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Introduction

Welcome to the latest edition of our financial litigation roundup. In this edition, we consider recent judgments and ongoing cases from the banking and financial world in the UK and Hong Kong, as well as legal developments across those jurisdictions.

London

RPC continues to build on its status as one of the few premier tier banking and finance litigation specialists which is able to service market counterparties against major banking institutions due to its predominantly conflict free position. We are proud to note that Chambers and Legal 500 both now recognise us as being in the highest bracket of conflict free firms operating in London's financial markets disputes sector, as well as well-earned individual rankings and reviews for our partners.

You can now follow more informal regular news and views from the department on Twitter @conflictfreeRPC.

Hong Kong and Singapore

RPC welcomed a new dispute partner in Hong Kong in October 2017. Jonathan Crompton specialises in banking and finance related disputes, including advising financial services firms on white-collar and regulatory investigations, and cross-border litigation. Jonathan's arrival comes at the same time as Jonathan Cary's relocation back to London after three years in the Hong Kong office. Jonathan Cary will continue to work closely with the team in Hong Kong and Singapore.

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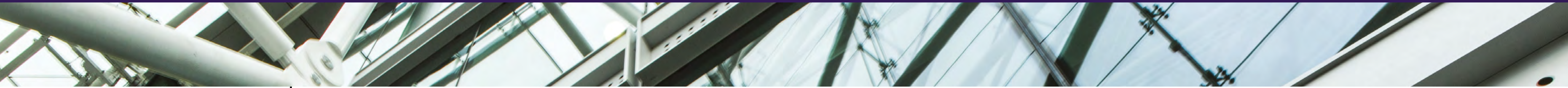

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Developments of note

- The Lloyds Shareholder group action is in trial (scheduled for 12 weeks which commenced in October). This group action relates to losses (put at £600m) which it is alleged the shareholder claimants suffered as a consequence of Lloyds' takeover of Halifax Bank of Scotland.
- The holdout claimants in the RBS Shareholder group action reached a last minute settlement with the bank for 82p per share, after an adjournment of the trial in June 2017 to allow negotiations to continue. A number of satellite disputes have arisen, including reported actions between groups of shareholders who settled at different stages in relation to the allocation of costs between them, and in relation to the distribution of the settlement monies received from RBS.
- *Fortress & Ors v BNP Paribas & Ors* – the "Golden Belt" litigation – is in trial. The case stems from the collapse of the Saad group in 2008, and concerns a $650m Sukuk transaction entered into with Maan al-Sanea, the chairman and principal of the Saad Group. The Trustee (Golden Belt 1 Sukuk Company) and various hedge fund investors are suing BNP Paribas, as arranger, manager, and bookrunner, for damages arising from its alleged failure to obtain a signature on the deal documentation from Maan al-Sanea in the "wet ink" form necessary to make it binding in Saudi law, with the result that Saudi proceedings against Maan al-Sanea are unlikely to give any recovery. In a connected case, the Trustee of the structure previously obtained summary judgment under the document equating to the Trust Deed. As this newsletter went to press, the judgment was handed down in the case against BNP Paribas, with the claimants succeeding in their claim for damages against BNP Paribas. A fuller analysis of the judgment will be provided in the next edition.
- Societe Generale and the Libyan Investment Authority reached a settlement of their previously reported dispute over $2.1bn of derivative trades which the LIA said it had been procured into entering through fraud and bribery. The settlement sum paid by UBS to the LIA has been reported as being $963m. The LIA is now seeking to sue Bear Sterns (now JP Morgan), Dresdner Bank (now Commerzbank), Credit Suisse and BNP Paribas on similar grounds, and has been taking steps to obtain approval to use the disclosure in the Soc-Gen action to assess those potential claims.
- A significant amount of tension has arisen in the CDS markets as a consequence of controversial ISDA Determinations Committee decisions and non-determinations in relation to recent defaults in the bond and loan markets. As yet, there is no visible litigation which has arisen but we are aware that credit protection buyers are actively looking at potential rights of action.
- *Bank Mellat v HM Treasury*: the Iranian bank's claim against the UK government, stemming from imposition of sanctions, is set down for trial in November. The long running dispute saw Bank Mellat lose a succession of hearings before the UK courts before enjoying a reversal of fortunes in the ECJ, which ruled that it was not a state-owned institution. The upcoming hearing is to determine an assessment of damages.
- The appeal in the LIBOR/swaps misselling case of *The Property Action Group v RBS* is set down for a 7 day hearing commencing on 29 January 2018. This appeal has been set up as a test case for all LIBOR related misselling claims, and will be decided on that basis.

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UBS AG and UBS Limited v Kommunale Wasserwerke Leipzig GmbH and others

This Court of Appeal judgment was the result of a very unusually broad permission to appeal from the first instance decision in which it was found that Kommunale Wasserwerke Leipzig GmbH (KWL) had been procured by the fraud of an agent (Value Partners) acting for UBS in paying bribes to a principal of KWL to induce it into entering into a series of single tranche collateralised debt obligations (STCDOs).

The Court of Appeal also found for KWL on a majority decision, but changed the basis for that finding. As Value Partners had been advisers to KWL, the appellate judges did not agree that it had been acting as UBS's agent in paying the bribes to KWL's principal. However, they did find that UBS's conscience was sufficiently affected by the existence and knowledge of the bribe paid by Value Partners to KWL to mean that it would unconscionable to allow UBS to enforce the STCDOs. (The majority did not accept, as was suggested in the dissenting judgment, that this was to "*misapply the moral standards of the vicarage to a commercial transaction*"). The Court of Appeal also held that KWL was entitled to rescind because of Value Partner's undisclosed conflict of interest, holding that the KWL principal's knowledge of the conflict of interest could not be attributed to KWL which had therefore not waived that conflict.

The full judgment dealt with a wide range of other issues due to the breadth of the permission to appeal (reflecting the serious nature of the findings against UBS) and can be found at http://www.bailii.org/ew/cases/EWCA/Civ/2017/1567.html.

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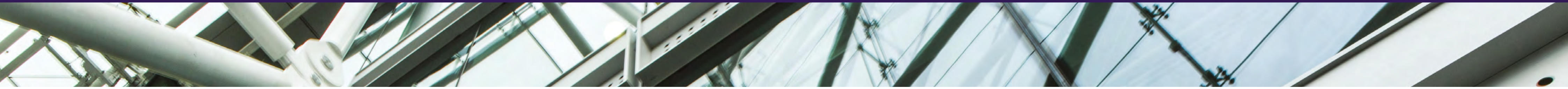
Secure Capital SA v Credit Suisse AG

This Court of Appeal judgment handed down by David Richards LJ concerned the contractual rights of holders of immobilised bearer notes issued by Credit Suisse, and in particular the rights of those holders who acquired their rights through the Clearstream system. Secure Capital asserted claims based on allegedly misleading statements made in the issuance documentation, in breach (it alleged) of contractual terms providing that statements in the issue documentation were true and accurate in all material respects.



Secure Capital was appealing against a first instance decision which found for Credit Suisse on a summary judgment application. The application was granted on the basis that Secure Capital did not have any contractual relationship with the Credit Suisse as the issuer, so could not bring a claim for breach of the contractual provision. The Court of Appeal dismissed the appeal. The judgment is well worth the read for anyone with an interest in the trading of fixed income securities and/or the intersection of electronic clearing systems with ownership rights in securities.

The judgment can be found at http://www.bailii.org/ew/cases/EWCA/Civ/2017/1486.html.

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Dana Gas PJSC v Dana Gas Sukuk Limited

Dana Gas PJSC (Dana Gas), the UAE energy company, has caused a huge stir in the Islamic financing markets with its attempts to force a restructuring of its $700m Sukuk al Mudarabah (Islamic finance equivalent of bond) facilities.

As part of its strategy, Dana Gas has sought a ruling from the Federal Court in the Emirate of Sharjah that the facility is not Shariah compliant and is therefore unlawful and unenforceable. It also obtained an injunction from the Sharjah court restraining the Sukuk entity (the functional equivalent of a bond trustee) from enforcing facility agreements.

The English proceedings initially arose because Dana Gas brought proceedings in London against the Sukuk entity challenging the validity of the facility agreements (and also obtained from the English court an injunction restraining any enforcement of facility agreements). On being required by the English court to make a decision as to whether to pursue proceedings in England or in the UAE, Dana Gas elected to proceed in England. It was therefore ordered to seek a stay of the UAE proceedings and a release of the UAE injunction. An expedited English trial was ordered for October 2017.

However, Dana Gas did little to discontinue the UAE proceedings until a further order was made against it by the English court in July. It then belatedly made an application to the UAE court to discharge the UAE injunction. However, shortly afterwards, shareholders in Dana Gas lodged another application before the Sharjah court seeking dismissal of Dana Gas's application and an antisuit injunction prohibiting all parties to the UAE proceedings from taking any steps in the English courts. Ultimately, the Sharjah court granted both of those remedies, and as a result Dana Gas and the Sukuk entity concluded that they could not continue with the English trial.

At that point, days before the scheduled trial date, Blackrock, as a substantial holder, stepped in directly and sought and obtained an interim anti-suit injunction from the English court preventing Dana Gas and the Sukuk from taking any steps in the Sharjah proceedings. Blackrock then applied to become an additional party to the English proceedings, effectively to step into the shoes of the Sukuk defendant, and for the English trial to proceed as planned (with or without the participation of Dana Gas).

The court concluded that the trial should proceed as planned, with an opportunity for Dana Gas to make representations at a later date before judgment if it succeeded in having itself released to do so by a lifting of the UAE anti-suit injunction. The high stakes collision between jurisdictions is set to continue, with potentially hugely significant impacts for the Islamic finance markets.

Shortly before press, the English court handed down substantive judgment after the short trial. The defendant Sukuk was not present at trial, having failed to get a release from the Sharjah court in time – the English court refused a request for a postponement of the hearing. Unsurprisingly, the Court held that the Sukuk was liable to the "bondholders" in English law – the alleged non-compliance with Shariah law was not in relation to and could not affect the English law part of the structure.

The final judgment can be found at http://www.bailii.org/ew/cases/EWHC/Comm/2017/2928.html.

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Deutsche Bank v CIMB Bank Berhad

This dispute is between the London branch of Deutsche Bank (DB) as the confirming bank under a series of letters of credit and the Singapore branch of the Malaysian issuing bank (CIMB).

The underlying facts have given rise to serious allegations of fraudulent trading as between other parties, which are being fought out in Singapore proceedings.

In the London proceedings, DB seeks to recover from CIMB as the issuer of the letter of credit €10m which DB paid out to the seller of the underlying goods. CIMB defends the claim on the basis that the documents presented to DB were non-conformant, and is not admitting that DB made the payments.

The judgment arose in the context of a procedural Request for Further Information made by CIMB of DB's pleading that it had paid out the £10m. The point is short, but significant. As framed by Mr Justice Blair: *"The issue is whether the issuing bank can inquire at all as to whether the confirming bank has made payment, or whether it must simply take the confirming bank's word for it."*

Somewhat surprisingly, there was no prior case law directly dispositive of this point one way or the other. Mr Justice Blair drew on a range of supporting quotations from cases and textbooks in finding that the confirming bank was obliged to prove that in fact it had made payment to the beneficiary. Accordingly, DB was ordered to plead a response to CIMB's Request for Further Information of how DB had made those payments.

The judgment can be found at http://www.bailii.org/ew/cases/EWHC/Comm/2017/1264.html.

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AMT Futures Ltd v Dr Klaus Gloeggler

Partial summary judgment was obtained by AMT against the defendant, in proceedings stemming from AMT's provision of derivatives brokerage services to German nationals. The judgment itself is not remarkable, and simply reflects the fact that AMT's contractual terms of business required its customers to submit to English law and jurisdiction.

What makes the matter of some interest is that is an example of continued jurisdictional friction between the English and various German courts in relation to derivative transactions marketed out of London to German retail investors. The core issue is the extent to which the contractual law and jurisdiction clauses bind the customers in in relation to claims framed in tort (delict). The English courts are firmly of the view that such elections are effective in encompassing tortious claims arising from the trading carried out under the contracts. The German courts have been more sympathetic to the notion that the tortious liability does not fall within the contractual election. Those tussles continue.

The judgment can be found at http://www.bailii.org/ew/cases/EWHC/Comm/2017/836.html.

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Court of Appeal judgment in Dexia Crediop S.P.A. (Appellant) v Comune di Prato

The Comune di Prato case is one of a line of cases involving European municipal authorities who entered into swap arrangements on terms which turned out to be disadvantageous, and have since sought to invalidate the arrangements on the basis that the contracts were entered into ultra vires or in breach of applicable local law and thus void or voidable. In essence, developments of the 1990s *Hazell v Hammersmith & Fulham LBC* defence, with multi-jurisdictional complications thrown in for good measure.

At first instance, the Comune had lost on its legal capacity/ultra vires arguments, but had succeeded in nullifying the swap arrangements. It persuaded the judge that under Article 3(3) of the Rome Convention (the swap contracts were entered into before Rome 1 Regulation came into force) a provision of an Italian legislative decree applied to the contracts and required a 7 day cooling off period to be included in them. As no such cooling off period had been included, the judge found the swaps contracts were voidable by the Comune under the provisions of that Italian decree.

The Court of Appeal upheld the court of first instance on the legal capacity arguments, finding that the relevant provisions of Italian constitutional law did not preclude the Comune from having the power to enter into the swaps.

The Court of Appeal went on to find that the judge had reached an incorrect decision on the application of the Rome Convention. The applicable part of the Rome Convention provides that "*The fact that the parties have chosen a foreign law … shall not, where all the other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of rules of the law of that country which cannot be derogated from the contract*" (our emphasis). At first instance, the judge had accepted the Comune's arguments that all the elements relevant to the situation were connected with Italy: that was the place both parties were incorporated, the place of all communications and the place the swaps were entered into and performed.

The Court of Appeal overturned the first instance decision on this point, finding that the "*use of the ISDA Master Agreement is self-evidently not connected with any particular country and is used precisely because it is not intended to be associated exclusively with any such country*". The international dimension of the swaps markets and the fact that Dexia had entered into back-to-back trades with non-Italian counterparties were both held to be reasons why not all the elements relevant to the situation were connected only with Italy. As such, local Italian law could not override the parties' contractual incorporation of English law.

The judgment can be found at http://www.bailii.org/ew/cases/EWCA/Civ/2017/428.html.

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Deutsche Bank v Comune di Savona

This is another case concerning a jurisdictional battle over swaps sold to Italian municipalities under standard ISDA terms imposing exclusive English law and jurisdiction (the English Clause). In this case, the position was complicated by the entry into a prior advisory agreement between Deutsche Bank (DB) and the Comune which contained an exclusive Italian jurisdiction clause (the Italian Clause).

Following a critical review of the swaps in issue by an Italian Court of Auditors, DB commenced in London seeking negative declarations that it had no liability to the Comune). The Comune subsequently commenced proceedings in Italy.

The judgment concerned an application by the Comune di Savona to strike out parts of DB's claims on the basis that they concerned matters which fell within the ambit of the Italian Clause, and to stay the remainder of the proceedings pending the Court of Appeal case in the Comune di Prato case above.

In his judgment, HHJ Waksman QC found that the Comune di Savona 's claims in the Italian proceedings related to advice provided by DB which in major part arose from and out of the prior advisory agreement, and so fell within the ambit of the Italian Clause. Given the existence of competing jurisdiction clauses, and following prior authority, the aim was to construe those clauses as each having mutually exclusive scope as far as possible. The judge rejected the contention that the English Clause, because it was contained in ISDA market standard terms, had to be given a universally consistent interpretation: the advisory agreement and its Italian Clause had to be taken into account in construing the ISDA Master Agreement's English Clause.

Against that background, the judge found that many of the declarations sought by DB concerned matters which fell within the Italian Clause, in essence because they concerned advice. In a significant win for the Comune, the claims for those declarations were struck out on the basis that they concerned matters to be determined in Italy. Notably, the claims for those declarations had in large part been founded on contractual estoppel provisions in the ISDA documentation. The judge refused to accept that those could be viewed in isolation from the underlying conduct, and so the effect of those fell to be determined by the Italian court in considering the claims for mal-advice and misrepresentation which were within its purview under the Italian Clause.

Judgment can be found at http://www.bailii.org/ew/cases/EWHC/Comm/2017/1013.html.

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UBS v (1) Glast Trust Corporation Limited and (2) Fairhold Securitisation Limited

This matter concerned the extent of a Note Trustee's ability to recover costs incurred in relation to the rights of Noteholders, where the costs related to advice provided to the Noteholders and not to the Note Trustee.

The underlying transaction involved a securitisation of sheltered housing assets in the UK, the income from which has been underperforming. Fairhold is the SPV issuer. Glast Trust Corp (GTC) is the Trustee. UBS is a swap counterparty to the issuer, and as such a beneficiary to the Trustee's security rights.

The Noteholders formed an action group and sought advice from Freshfields and Rothschild, incurring £2.5m of fees. They also secured the appointment of GTC as a replacement Trustee. Subsequently, by resolution, the Noteholders directed the Trustee to enter into fee agreements with Freshfields and Rothschild to cover past and future costs.

In the meantime, UBS had exercised an alleged right to early termination of the swaps, and was claiming in excess of £300m from the Issuer. At the instigation of the Noteholders, GTC refused to make any payment to UBS on the basis that the Issuer has rescinded the swaps because of alleged misrepresentations by UBS.

The issue arose because, under the applicable payment waterfall, the Trustee's costs and expenses ranked first in priority, before UBS, in turn before the Noteholders.

At the hearing, the Trustee had modified its position that it was entitled simply to adopt the costs incurred by the Noteholder action group, and accepted that it was bound to review those and exercise an independent discretion as to whether they were incurred for the defined contractual purposes. The court endorsed this approach, noting that the powers to recover costs were always broad for Note Trustees, but not unlimited. The order made put in place a protocol by which the Trustee would have to seek from the relevant advisors a breakdown of the fees and on what they were incurred – and whether they fell within the contractual provisions. UBS would then be given an opportunity to object, with all parties having liberty to apply to the court for further directions.

Judgment can be found at http://www.bailii.org/ew/cases/EWHC/Comm/2017/1788.html.

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RBS rights issue litigation

In the last stages of the attritional settlement with the various groups of claimants in the RBS rights issue case, an application was made by RBS against two of the litigation funders standing behind the hold-out claimant groups, seeking orders for security for costs. The application against one of the funders was granted, the other was refused. The detailed basis for those decisions will inform future decisions (and can be found at http://www.bailii.org/ew/cases/EWHC/Ch/2017/1217.html). In an unexpected step, the court also imposed as a condition of the order that RBS should provide a cross-undertaking in damages to the litigation funder providing the security for costs.

The judgment was otherwise most notable for the *"very great concern"* Mr Justice Hildyard expressed about *"the extraordinary (indeed, in my experience, unparalleled)"* RBS defence costs (which had been estimated at the time of this application to be £129m through to trial).

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Lehman Waterfall cases

The final stages of the insolvency proceedings for Lehman Brothers International Europe Limited (LBIE), the London trading arm of Lehman, are drawing closer. Two judgments were issued this summer, and a third application is in the process of having settlement approved by the supervising court:

The "Waterfall 1" case
This made its way up to the Supreme Court and in May 2017 Lord Neuberger delivered the leading judgment which largely sided with the Lehman liquidators against various creditors. The case concerned a number of technical insolvency points which affected the distributions to creditors (and hence the waterfall moniker given to these cases). The most significant finding for creditors will be the finding that the subordinated loans made to the UK Lehman holding entity by Lehman Brothers Holding Intermediate 2 Limited (and through it, by the US ultimate parent company) were subordinated to claims for statutory interest by other creditors. Amongst other technical points which were more specific to the Lehman situation, the Supreme Court held that:

- Creditors owed sums in foreign currencies have their claims fixed in sterling on the date of administration and are not entitled to claim for any subsequent changes in foreign currency value between the date of administration and the date of payment.
- Any rights to statutory interest which accrue under an administration fall away and cannot be enforced against subsequently appointed liquidators (with the statutory right to interest under a liquidation only arising as at the date of the appointment of the liquidators). The Supreme Court acknowledged this was likely an unintended oversight in the drafting of the Insolvency Rules, but held that it was not the judicial branches' role to step in to correct such oversights in the framing of legislation.

The full judgment can be found at https://www.supremecourt.uk/cases/docs/uksc-2015-0137-judgment.pdf.

The "Waterfall 2" case
Mr Justice David Richards (the assigned judge for Lehman insolvency matters) handed down two judgments on 3 August July 2017 setting out detailed parameters for the calculation of statutory interest claims and other matters.

Further details on these technical findings can be found in an excellent summary by South Square chambers here.

The full case reports are at http://www.bailii.org/ew/cases/EWHC/Ch/2015/2269.html and http://www.bailii.org/ew/cases/EWHC/Ch/2015/2270.html.

The "Waterfall 3" case
Waterfall 3 application was between the administrators of LBIE and of other Lehman entities. Settlement of this application followed the Supreme Court judgment in Waterfall 1, which resolved some of the key points in dispute. Details of the settlement are here.

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Law Debenture Trust Corp v Ukraine

Mr Justice Blair found for Law Debenture Trust Corp (representing the interests of the Russian state as holder of Notes issued by Ukraine) against the Ukraine. The US$3bn Euronotes were issued in December 2013 towards the end of the Yanukovych regime, as part of a financial support package which the Ukraine alleged was an element of a strategy designed to deter the Ukraine from entering into an Association Agreement with the EU. The Notes had a two year term with a maturity date of 20 December 2015. In February 2014, Yanukovych fled the Ukraine, and shortly afterwards Russia invaded Crimea.

The new Ukrainian government did not make repayment of principal on maturity. On being sued in the English courts by the Trustee, the Ukraine defended the proceedings on the basis that:

- it lacked capacity to issue the Notes
- the contracts had been entered into under duress
- Russia had breached implied terms that it would not interfere with the Ukraine's ability to repay, or would not demand payment if Russia was in breach of international obligations to the Ukraine
- Ukraine was entitled as a matter of international public law to refuse payment as a countermeasure to Russia's invasion of its territory.

The Trustee made an application for summary judgment. Mr Justice Blair granted that application, finding that:

- a sovereign state cannot lack capacity to borrow, and the Minister of Finance at the time had ostensible authority to issue the Notes
- the duress defence could not succeed because such matters were acts of foreign states which lay on the plane of international law and so were not justiciable by the English courts
- there was no room to imply the terms which the Ukraine sought to imply into the Note contracts, not least because they would have rendered the Notes untradeable and unworkable thus contradicting their express terms
- whether or not the Ukraine was entitled to withhold repayment as a countermeasure against Russia was a matter of public international law which was not justiciable before the English courts.

The judgment can be found at http://www.bailii.org/ew/cases/EWHC/Comm/2017/655.html.

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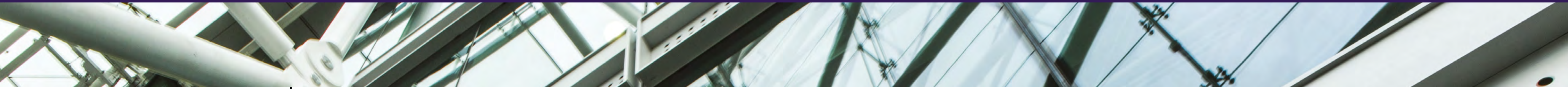

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Developments of note

Hong Kong

- Judgment is currently awaited in the latest episode of the high profile dispute between Elliott Management and Bank of East Asia, Limited (BEA). Elliott has raised various complaints regarding the alleged mismanagement of BEA, in particular in relation to share placements in 2015. BEA applied to strike-out the unfair prejudice petition filed by Elliott in 2016 with the hearing of that application taking place in July 2017. Shareholder activism of this nature remains relatively rare in Hong Kong (and, indeed, in Asia more widely) which means this dispute is being watched with particular interest.
- Hong Kong's Financial Dispute Resolution Centre (FDRC) has issued the conclusions of its consultation on expanding the Financial Dispute Resolution Scheme. Whilst the FDRC has scaled back on the scope of new claims that can be brought it has proposed a significant expansion of the range of claims to be referred to the FDRC, and the services to be offered by the FDRC including the introduction of voluntary mediation-only and arbitration-only options to supplement its current med-arb procedure. See our summary of the key proposals here.
- The client agreement requirements mandated by the Securities and Futures Commission (SFC), by which banks and financial intermediaries must ensure the suitability of investment recommendations, came into effect on 9 June 2017. This will prevent banks from avoiding liability for investment losses before the courts by relying on their contractual terms to argue they had no obligation to advise on suitability.
- The Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance was passed by the Legislative Council in June 2017 (having been introduced in January 2017). Currently, the Ordinance is expected to come into effect in the first half of 2018. It will enhance Hong Kong's reputation as the premier dispute resolution hub in Asia; the Hong Kong International Arbitration Centre is already the most preferred arbitral institution in Asia and the third most preferred in the world. The Ordinance is of considerable interest to financial institutions in Asia given the increase in the use of arbitration for disputes arising out of complex financial products.

For further information see "Third Party Funding Developments – Hong Kong and Singapore"

Singapore

- On 1 March 2017 new legislation came into force in Singapore allowing third party funding in international arbitration, and in related proceedings or mediation. The Civil Law (Amendment) Act 2017 abolishes the torts of maintenance and champerty, and allows a qualifying "Third Party Funder" to provide funding to a party in international arbitration. Section 107 of the Legal Profession Act has also been amended to allow solicitors to introduce or refer third party funders to clients, and to prepare and advise on the relevant third party contract. The Asia Pacific market is watching with interest to see how this wider access to third party funding in arbitration will shape Singapore's expanding dispute resolution landscape.

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Chang Pui Yin v Bank of Singapore Limited (CACV 194/2016)

On 20 July 2017 the Hong Kong Court of Appeal dismissed Bank of Singapore's appeal against the Court of First Instance's August 2016 decision in *Chang Pui Yin v Bank of Singapore Limited* (CACV 194/2016). Husband and wife investors had succeeded in establishing at first instance that, as a matter of contractual interpretation, the bank owed advisory duties to them and their investment vehicle, in particular a duty to act with reasonable care and skill in recommending investment products. The bank appealed against the judge's construction of the relevant contractual provisions, including its standard contractual terms on risk disclosure and limitation of liability, and his findings that the Unconscionable Contracts Ordinance (Cap.458) (UCO) and the Control of Exemption Clauses Ordinance (Cap.71) (CECO) did not apply to private banking services.

In dismissing the appeal, the Court of Appeal (referring to English case law and the UK Unfair Contract Terms Act 1977) found that UCO and CECO do apply to private banking services, and held that:

- in this case section 5 of UCO should be exercised, so as to limit the bank's ability to rely on clauses of the client agreement that would give rise to an unconscionable result, and
- the provisions of the client agreement which sought to limit liability were not fair and reasonable and therefore, under CECO, the bank could not rely on them to escape liability. The Court emphasized that in determining whether a clause is reasonable, courts should construe the clauses in the context of the dealings between the parties at the time the relevant agreements were executed.

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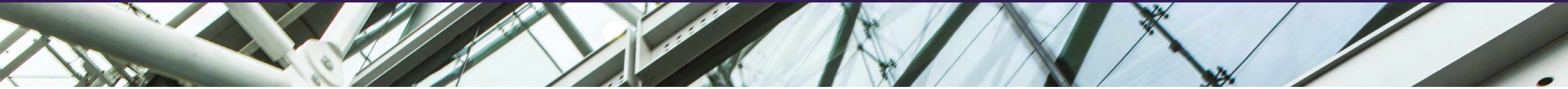
Zhang Hong Li v DBS Bank (Hong Kong) Ltd [2017] HKEC 772

In this recent case, the Hong Kong Court of First Instance awarded the customers of entities related to a bank damages for losses suffered during the global financial crisis, based on the existence of a trust structure established for the clients.

The action was brought by the Zhang family (the beneficiaries of the trust), the current trustees and the trust vehicle, against DBS Bank, trustee and management companies related to the bank, and their employees. The plaintiffs sought damages for losses arising in 2008, claiming that the defendants had not supervised Mrs. Zhang in making investment decisions on behalf of the trust.

Whilst the Court found that the bank itself was not liable, because it had a purely contractual relationship with its customer and did not owe any advisory or fiduciary duties, it held that the presence of a family trust structure imposed fiduciary duties on the trustee and management entities of the bank. Those entities' breaches of their fiduciary and supervisory duties amounted to "gross negligence", which entitled the plaintiffs to equitable compensation.



The Court of First Instance rejected a number of the claims, in particular those for breach of fiduciary duty and knowing assistance against DBS Bank itself, its private banking division and its employees. The Court held that the banking relationship was exclusively governed by the contractual relationship and was not advisory in nature. The Court confirmed the principle that the establishment of a fiduciary relationship in the banker-customer relationship requires exceptional circumstances, which did not exist in the present case.

However, the Court found that DBS Trustee had failed to discharge the high level of supervisory duty over the investments made, which amounted to a "serious or flagrant" act of "gross negligence". DBS Management had also failed to properly discharge its director's duties, specifically its duty to act bona fide in the performance of its functions and management of the trust company's affairs. The Court ordered DBS Trustee and DBS Management to pay equitable compensation (in an amount to be determined) in favour of the trust and current trustees. The language used by the court about DBS Trustee's conduct suggests that the result may have been different had the alleged breaches of duty not been so "serious and flagrant".

The case shows that while the Hong Kong courts will uphold the contractual bargain between a bank and its customer, they are also willing to find a bank's related entities liable for investment losses suffered by customers in appropriate circumstances. These include where trustee and nominee director entities are used, imposing fiduciary obligations on the bank that would not otherwise have existed.

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Competition Commission v Nutanix Hong Kong Limited & Ors (regulators' use of information obtained during investigation)

Regulated entities, particularly financial institutions, will have experienced increased regulatory oversight in their home jurisdictions and overseas. A regulator's power usually includes the investigation of alleged abuse or market contraventions by interviewing individuals and compelling the delivery-up of documents. Indeed, unreasonable refusals to cooperate can attract serious sanctions. The use which a regulator can make of such documents and information depends on the relevant statute and is a topical issue in Hong Kong.

While most regulatory statutes expressly recognise the protection of legal professional privilege (for example, confidential solicitor and client communications dealing with legal advice), it is not unusual for a regulatory provision to remove an individual's right to refuse to answer certain questions or to handover certain documents because he or she might incriminate him or herself (the so-called privilege against self-incrimination). Examples of such provisions can be found in Hong Kong's Prevention of Bribery Ordinance and the Securities and Futures Ordinance.

Where the privilege against self-incrimination has been abrogated in regulatory contexts it has usually been replaced with a "direct use prohibition". This will impose certain restrictions on the use which a regulator or law enforcement agency can make of statements made or documents handed over during an investigation. The precise scope of the abrogation of the privilege and restriction on use depends on the wording of the statute.

Competition Commission v Nutanix Hong Kong Limited & Ors, 3 October 2017, is a recent case on point. It confirms that the direct use prohibition (on this occasion contained in s. 45(2) of the Competition Ordinance) protects the individual or entity to whom a regulatory notice is addressed and who is required to cooperate. The benefit of the prohibition (ie, the restriction on use) does not extend to a third party such as an individual's employer (even where the employer is the subject of an investigation by the Commission). Therefore, unless a statutory provision states otherwise, an individual cannot claim the benefit of the prohibition on an employer's behalf and an employer cannot claim it on an individual's behalf. A corporation can claim the benefit of the prohibition in its own right where a regulatory notice is addressed to it; in that case, an issue arises as to which principal officer(s) will represent the company (which is fact specific).

A related and problematic issue in Hong Kong is that there is no free-standing concept of "derivative use immunity". Therefore, the use which a regulator can make of answers or materials obtained during an investigation depends primarily on the wording of a statute or a court order or an undertaking. Absent such restrictions, a regulator can usually make inferential use of evidence it obtains under compulsion to assist with its general inquiries. Readers will readily appreciate that a regulator's derivative use of such evidence can make significant inroads into the limited protection available to regulated entities and those to whom regulatory notices are addressed.

The *Nutanix* case also helps clarify aspects of the common law in Hong Kong regarding the privilege against self-incrimination. In those instances where the privilege has not been replaced with a direct use prohibition, an individual may be entitled to refuse to answer questions in civil proceedings. However, an individual cannot refuse to do so on the basis that this might incriminate his or her employer or a company of which he or she is a director. In short, where it is available, the privilege against self-incrimination cannot be claimed for the benefit of a third party (other than a spouse).

This area of the law (and the myriad regulatory powers in Hong Kong) is becoming increasingly complex. Where an individual or entity is the subject of a regulatory investigation the emphasis is on (among other things) obtaining legal advice as soon as possible and ensuring (where applicable) that relevant parties are separately advised.

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SFAT fines HSBC Private Bank record-breaking HK$400 million and suspends its securities licenses

On 21 November 2017, Hong Kong's Securities and Futures Appeals Tribunal fined HSBC Private Bank (Suisse) SA HK$400m and suspended its licenses to deal in securities (partially) and advise on securities (fully). This is the largest fine issued by SFAT to date, dwarfing the previous largest fine of HK$42m.

The sanction relates to the private bank's sale of complex derivative products (including Lehman Brothers products) in the run up to the financial crisis. SFAT confirmed the Securities and Futures Commission's finding of misconduct attributable to systemic failures in the identification and matching of client risk appetite to product risk. Importantly, SFAT also confirmed the SFC can use a "multiplier" in calculating the fine, by multiplying the fine for each systemic failure (in this case HK$5m) by the number of legitimate complaints involving that failure.

SFAT rejected the SFC's attempt to multiply the fine for certain products twice (by both the number of systemic failures involved and the number of complaints). It therefore reduced the fine from HK$605m to HK$400m, and converted revocations of the private bank's licenses into one year suspensions.

HSBC Private Bank may still appeal but has responded publicly that its private banking business in Hong Kong is now operated under a different regulated entity whose licenses are not affected by the decision.

For further information please see our recent blog post by Jonathan Crompton.

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Hong Kong regulatory developments

- **Moody's "red flags" report**. The Hong Kong Court of Appeal has upheld the March 2016 decision of the Securities and Futures Appeal Tribunal (SFAT) that Moody's was required to comply with the SFC's Code of Conduct (the Code) when it published its July 2011 "red flags" report about several Chinese companies, and failed to do so. While disagreeing with SFAT that the "red flags" report was itself a credit rating, the Court of Appeal upheld SFAT's decision that the SFC had jurisdiction because the "red flags" report was **activity related** to credit ratings, and therefore could be misconduct under section 193 of the Securities and Futures Ordinance (SFO). See our summary of SFAT's decision at https://www.lexology.com/library/detail.aspx?g=329e66f2-ee86-4de6-bb4d-bf4021d28f12.
- **New Manager-in-Charge regime for non-licensed management of licensed entities**. On 17 October 2017, the SFC announced that its new Manager-In-Charge (MIC) regime had come into full effect. This followed a six month transition period during which licensed corporations were required to designate and notify the SFC of MICs in charge of 8 "core functions", including overall management oversight, key business lines, operational control and review, risk management, finance and accounting, information technology, compliance and anti-money laundering. The MIC regime does impose new obligations on licensed corporations to identify and designate MICs, for the board of the licensed corporation to approve them, and for the corporation to notify the SFC of its organisational structure including all MICs. The SFC also expects MICs of the overall management oversight and key business lines to become Responsible Officers, although they likely would have been already.
- **SFC continues seeking orders for restitution**. *Securities and Futures Commission v Sun Min*, 17 July 2017, is another recent example of the regulator using its extensive powers under section 213(2)(b) of the Securities and Futures Ordinance to seek so-called "restorative" orders in the form of restitution on behalf of counterparties (investors) to the relevant transactions. In doing so, the lead market regulator in Hong Kong is effectively assuming the role of a class action representative claimant in civil proceedings.

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Hong Kong Anti-Money Laundering update 2017

- **Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill**. In the run-up to the next joint mutual evaluation by the two inter-governmental bodies (the Financial Action Task Force and the Asia Pacific Group on Money Laundering) in Autumn 2018 (for reporting in Summer 2019), the Hong Kong government is seeking to enact the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill. If passed, the bill will (among other things) extend the statutory record-keeping and customer due diligence requirements for banks under the principal Ordinance of 2012 to certain designated professions in Hong Kong (namely, lawyers and accountants) and estate agents.
- **Suspicious transaction reports**. The Joint Financial Intelligence Unit (effectively, the police) has published a summary of number of suspicious transaction reports (STRs) for the year up to 31 October 2017. The JFIU's website confirms that the number of STRs received during this period was 75,401, which is more than any year between 2012 (when the principal Ordinance came into force) and 2015. The final figure for 2017 will almost certainly exceed the 76,590 received for 2016.

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