, Cooke J held that the Agreement had been subject to a novation and therefore that UGL had lost the right to rescind that agreement, following which Teare J awarded summary judgment to the Lenders who were party to the first action.

The Court of Appeal subsequently held that this decision of Cooke J was wrong; the issue as to whether or not a novation had taken place was a triable issue.

Accordingly, Teare J set aside the summary judgment on 3 October 2014 and at the same time dismissed (a) an application by Unitech and UGL to amend their Defence; and (b) an application by the Lenders that the set-aside be conditional on UGL making a payment into court of $120 million (being the principal amount (with non-contractual interest) outstanding under the loan).

These failed applications before Teare J then fell to be considered by the Court of Appeal.

Issue one: The defendants' application to amend the defence

In relation to the first issue, Unitech and UGL sought to amend their defence to allege, amongst other things, that:

1. the Bank failed to disclose to Unitech the unusual features of the Agreement with UGL (namely the unsuitability of the Swap agreement and the alleged manipulation of LIBOR); and
2. the Bank's breaches of the Agreement (e.g. manipulation of LIBOR) discharged Unitech from its liability under the guarantee.

In refusing to allow these amendments:

1. the Court of Appeal noted that whilst the law on 'unusual features' was a 'developing doctrine', having a potential defence to the Guarantee did not assist Unitech as the Agreement provided that if 'for any reason' any amount was not recoverable under the guarantee, Unitech would indemnify the Bank; and
2. for the same reason, whether or not the Bank had breached the contract by manipulating LIBOR was irrelevant as Unitech would still be liable under the alternative indemnity provided in the Agreement.

Other proposed amendments relating to the defence of Illegality and alleged breaches of European competition law and the Bretton Woods Agreement 1944 were also rejected.

After dismissing the appeal brought by the Unitech parties, the Court of Appeal then turned to consider the Lenders' cross-appeal, i.e. that the dismissal of the summary judgment awarded to it earlier by Teare J under CPR Part 24 be conditional on a payment being made into court for the outstanding debt.

Issue two: The Lenders' application for an order that a payment be made into court

It was common ground that if UGL were to succeed at trial on its misrepresentation defence, it would be entitled to rescind the Agreement but only on condition that it made restitution of the outstanding amount of the principal it had received, amounting to some $120 million. If UGL's misrepresentation defence failed then UGL would be liable for $177 million under the Agreement. The best result that UGL could therefore hope to

achieve would be one where it would have to pay $120 million to the Lenders. It was on that basis that the Lenders had applied for an interim payment of $120 million or an order that UGL only be allowed to continue defending the claim if it made a payment into court of that amount.

Decision of Teare J

At first instance Teare J had expressed the view (albeit with some hesitation) that the applicable law did not enable him to make the order sought as there was no provision in the CPR under which the court could order such a payment:

- a conditional order under CPR Part 24 could only be made if it were improbable that the rescission defence would succeed and that was not the case here;
- although there is a power under CPR 3.1(3) to make a conditional order when setting aside a previous order, Court of Appeal guidance given in *Huscroft v P & O Ferries Limited* [2010] EWCA Civ 1481 makes it clear that the power under CPR 3.1(3) cannot be used to circumvent the requirements of another part of the CPR where that other part applies to the particular type of application under consideration. What was being considered here was the setting aside of an order made under Part 24. Part 24 was therefore relevant. A conditional order could not have been made under Part 24 (for the reason given in the bullet point above) and CPR 3.1(3) could not be used to circumvent the requirements of that Part;
- according to CPR 25.7.(1)(c), an interim payment can only be ordered in circumstances where the court is satisfied that if the case went to trial the Lenders would "obtain judgment" for a substantial amount of money. If the Lender's claim for sums due under the Agreement was dismissed because the defence of rescission succeeded but UGL had to give counter-restitution this would not amount to the Lenders "obtaining judgment" for that sum.

Court of Appeal decision

The Court of Appeal disagreed.

It held that CPR Part 24 does not itself contain any provision which grants a power to impose a condition requiring a payment into court. It does however contain a cross-referencing reminder to CPR 3.1(3) which provides that the court may attach conditions when it makes an order. In the circumstances of the instant case it was therefore the general power in CPR 3.1(3) which was relevant not Part 24. In contrast, CPR Part 25 contains specific provisions which grant a power to make interim payments and CPR 3.1 (3) could not be used to get round those provisions.

The judge had therefore exercised his discretion under CPR 3.1(3) on an incorrect basis. He should have applied the rule guided by the overriding objective which requires cases to be dealt with "*justly and at proportionate cost*", "*in ways which are proportionate*" and "*expeditiously and fairly*". On the facts of the instant case it would be a highly unsatisfactory result and clearly contrary to the overriding objective not to require a payment into court. There was clear justification for the sum of $120 million to be paid immediately.

In the alternative the Lenders were entitled to an interim payment under CPR 25.1.(1)(k) which states that the court can make an order for an interim payment:

"…on account of any damages, debt or other sum (except costs) which the court may hold the defendant liable to pay".

The Court of Appeal regarded the term "*other sum*" as being capable of covering a payment by way of restitution as a condition for rescinding an agreement. Also the phrase "*which the court may hold the defendant liable to pay*" was sufficiently wide to cover the situation like that contemplated in the instant case, where a court rules that a defendant's purported rescission of a contract will only be recognised if the defendant makes appropriate restitution by paying a sum to the claimant.

Given that the Lenders had expressed a preference for a conditional order rather than an interim payment that was the order which the Court of Appeal made.

Impact of the decision

The size of the conditional order made against the Unitech parties may mean that it cannot be paid which would bring these proceedings to an end.

Furthermore, the Court of Appeal judgment in *Unitech* is a useful decision for banks, as it demonstrates that where a customer seeks rescission in respect of an unpaid debt, it may have to pay to the Bank the principal amount which is outstanding in order for the claim to continue to trial.

Whilst potentially stifling a debtor's ability to litigate, the decision made by the Court of Appeal seems to be the right one in circumstances where the principal debt represents the minimum amount that will need to be paid to the Bank even if the debtor is successful and the remedy of rescission is granted.

Court approves predictive coding for disclosure review

By Jeremy Andrews (Partner) and Sarah Ellington (Senior Associate)

Given the increasing number of documents (including "data" in its many forms) being created every day and the requirement that court processes, including disclosure, be dealt with at "proportionate cost", it was perhaps inevitable that sooner or later the English courts would follow the example of the US and Irish courts by endorsing predictive coding in appropriate cases.

E-disclosure: a growing problem

The issue of how to deal with large volumes of electronically stored information (**ESI**) came to the forefront of practitioners' minds in 2009 in the case of *Goodale v Ministry of Justice* [2009] EWHC B41 (QB), in which Senior Master Whitaker characterised the volume of ESI as "*a serious practical problem for the case management of disclosure which is now occurring on a regular basis*". In that case, the Master advocated the use of test searches using key words, following which the parties were to re-evaluate the volume of data returned from those searches and attempt to agree on further steps. In that case the Senior Master also mentioned an early form of predictive coding.

Five and a half years later, in *Pyrrho Investments Limited v MWB Property Limited & others* [2016] EWHC 256 (Ch), Master Matthews has explained how predictive coding is to be used, making reference to US and Irish authorities which have already endorsed its use in suitable cases. This is the first reported case of an English court approving the use of predictive coding to replace human review and is expected to open the door to more parties agreeing to its use in the future.

What is predictive coding?

Call it what you will: Computer Assisted Review (**CAR**); Technology Assisted Review (**TAR**); or predictive coding; the process involves "training" a computer to find conceptually similar documents within a data set and the computer then "predicting" whether a particular document would be marked relevant or not relevant by a reviewer.

Over several batches, the computer learns from decisions fed in to it by a senior reviewer, until the coding "predicted" by the computer matches the choices made by the senior reviewer and the senior reviewer no longer needs to overturn decisions made by the computer to form a complete relevant review set.

What are the alternatives?

Manual review

Also known as a "linear" or "page turn" review, a manual review is often still completed for hard copy documents. It involves looking at each of the documents one by one and a human making a judgment as to whether that document contains relevant information for the purposes of disclosure. It can be both expensive and time consuming as it is particularly labour intensive. It involves many humans making their own decisions, and therefore there is a huge potential for mistakes and inconsistencies. The US cases in support of predictive coding have suggested that predictive coding is up to 70% more reliable than manual review.

Key word searches

Searching for documents based on whether they include particular key words can be effective to narrow the number of documents subjected to review, but as one US court has suggested, "*in too many cases…the way lawyers choose key words is the equivalent of the child's game of "Go Fish". The requesting party guesses which key words might produce evidence to support its case without having much, if any, knowledge of the responding party's "cards*" " (*Moore v Publicis Groupe* 11 Civ. 1279 (ALC) (AJP)).

Predictive coding has the potential to decrease the costs of large scale review and avoid the issues commonly associated with key word searches, namely their imprecision and the possibility of them returning a number of "false positives" meaning that reviewers end up reviewing large numbers of irrelevant documents.

What are the restrictions on predictive coding?

In the Pyrrho case, Master Matthews considered that "*provided that the exercise is large enough to absolve the up-front costs of engaging a suitable technology partner, the costs overall of a predictive coding review should be considerably lower*".

Predictive coding will only be suitable where there are a large number of documents for review. The algorithms which the computers use to predict whether or not a document will be relevant need a critical mass to work properly. The accuracy of the system will also be determined by whether the review set contains enough conceptually similar documents. Emails and word documents may well contain documents with similar wording, syntax etc, but data sets which include documents such as Excel documents, video recordings and/or voice recordings, as well as other data sets which would fall within the wide definition of document within

the CPR are unlikely to be suitable. The same issue occurs with data sets which contain a wide variety of documents, as this lack of confluence within the documents will make it difficult for the computer to make decisions based on previous inputs.

Whilst the use of predictive coding may still be possible in these instances, it may need to be teamed with some form of manual review for documents falling outside the core parameters.

Use of predictive coding must also have been envisaged from an early stage, as documents will only be suitable for predictive coding if they have been processed in a specific way. Consideration also needs to have been given as whether to search across family documents (i.e. to process families – for example, an email and its attachment(s) – as one document).

Whilst the use of predictive coding is likely to result in a reduction of fees associated with the review because fewer man hours may be needed to finalise the review, upfront data processing fees will be substantially increased, especially if no key word searching is used.

In such a case, the number of documents processed and loaded into a review platform will be substantially higher than if key words had been used at a pre-processing stage to cut down the amount of data to be loaded.

Predictive coding has in fact been in use in practice for quite some time. It does not necessarily replace a manual or key word review in many instances, but may be used as a checking exercise, for example feeding in key documents at an early stage case assessment or the use of key word searches to prioritise review.

Employing predictive coding still requires substantial input for each iteration from one or more reviewers. The reviewers need to be senior (as it is their decisions on the relevance of the sample document set which inform the algorithm), and if there is more than one reviewer they each need to have a clear shared understanding of the relevance of documents in order to reduce the number of "overturns" – where the computer incorrectly predicts whether a document will be relevant or irrelevant – and therefore the overall length of the process.

Further, each relevant document will still need to be reviewed both in order to cement the lawyer's understanding of the case, and to check for privilege and the removal of duplicates – thereby ensuring the proportionality of the review to be undertaken by the other side.

On a note of caution the Court in *Pyrrho* made specific reference to the parties having been correct in obtaining judicial approval for the use of predictive coding. This is perhaps unsurprising in light of the requirements for disclosure reports to be considered at the Case Management Conference (**CMC**) stage, but should act as a warning to parties who might look to agree alternatives at a later stage to ensure that the court is made aware of and gives approval to any change which will cause a significant departure from what has been discussed at a CMC.

SPOTLIGHT ON...

Enforcement of foreign judgments in the UAE – a new dawn?

By Henry Quinlan (Partner), Adam Vause (Partner), Charlotte Leith (Legal Consultant) and Sam Stevens (Legal Consultant)

What has happened?

In a recent decision, the DIFC Court of Appeal has handed down a judgment that has the potential to alter the enforcement landscape in the UAE significantly.

The DIFC Court of Appeal has ruled that parties may enforce foreign judgments in the DIFC Courts (even in circumstances where the judgment debtor has no presence or assets in, or connection with, the DIFC), and may then take the resulting DIFC Court judgment to the Dubai Courts for enforcement.

The Court of Appeal's landmark ruling overturns the first instance judgment in *DNB Bank ASA v Gulf Eyadah Corporation and Gulf Navigation Holdings PJSC*. The lower Court had determined that, although the DIFC Courts had jurisdiction to enforce and recognise foreign judgments within the DIFC, it did not have the power to refer those recognised foreign judgments to the "onshore" Dubai Courts for execution against assets located in Dubai (but outside the DIFC).

Why is this important?

The judgment appears likely to make the enforcement of foreign court judgments in the UAE a quicker and less hazardous process than has been the case until now.

Historically, the UAE has been a challenging place in which to enforce foreign court judgments. This is principally because:

a) in the absence of an international treaty between the UAE and another country for the mutual recognition and enforcement of court judgments, the UAE courts invariably refuse to enforce foreign court judgments; and

b) even if a treaty does exist, the ability of a party to challenge that judgment all the way to the Dubai Court of Cassation can typically lead to a long-winded, expensive and unpredictable enforcement process.

While the UAE has entered into standalone mutual enforcement treaties with a number of countries, including (among others) France, India and China, there are some notable exceptions where no treaty exists e.g. the USA, England, Germany and Russia.

However, under DIFC Law, the DIFC Courts are required to recognise and enforce final and binding foreign court judgments *regardless* of whether the UAE has a treaty in place with the relevant country or not. Significantly, once a foreign court judgment has been recognised by the DIFC Court, it then effectively becomes a DIFC Court judgment – and under Dubai law, DIFC Court judgments are automatically enforceable in the onshore courts of Dubai via the (now well-trodden) mutual enforcement mechanism which exists between the two court systems.

Comment

The judgment represents an important departure from the previous position under which it was difficult (and often impossible) to enforce a foreign judgment in Dubai. The Court of Appeal's ruling also highlights the increasingly important role of the DIFC Courts as a "conduit jurisdiction" for the enforcement of foreign arbitral awards, and court judgments and orders against parties based in Dubai (but outside the DIFC financial free zone).

Those currently (or likely to be) involved in foreign litigation against individuals or companies located in "onshore" Dubai (i.e. outside the DIFC) should certainly take heed of this important judgment.

The case in brief

DNB Bank ASA sought to enforce an English High Court judgment in Dubai via the DIFC Courts, which required Gulf Eyadh Corporation and Gulf Navigation Holding PJSC to pay USD 8.7 million in damages (plus costs). Gulf Eyadh Corporation and Gulf Navigation Holding PJSC are located in onshore UAE and have no connection whatsoever with the DIFC.

The DIFC Court of First Instance held that, whilst the foreign judgment could be recognised and enforced within the DIFC (only), the Court did not hold the power under the relevant DIFC Law to refer that recognised foreign judgment to the onshore Dubai Courts for execution.

DNB Bank appealed this decision, on the grounds that the DIFC Courts should consider their decision to recognise and enforce a foreign judgment as an "independent local judgment" (i.e. a judgment issued by the DIFC Courts in their own jurisdictional capacity) which is capable of being taken onshore for enforcement.

The Court of Appeal agreed with this submission and found that, as the effect of a decision to recognise and enforce the foreign judgment was to render a DIFC Court judgment in the same terms as the foreign judgment, it was possible for that judgment to be taken onshore for enforcement in the usual way.

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