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Welcome to the Q4 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.

ON THE HORIZON

SENIOR WOMEN IN FINANCIAL SERVICES – HOW TO ADDRESS THE PROBLEM OF GENDER IMBALANCE

By Jean-Pierre Douglas Henry (Partner) and Paula Johnson (Senior Professional Support Lawyer)

Many financial services firms employ more women than men in junior roles. But analysis shows that the chances of women progressing from middle to senior management roles are worse in the financial services industry than in any other sector. The issue is not a new one but it is a significant problem which needs to be addressed as many talented women are choosing to leave the sector altogether.

Recognising that problem earlier this year the government asked Jayne-Anne Gadhia, CEO of Virgin Money, to carry out a review of the representation of women in senior managerial roles in the UK's financial services industry ("the Review") and to make recommendations. Her initial research shows that most progress has been made by those organisations which address the issue head-on and that progress can only be made if the right tone is set from the top.

The Review has been canvassing views from across the sector and is currently consulting on the following preliminary recommendations:

- firms should set internal targets for gender progression;
- these targets should be published annually and progress against them reported and explained;
- the strategy to meet these targets should be documented by an accountable executive and the strategy should be part of the published report;
- the pay of executives/senior leaders should be linked to their success in achieving increased representation of females in senior roles.

The aim of these proposals is to force the issue of gender progression up the agenda.

The Review has also been seeking feedback on other wider issues such as:

- whether quotas or fixed targets at specific levels should be introduced;
- whether investors and shareholders are likely to take a greater interest in gender diversity if data is made publically available;
- whether shared parental leave goes far enough to re-balance childcare responsibilities and how important this issue is in improving gender diversity;
- whether the culture of "presenteeism" creates barriers for women;
- how important flexible working is at a senior level in encouraging gender diversity.

The consultation closed on 14 December 2015 and it is anticipated that a final report will be published in the New Year. We regard this as a significant and important topic and will provide further updates in due course.

In the meantime HSBC has recently announced that it intends to appoint women to half of its senior roles in the UK by 2020. This is an ambitious target but one which should be applauded. It places HSBC right at the forefront of promoting gender diversity in British banks and may encourage other banks to follow suit.

FIRST TRIAL IN THE FINANCIAL LIST OVER VALIDITY OF DERIVATIVES TRANSACTIONS DRAWS TO A CLOSE

By Jamie Curle (Partner) and Paula Johnson (Senior Professional Support Lawyer)

The trial of the first case to be heard in the new Financial List has finished and we await the judgment from Mr Justice Blair with interest. The case was transferred in the middle of October, shortly after the Financial List first became operational.

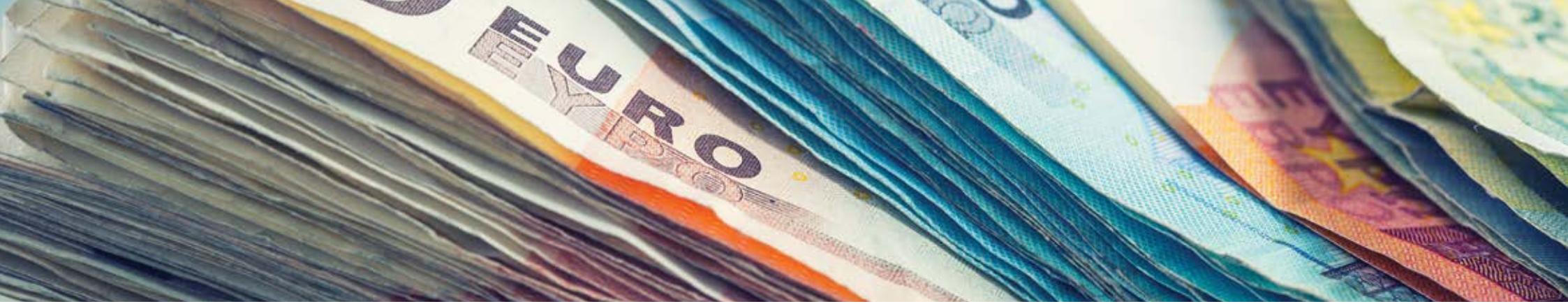
The Financial List is a specialist cross-jurisdictional list set up to handle claims related to the financial markets. It is a joint initiative of the Chancery and Commercial Courts and cases within the list will tried by a pool of specialist judges drawn from both of these courts. Click here to read our earlier article on the Financial List and the sort of claims which might fall within its remit.

This first case, *Banco Santander Totta v Companhia Carris De Ferro de Lisboa SA & Others*, concerns the validity of nine derivative transactions entered into by four Portuguese public transport companies and Banco Santander Totta (the "Bank"). The transport companies have ended up paying interest at very high rates (up to 40%) under some of the swap agreements at a time when Euribor rates have been less than 1%.

The main issues for the court to determine are whether the transport companies had the capacity to enter into the transactions and whether the agreements are binding on them. Arguments about capacity are commonly raised in derivatives disputes involving public and quasi-public bodies who seek to argue that the transactions they entered into were "ultra vires" (i.e. entered into in excess of the organisation's legal powers or authority) and therefore not binding on them. If such bodies are found to lack capacity, banks' contractual claims against them fail and recoveries are limited to smaller amounts under the law of restitution. An appeal in a case dealing with similar issues, *Credit Suisse International v Stichting Vestia Groep [2014] EWHC 3103 (Comm)* was due to be heard by the Court of Appeal back in July but settled at the last moment.

The judgment in *Banco Santander Totta v Companhia Carris De Ferro de Lisboa SA & Others* will be of interest to all those involved in drafting similar agreements or litigating such claims. It will also be interesting to find out whether the experiences of the parties in litigating their case in the Financial List have been favourable. Will the management of the trial and the quality and speed of the judgment encourage other parties to follow suit and transfer or initiate their claims in the Financial List?

We will provide an update on the outcome of the case in due course.



REVISED DRAFT PRE-ACTION PROTOCOL FOR DEBT CLAIMS OUT FOR CONSULTATION

By Stewart Plant (Partner) and Paula Johnson (Senior Professional Support Lawyer)

The Ministry of Justice is consulting on a revised draft Pre-action Protocol for Debt Claims ("Debt Protocol") after an earlier version was lambasted by representatives of the credit industry as being totally disproportionate. The new version attempts to strike a more proportionate balance between the needs of creditors, debtors and debt advisors.

Debt claims make up a huge swathe of the business of the courts. Lord Justice Jackson identified the need for a specific pre-action protocol for such claims in his final report reviewing civil litigation costs. The aim of such a protocol was to ensure that debtors, or alleged debtors, should be provided with sufficient information to enable them to get advice on their position before a claim was issued against them.

However, the draft Pre-Action Protocol for Debt Claims which the Civil Procedure Rule Committee (CPRC) put out for consultation in September 2014 caused consternation amongst the credit industry due to the volume of paperwork and information that creditors would be required to provide. Under its provisions creditors would not only be obliged to provide very detailed statements of account and a raft of other documents and information relating to the alleged debt but also a full copy of the Debt Protocol itself. This was considered disproportionate given that 95% of such claims go undefended.

In 2015 a new sub-committee of the CPRC was formed to consider the draft in light of the consultation responses. Representatives of the Civil Court Users Association, a debt purchaser organisation and a debt advice provider were all co-opted onto the sub-committee to ensure that relevant stakeholders' views were taken into account. That sub-committee has now produced a new draft which has involved a large degree of re-working.

The main change has been to the volume of documentation which creditors will have to provide to alleged debtors as of right. A two stage approach will now be adopted whereby some information will have to be provided as of right with or in the letter of claim, with other information and documents being made available on request and debtors being prompted to consider what information they might want to ask for.

The burden on creditors to supply debtors with a full copy of the Debt Protocol has also gone. Instead creditors will have to provide debtors with a standard Information Sheet which sets out in plain English what their rights and obligations under the Debt Protocol are.

It looks as though creditors will be required to enclose a copy of any written agreement relating to the debt when they send the letter of claim. Creditors had argued that this would be disproportionately costly given that the debtor will already have received a copy of the written agreement when the debt was incurred. Also many creditors' processes are not set up in such a way as to enable them to readily find an agreement relating to an individual's case. In situations where the debt has been assigned, the debt purchaser wanting to initiate proceedings may not have received a copy of the credit agreement from the original creditor.

The sub-committee had sought to reach a compromise on this issue by providing that the written agreement should be provided as of right with the letter of claim "unless providing the agreement is disproportionately burdensome to the creditor". The CPRC was however unanimous in its view that such an agreement should be supplied as of right and that it would be inappropriate for creditors to decide whether it would be disproportionately burdensome to do so. Debt advisors need to be able to see the written agreement in order to be able to advise on compliance with the Consumer Credit Act, limitation issues and unfair contract terms. Having to request a copy of the agreement would simply cause delay. Further, creditors and debt purchasers alike shouldn't be commencing proceedings without checking the underlying agreement and ensuring that there is adequate documentation to support the claim.

The draft is now out for consultation until 11 January 2016. We will provide a further update once the consultation has closed and the Ministry of Justice have confirmed how they intend to proceed. Creditors may need to review how they will go about filing and retrieving written agreements if the requirement to supply the debtor with a copy of the written agreement is retained in the final version of the Debt Protocol.

RECENT DEVELOPMENTS & CASES

A WORD OF CAUTION: DOES YOUR PREPAYMENT INDEMNITY CLAUSE WORK?

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

An earlier version of this article first appeared in the December 2015 issue of Butterworths' Journal of International Banking and Financial Law

The High Court decision in *K/S Preston Street v Santander [2012] EWHC 1633* and the more recent decision in *Barnett Waddington v RBS [2015] EWHC 2435* highlight the importance of careful drafting of prepayment indemnity clauses and the need to seek early legal advice when faced with customer challenges. Both cases concern the construction of prepayment indemnity clauses in fixed rate loan agreements. In each case, the borrowers wanted to prepay the loan early. The banks sought an indemnity for their costs/losses as a result of the early prepayment. The borrowers denied that the banks were entitled to recover any such costs/losses.

In *K/S Preston*, the relevant clause stated that:

"*In addition to any prepayment costs…the partnership shall indemnify the bank on demand against any cost, loss, expenses or liability… which the bank incurs as a result of the repayment of the loan during the fixed rate period…*"

First the court had to decide whether this clause applied to prepayments at all. The borrower argued that the indemnity clause applied only to "repayment" of the loan not "prepayment". It said the loan agreement clearly distinguished between the two and had a separate prepayment clause which set out the fees payable on prepayment. It argued that any ambiguity should be construed against the bank as the drafting party (*contra proferentum*). The bank argued that this analysis was clearly wrong and made no commercial sense in the context of the agreement.

The judge rejected the borrower's argument, finding no ambiguity in the wording. The clause clearly envisaged prepayment of the loan "*during the fixed rate period*".

This left the issue as to what cost(s)/loss(es) the bank could recover. Could it recover both its past and prospective loss of interest at the contractual rate, less what it could earn re-lending the money on the interbank market? The judge noted that because the claim was not based on a breach of contract (as early redemption was permitted under the loan agreement), the law on penalties (and an assessment of **future losses**) did not apply. He therefore held that the bank had to establish its actual incurred loss arising from the borrower's contractual entitlement to prepay early.

The judge thought the use of the word "*incurs*" rather than the phrase "*incurs or to be incurred*" significant. He also noted that the indemnity had to be triggered "*on demand*". He therefore held that the indemnity was limited to the bank's actual crystallised cost(s) or loss(es).

In *Barnett Waddington* when the bank entered into the loan agreement with the borrowers it also entered into an internal hedging arrangement with another department within the bank. The loan agreement provided that the borrowers would indemnify the bank for costs "*incurred in the unwinding of funding transactions undertaken in connection with the Facility*". When the borrowers wanted to prepay the loan, the bank sought to charge them approximately £2m in termination fees which it said was the cost of breaking the internal swap.

The court held that the borrowers were not liable for such fees as the internal swap did not qualify as a "*funding transaction*". It was not a "**transaction**" as the definition of loss in the loan agreement and the indemnity in question

envisaged a transaction between two different legal entities and different departments in the same bank did not qualify as such. Nor could it qualify as a "**funding**" transaction as it was not a transaction entered into by the bank in order to fund the facility to the borrowers.

Lessons/Practical Tips:

The cases emphasise the need to draft indemnity clauses carefully. Note the following key points:

- lenders are likely to face difficulty in evidencing what is actually done with the prepaid sums. In most cases, lenders will not reinvest the prepaid monies and/or terminate any external back-to-back hedge (as most fixed rate loans are hedged on a portfolio basis);
- in principle, banks may be entitled to future losses so long as the clause is drafted widely enough to ensure it captures costs, losses "*to be incurred*" and is not limited to costs "*incurred*";
- when seeking to recover future losses, the safest option will be to include a detailed formula, or even a table, in the loan agreement from which any future loss can easily be calculated. Lenders may also want to include a provision that a certificate calculating the lender's loss will be deemed to be conclusive evidence save for a manifest error;
- both cases referred to above were decided on the construction of their relevant indemnity clauses. Interpretation cases are by their very nature very difficult to call. Each case will be different and the eventual outcome will turn on the individual facts and circumstances and the relevant wording of the clause; and
- lenders should seek early legal advice when faced with an early prepayment fee challenge. A response which gives the impression that a lender has not suffered/will not suffer an actual cost/loss upon early prepayment can both fuel the customer's appetite for litigation and seriously undermine future litigation strategy.

A NEW THORN IN THE SIDE OF CLAIMANTS IN SWAP MIS-SELLING CLAIMS

By Hugh Evans (Partner) and Rachel Tookey (Senior Associate)

In December 2015 the High Court handed down its judgment in *Thornbridge Limited v Barclays Bank PLC* [2015] EWHC 3430 (QB), a swaps mis-selling claim involving an interest rate hedge. The customer lost on all counts. The judgment is helpful for banks facing similar claims in that it demonstrates that, even if there are concerns that a bank may have strayed into the territory of giving advice, the court will consider the relationship as a whole and will distinguish between (a) a salesperson explaining the product they want to sell and (b) an advisor advising on which product to take.

Background

The claimant was a property investment business run by a Mr & Mrs Harrison. In March 2008 Thornbridge sought a loan to purchase a commercial property and Barclays offered a 15 year loan of £5.6m which required the customer to enter into an interest rate hedge.

Mr Burgess of Barclays Capital had several discussions over the phone and by email with Mr Harrison and sent a written presentation setting out the hedging products available. Following these discussions, Thornbridge entered into a 5 year swap at 5.65%. However, when interest rates subsequently fell, Thornbridge paid more for its funding than it claimed it had envisaged.

Thornbridge alleged that:

- the bank advised it to enter the swap;
- the advice was negligent as the product was unsuitable;
- there was a failure to provide adequate information about break costs and other available products; and
- that if properly advised it would have purchased a cap.

Advice

The court looked in detail at the contents of the emails and phone calls and determined that Barclays had not advised or recommended a product. Mr Burgess had not strayed into the role of advisor by giving a view on what might happen to rates in the future; the products were laid out and did not steer Thornbridge towards a swap. Even a response by Mr Burgess that he "was going to suggest that anyway to be honest" did not amount to advice; expressions of opinion had to be viewed in the context of the entire course of dealings. The judge found that this was the expression of a salesman selling his product, not an advisor providing advice. Mr Harrison had understood the options he was being given and ultimately decided on the appropriate one for his company.

The judge noted that Barclays had not received a fee for any purported advice.

Terms of contract

The decision that Barclays had not given advice would have been enough to dispose of the matter but for completeness the judge considered Barclays' terms. The swap confirmation letter contained a non-reliance clause and the judge held this was a basis clause as it reflected the basis upon which the parties had entered into the swap. Accordingly, even if Thornbridge had been right in asserting that advice had in fact been given, the basis clause would have prevented it from asserting as much.
Helpfully, the court also held that the clause was not subject to UCTA but if it had been, it would not have fallen foul of the reasonableness test. This is the first time that a court has held that a bank's derivatives terms meet the UCTA test and is an improvement on an opposite but *obiter* finding in *Crestsign Ltd v (1) National Westminster Bank PLC (2) The Royal Bank of Scotland* [2014] EWHC 3043 Ch ("***Crestsign***").

Information

The judge found that in the absence of an advisory relationship, Barclays did not need to provide full information about the products it was willing to sell so as to enable Thornbridge to take an informed decision on which product to purchase. In her analysis of the law on this point the judge took a narrow approach to Barclays' information duty and in doing so declined to follow the broader analysis of the judge in *Crestsign*.

The judge went on to hold that Barclays could not be criticised for failing to give different illustrations showing falls in interest rates.

Causation

Thornbridge alleged that, if it had been properly advised, it would have opted for a cap and paid the premium. The court, however, found that Mr Harrison was only looking to protect against interest rate rises and would not have opted for a cap. The fact that a cap had the added advantage of not attracting break costs was unlikely to have influenced Thornbridge as a break was not envisaged.

On that basis Thornbridge's claim would have failed on causation as it would have still proceeded with the swap.

The judge also found in favour of Barclays on a number of technical legal points including the incorporation of COBS into the sales contract and rights of action under section 138D FSMA.

How will this impact litigation going forward?

Although the findings are specific to the facts, the judgment contains many positive comments that can be relied on by banks when defending claims. In particular, if there are concerns that a bank has strayed into advice territory and provided views of rate movements, *Thornbridge* shows that the court will look at the relationship as a whole.

Even if there is a risk that a bank may have advised, it may be able to rely on its basis clauses. Additionally, the judgment shows that the court should subject arguments about suitability and allegations that other products would have been taken to careful scrutiny – claimants cannot base their cases on what they now know from hindsight.

COURT OF APPEAL OVERTURNS DECISION IN TITAN 2006-3 v COLLIERS IN FINDING THAT VALUER IN CMBS STRUCTURE WAS NOT NEGLIGENT. COURT CONFIRMS OBITER THAT ISSUER IN CMBS STRUCTURE HAS TITLE TO SUE A VALUER IN A CMBS SECURITISATION.

By Jeremy Andrews (Partner), Paul Smith (Legal Director) and Sean McGuiness (Associate)

In the last edition of Banking Disputes Quarterly, we reported that the Court of Appeal was due to consider the Commercial Court's ruling in *Titan Europe 2006-3 plc v Colliers International UK plc* [2015] EWCA Civ 1083: click here to access our earlier article. The first instance decision was significant as it was the first analysis by an English Court as to whether the SPV issuer of commercial mortgage-backed securities ("CMBS") or the noteholders of the securities was the appropriate claimant to pursue a negligence claim against the valuers of the underlying commercial property. On the facts of this case, the Commercial Court found that the issuer could bring the claim, that the valuer had indeed been negligent, and awarded damages to the issuer. The Court of Appeal has now overturned that decision on the facts, but has confirmed the principle that an issuer may bring a claim in negligence against the valuer in the context of a CMBS structure.

The Commercial Court decision at first instance

Prior to the global financial crisis in 2005, the landlord of a warehouse in Germany sought a loan from Credit Suisse to be secured against the property. Credit Suisse instructed Colliers to value the property and, on the basis of Colliers' valuation of €135 million, advanced a facility of €110 million to the landlord.

The loan was packaged as part of a loan portfolio acquired from Credit Suisse by an SPV, Titan Europe 2006-3 plc ("Titan"), and the noteholders in Titan thus became the ultimate beneficiaries of the loan. In September 2009, following the collapse of Lehman Brothers and the global financial crisis, both the landlord and tenant of the property which Colliers had valued became insolvent. The last payment of rent to the landlord was made in December 2009 and ultimately the security over the property was enforced and the property sold for €22.5 million.

Titan, as the issuer of the notes, brought a claim against Colliers for negligently over-valuing the property. Colliers argued that Titan did not have standing to bring the claim, since it was the noteholders, not Titan as issuer, who suffered the loss, the no-recourse provisions of the notes effectively passing any losses from the loan portfolio to the noteholders. Further, Colliers pointed to the possibility of duplicated liability if both Titan and the noteholders were permitted to bring parallel claims. These were the questions which were of broader interest to participants in the CMBS industry.

The Commercial Court rejected Colliers' arguments, Blair J basing his decision primarily on the contractual framework in relation to the notes, emphasising the importance of the underlying contractual terms to issues of standing and loss in complex financial instrument cases such as this. Here, the contractual framework made Titan responsible for administering the CMBS structure, including taking recovery action where necessary and distributing any sums recovered to noteholders pursuant to the payment waterfall provisions in the securitisation documents. Blair J questioned whether in the circumstances of this case the noteholders could have brought their own claim against Colliers, given the difficulty of establishing reliance and loss in circumstances where the defaulting loan was only one of a number of loans in the portfolio.

As regards the question of Colliers' alleged negligence, Blair J held that Colliers had indeed been negligent and that the true value of the property at the time of the valuation

was €103 million, as opposed to the €135 million valuation given by Colliers. Titan was therefore entitled to sue for damages in the sum of €32 million, being the difference between Colliers' €135 million valuation and the true value of €103 million.

The Court of Appeal decision

The Court of Appeal overturned the decision insofar as it related to Colliers' negligence, finding that the true value of the property of the relevant time was likely to be around €118 million and therefore within an acceptable margin of error from Colliers' valuation of €135 million.

However, the Court of Appeal acknowledged the importance to the CMBS industry of the underlying questions of principle as to who had standing to bring the claim and who had suffered the loss, and therefore considered it appropriate to express its views on an *obiter* basis. On these issues, the Court of Appeal followed Blair J's ruling in the Commercial Court.

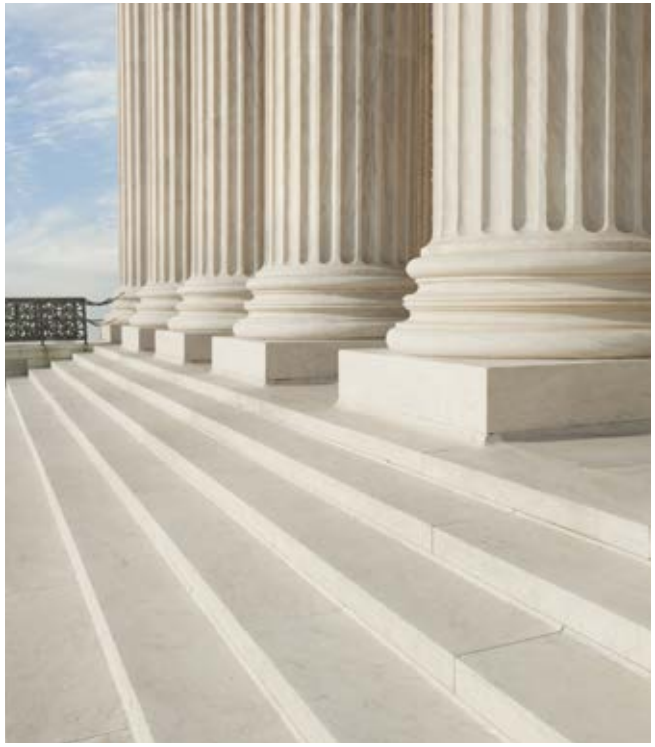
As regards title to sue, the Court of Appeal noted that it would have put primary emphasis on the fact that Titan remained the legal and beneficial owner of the loan and of the securities. The Court of Appeal said that fact of itself gave Titan a right to sue and recover substantial damages.

As regards who had suffered the loss, the Court of Appeal rejected Colliers' argument that Titan had suffered no loss, finding that Titan did sustain a loss at the point it acquired the loan from Credit Suisse, because the price Titan paid for the loan portfolio was based on the over-valuation of the property, and was therefore too high.

The Court of Appeal drew an analogy between Titan and its noteholders and the relationship between a company and its shareholders, noting that: *"no one suggests that, because the shareholders may be the ultimate losers in a case of this kind, the company has not suffered a loss"*. The court also noted that if the noteholders had brought their own claim separate from the claim by Titan, Colliers might have argued that the loss claimed by the noteholders was reflective of Titan's loss and should thus be defeated by the doctrine of reflective loss, as exemplified by *Johnson v Gore Brown* [2002] 2 A.C. 1.

Comment

The Court of Appeal's confirmation of the principles underlying the Commercial Court's first instance judgment is significant. These decisions resolve previous uncertainty as to the possibility of an issuer bringing a negligence claim against a valuer. Going forward, issuers, investors and other participants in the CMBS market should proceed on the basis that such claims may well be possible in the English Courts, subject to careful review in each case of the specific terms of the relevant contractual documents.



SUPREME COURT CLARIFIES SCOPE OF FREEZING ORDERS IN CONTEXT OF LOANS

By Jamie Curle (Partner), Paul Smith (Legal Director) and Yasmin Bailey (Associate)

In the long-running saga of JSC BTA Bank's claims against its former chairman and majority shareholder, Mukhtar Ablyazov, the Supreme Court recently handed down a judgment clarifying the scope of the standard form freezing order. In JSC BTA Bank v Ablyazov [2015] UKSC 64 the Supreme Court considered in particular the meaning of "asset" under the terms of a freezing order granted in 2009 against Mr Ablyazov, and whether by instructing his lenders to pay the proceeds of certain loan agreements to his lawyers, co-defendants and other recipients, Mr Ablyazov had breached the terms of the freezing order.

The Supreme Court partially overturned the decision of the Court of Appeal, holding that the proceeds of these loan agreements were indeed "assets" on the basis that the respondent had the power to directly or indirectly dispose of, or deal with those proceeds as if they were his own, and that Mr Ablyazov had therefore breached the freezing order.

Background

Mr Albyazov was formerly the chairman and majority shareholder of JSC BTA Bank (the "**Bank**"). Following the Bank's nationalisation in 2009 Mr Albyazov fled to England, where he was subsequently pursued by the Bank which commenced 11 sets of proceedings seeking recovery of some US$ 10 billion that Mr Ablyazov had allegedly misappropriated. In November 2009, the Bank successfully obtained a freezing order against Mr Albyazov (the "**Freezing Order**"), paragraph 5 of which stated that the Freezing Order applied to

"all the respondents' assets whether or not they are in their own name and whether they are solely or jointly owned and whether and whether or not the respondent asserts a beneficial interest in them. For the purpose of this Order the respondents' assets include any asset which they have power, directly or indirectly, to dispose of, or deal with as if it were their own. The respondents are to be regarded as having such power if a third party holds or controls the assets in accordance with their direct or indirect instructions".

This wording is taken from the standard form freezing order found at appendix 5 of the Admiralty and Commercial Courts Guide (which differs from the pre-2002 form of order by providing for an "*extended definition*" of assets).

Mr Albyazov had entered into a number of loan agreements between 2009 and 2010 with companies registered in the BVI. Whilst the Supreme Court proceeded on the basis that these were valid and binding loan agreements, it noted the Bank's position and the earlier Commercial Court judgment of Christopher Clarke J that there was "strong ground for believing" that these companies were "creatures or conduits" set up by Mr Ablyazov, although this does not appear to have affected the Supreme Court's reasoning. Mr Ablyazov had exercised his draw down rights under those loan agreements in full, by directing the lenders to make various payments, most significantly payments of over US$16 million to Mr Ablyazov's former solicitors.

The Bank's case was that Mr Ablyazov's instructions in this regard amounted to a breach of the Freezing Order. However, the Bank's case had been dismissed at both first instance and by the Court of Appeal, and the Bank therefore appealed to the Supreme Court. Notably, there was no dispute as to the *validity* of the Freezing Order and whether it should have been ordered in the first place – the dispute related solely to the scope and interpretation of the Freezing Order.

The Supreme Court's Analysis

The Supreme Court considered three issues:

1. whether the respondent's right to draw down under the loan agreements was an "*asset*" within the meaning of the Freezing Order;

2. if so, whether the exercise of that right by directing the lenders to pay sums to third parties constituted "*disposing of*" or "*dealing with*" or "*diminishing the value*" of an "*asset*"; and
3. whether the proceeds of the loan agreements were "*assets*" within the meaning of the extended definition in paragraph 5 of the Freezing Order on the basis that the respondent had power "*directly or indirectly to dispose of, or deal with* [the proceeds] *as if they were his own*".

Lord Clarke, who gave the agreed sole judgment, gave a negative answer to the first two of these questions but upheld the Bank's appeal on the third issue.

Lord Clarke began by reviewing the various arguments made in the Court of Appeal, which were rehearsed before the Supreme Court, regarding the correct approach to the construction of freezing orders. Various principles of approach and construction were advanced, including the "*enforcement principle*", the "*flexibility principle*" and the "*strict construction principle*". From these principles Lord Clarke distilled some key guidance as to the approach the Court should take when considering the scope of freezing orders:

1. "*The sole question is what the Freezing Order in fact made means. It is also important to note that the answer to the question of construction does not depend upon any analysis of the respondent's conduct*" (paragraph 16);
2. "*If it is desirable that a broader meaning should be given to* [the freezing order] *than is appropriate applying ordinary principles, the solution is not to give it a meaning which it does not have but to vary the order (and the relevant standard form of order) appropriately for the future*"; accordingly, the flexibility principle is not relevant (paragraphs 17 and 18);
3. "… *orders of this kind are to be restrictively construed in accordance with Beatson LJ's strict construction principle*", which had been explained by Beatson LJ in paragraph 37 of his Court of Appeal judgment where he said that "*because of the penal consequences of breaching a freezing order and the need of the defendant to know where he, she or it stands, such orders should be clear and unequivocal, and should be strictly construed*" (paragraph 19);
4. "*The expression 'assets' is capable of having a wide meaning. For example, it can include a chose in action. However, like any document, a freezing order must be construed in its context. That includes its historical context*" (paragraph 21).

Lord Clarke went on to consider the meaning of the term "*assets*", noting that it "*is capable of having a wide meaning*" and "*can include a chose in action*". Lord Clarke reviewed a number of relevant cases referred to in the Court of Appeal and in submissions before the Supreme Court, and while he recognised that the definition of assets had been cautiously and gradually extended over time by amendments to the standard form freezing order, he concluded with the summary that "*[t]he cases and legal writings referred to above show that there has over the years been a settled understanding that borrowings were not covered by the standard form of freezing order*" (paragraph 34). Lord Clarke did not consider it appropriate for the Supreme Court to

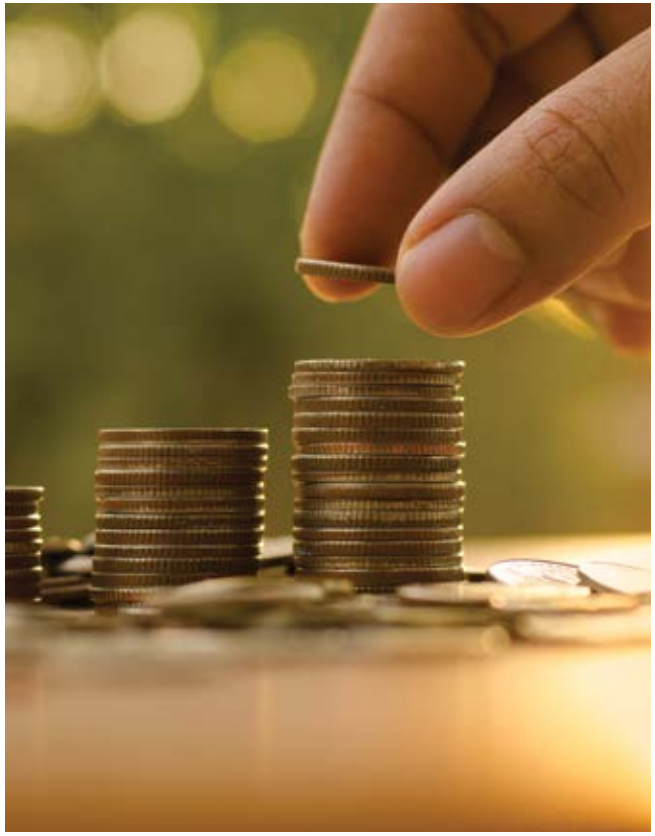
reverse the previous cases, which would effectively overturn the clarity and certainty which the courts and legal commentators had come to attach to the meaning of the standard form freezing order as it was up to 2002. On this basis, Lord Clarke found against the Bank in relation to the first two questions outlined above, since the Bank's arguments on these questions relied upon the old standard wording of the freezing order.

However, in relation to the third question, Lord Clarke considered that the Court of Appeal had taken too narrow an approach to the extended definition of assets found in paragraph 6 of the current standard form freezing injunction at appendix 5 of the Admiralty and Commercial Courts Guide (paragraph 5 of the Freezing Order in the present case). The relevant wording of the extended definition was as follows: "*the respondents' assets include any asset which they have power, directly or indirectly, to dispose of, or deal with as if it were their own*". Lord Clarke observed that "*the whole point of the extended definition of "assets" is to catch rights which would not otherwise have been caught*". Here, although Mr Ablyazov did not own the relevant assets, under the terms of the loan agreements he had the power to directly or indirectly dispose of or deal with them as if they were his own. The fact that by drawing down the loans Mr Ablyazov would incur a liability at some stage to reimburse the lender was rejected by Lord Clarke as immaterial.

Significance

This Supreme Court decision provides important guidance as to the approach to be taken when construing the specific terms of a freezing order. It also makes clear that a respondent subject to a freezing order will need to act in accordance with the terms of the order when exercising any contractual rights under a loan agreement or overdraft facility, since the funds available pursuant to such arrangements will fall within the extended definition of assets under the standard form freezing order.

However, a potential grey area is opened up by Lord Clarke's conclusion that the focus of the extended definition "is *not on assets which the respondent owns (whether legally or beneficially) but on assets which he does not own but which he has power to dispose of or deal with as if he did*". It is likely that claimants will seek to rely on this formulation to apply freezing injunctions to the assets of companies or other vehicles which they say are controlled by a single director, shareholder or other individual respondent.



SPOTLIGHT ON...

NEW YORK PROPOSES NEW FINANCIAL REGULATIONS THAT THREATEN CRIMINAL CONSEQUENCES FOR SENIOR FINANCIAL EXECUTIVES

By Richard F. Hans (Partner), Kevin Walsh (Partner), Douglas Walter Mateyaschuk (Partner)

Citing "*heightened global security concerns*," New York's Governor Andrew Cuomo and New York's Department of Financial Services (NYDFS) have proposed a set of new financial regulations that include requiring banks' chief compliance officers (CCOs) to certify that their institutions maintain robust anti-terrorist financing and anti-money laundering programs, with potential personal criminal consequences to the officers for providing false or misleading certifications.[1]

These proposals come after a recent series of terrorist financing and anti-money laundering investigations have resulted in significant fines imposed against banking institutions that the NYDFS found to have "*shortcomings in the transaction monitoring and filtering programs*" and "*a lack of robust governance, oversight and accountability at senior levels*."[2] In announcing these proposed regulations, Governor Cuomo stated that "*it is especially vital that banks and regulators do everything they can to stop the flow of illicit funds*," adding that "*[m]oney is the fuel that feeds the fire of international terrorism*."[3] These proposals are subject to a 45-day public notice and comment period before becoming final.

Transaction Monitoring And Watch List Filtering Programs Defined

Although there has been broad adoption among financial institutions operating in New York State of programs and policies to monitor accounts and transactions for suspicious activity, the proposed regulations impose stringent requirements as to what those programs and policies must include. Now each regulated institution, including banks chartered pursuant to the New York Banking Law, and all branches and agencies of foreign banking corporations licensed pursuant to that law, must maintain a "Transaction Monitoring Program" that maps BSA/AML risks to the institution's businesses, products, services and customers/counterparties.[4] This proposed program must "*at a minimum*" be subject to ongoing end-to-end, pre-and post-implementation testing and incorporate all current BSA/AML laws, regulations and alerts, as well as "*any relevant information available from the institution's related programs and initiatives, such as 'know your customer due diligence,' 'enhanced customer due diligence' or other relevant areas, such as security, investigations and fraud prevention*."[5]

Regulated institutions are also required to maintain a "Watch List Filtering Program" designed to interdict transactions, before their execution, that are prohibited by applicable sanctions (including OFAC) and internal watch lists. This program must "*at a minimum*" (i) be based on technology or tools for matching names and accounts (such as, but not necessarily, software that employs "fuzzy logic" and accounts for "culture-based name conventions"); (ii) utilize watch lists that reflect

current legal or regulatory requirements; and (iii) be subject to on-going analysis to assess its performance and whether it continues to "*map to the risks of the institution.*"[6]

The proposed regulations, which will, if adopted, layer onto the existing and extensive federal and state laws and regulations, also include ongoing government and management oversight and data integrity and verification requirements that apply to both the Transaction Monitoring and Watch List Filtering Programs.[7] And each program is also required to be tailored to a "Risk Assessment of the institution" which "*takes into account, among other things, the institution's size, businesses, services, products, operations, customers/counterparties/other relations and their locations, as well as the geographies and locations of its operations and business relations.*"[8]

Annual Certification Of Compliance Required

The provisions of the new regulations that should be of most concern to managers are Sections 504.4 and 504.5. Under Section 504.4, each regulated institution is required to submit by April 15th of each year a certification of compliance duly executed by its CCO or "*their functional equivalent*" (the Annual Certification). Under Section 504.5, in addition to stating that all regulated institutions are subject to penalties for non-compliance with these rules, **a certifying senior officer "*who files an incorrect or false Annual Certification also may be subject to criminal penalties for such filing.*"**

The proposed text of the Annual Certification is as follows:

"In compliance with the requirements of the New York State Department of Financial Services (the "Department") that each Regulated Institution maintain a Transaction Monitoring and Filtering Program satisfying all the requirements of Section 504.3 and that A Certifying Senior Officer of a Regulated Institution sign an annual certification attesting to the compliance by such institution with the requirements of Section 504.3, each of the undersigned hereby certifies that they have reviewed, or caused to be reviewed, the Transaction Monitoring Program and the Watch List Filtering Program (the Programs) of (name of Regulated Institution) as of _____ (date of the Certification) for the year ended_____(year for which certification is provided) and hereby certifies that the Transaction Monitoring and Filtering Program complies with all the requirements of Section 504.3.

By signing below, the undersigned hereby certifies that, to the best of their knowledge, the above statements are accurate and complete."

The proposed rule seems to establish an almost strict criminal liability, as it appears to impose such penalties without any consideration of *scienter*. However, it is unclear how this rule will be interpreted in light of the Annual Certification's requirement for CCOs to certify that their institutions are in compliance with the rules "*to the best of their knowledge*." The proposal does not state what the criminal penalties will be or under what law they will be imposed.

Continuing Trend Of Personal Liability

These proposed certification requirements raise significant concerns and risks for senior financial executives, most particularly the CCOs, and reflect an increased regulatory focus on individual liability. Aggressive civil enforcement actions have been brought in the past year by the U.S. Department of the Treasury and the Securities and Exchange Commission (SEC) against CCOs, the most noteworthy of which is that taken against Thomas Haider, the former chief compliance officer of MoneyGram International. The US Financial Crimes Enforcement Network (FinCen) initially fined Haider $1 million for allegedly not ensuring that his former employer followed AML laundering laws; the government subsequently filed a civil action to reduce the assessment to judgment and to

enjoin Haider from ever working at a financial institution. In his defense, Haider has argued that the penalty assessed by FinCen may only be imposed on a financial institution, not an individual, and that FinCen's assessment procedures were so deficient as to deprive him of due process.[9]

Similar enforcement actions have been filed by the SEC in 2015 against CCOs for alleged violations of the Investment Company Act and the Investment Advisers Act. These actions have prompted dissent from Commissioner Daniel Gallagher, who sees these initiatives as counter-productive because, in imposing what is essentially a strict liability standard, they send "*a troubling message that CCOs should not take ownership of their firm's compliance policies and procedures, lest they be held accountable…*"[10] In the same statement, Commissioner Gallagher also noted that some of the blame for inadequate compliance rested with the agency itself, which "*in the eleven years since the rule was adopted, [had] not issued any guidance about how to comply with the rule.*"

The proposed NYDFS rulemaking takes the risks to CCOs beyond the civil realm and to a new and more serious level, that of potential criminal liability.

Conclusions

The new proposed rules demonstrate an increasing, and to some industry observers, alarming, focus on personal liability for senior financial executives charged with overseeing anti-terrorist financing and anti-money laundering compliance. While these proposals may be revised subject to public comment, and may ultimately be challenged in the courts, regulated institutions must now evaluate their compliance programs and policies in light of these new regulations, and be prepared to make those changes—which in some cases may be significant—that will be required to ensure compliance. In light of the draconian potential penalties that they now confront, CCOs and their employers must closely evaluate their potential liability exposure as a result of the Annual Certification requirement and, should they nevertheless wish to continue in their roles, assess how best to assume and fulfil their obligations in satisfaction of the new regulations.

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1 NY Dep't of Fin. Services, Press Release: Gov. Cuomo Announces Anti-Terrorism Reg. Requiring Senior Fin. Executives to Certify Effectiveness of Anti-Money Laundering Sys. (Dec. 1, 2015) (hereinafter "Dec. 1 Press Release").

2 NY Dep't of Fin. Services, Superintendent's Regs., Banking Div. Transaction Monitoring And Filtering Program Requirements And Certifications, §§ 504.1-504.6 (Dec. 1, 2015) available at http://www.dfs.ny.gov/legal/regulations/proposed/rp504t.pdf (last accessed Dec. 3, 2015) (hereinafter "Dec. 1 Regs.).

3 Dec. 1 Press Release.

4 Dec. 1 Regs., § 504.4(a).

5 Id. (listing additional attributes that must be included in the Transaction Monitoring Program).

6 Id., § 504.4(b) (listing additional attributes that must be included in the Watch List Filtering Program).

7 Id., § 504.4(c) (listing additional requirements that pertain to both programs).

8 Id., §§ 504.2-504.3.

9 This case remains pending (U.S. Department of the Treasury v. Thomas E. Haider, No. 0:15-cv-01518-DSD-HB (D. Minn.) (filed Dec. 18, 2014)).

10 US SEC, Statement of Recent SEC Settlements Charging Chief Compliance Officers With Violations of Investment Advisers Act Rule 206(4)-7 (June 18, 2015) available at http://www.sec.gov/news/statement/sec-cco-settlements-iaa-rule-206-4-7.html (last accessed Dec. 3, 2015).