FINANCIAL SERVICES LITIGATION GROUP WEBCAST SERIES 2019

Finance litigation: key cases of 2019

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In this webcast Helen Fitz-Hugh talks about three significant cases relevant to banks and other financial institutions in 2019 so far.

Marme Inversiones and Natwest Markets and others

In this lengthy judgment in relation to a benchmark misrepresentation claim, Mr Justice Picken found firmly in favour of Natwest Markets PLC, and five other banks, in denying the claimant its claim for 996 million EUROs, or alternatively rescission.

By way of background, the claim arose out of a 2008 Spanish property deal for which Marme obtained financing of around 1.5 billion EUROs from a syndicate of lenders. Marme agreed to pay interest at a rate referable to the Euro Interbank Offered Rate, EURIBOR, and entered into five interest rate swaps with the five defendant banks.

Only a few days after completion of the transaction in September 2008, Lehman brothers filed for bankruptcy. In the intervening financial crisis, Marme found itself unable to refinance and subsequently had to repay the loan when it fell due in September 2013.

In 2014 Marme entered into a Spanish insolvency process, in which the defendant banks brought claims for payments outstanding under the interest rate swaps. That same year, Marme issued these proceedings for rescission of the swaps, and / or damages in lieu, on the basis that:

- Natwest had made untrue representations about the "*integrity of the process*" by which EURIBOR was set; and
- Natwest had held itself out as having authority to act as agent of the other banks and but for that misrepresentation, Marme said it would have negotiated more favourable finance terms.

The judgment covers a range of issues but of particular note are its findings on implied representations and reliance:

- The test for implied representations is not the same as for implied terms. For an implied representation to be found, "*clear words or clear conduct*" are required.
- The court will not imply a representation from conduct in terms which are: "*vague, uncertain, imprecise or elastic*."
- Whether or not a representation is implied is a question of fact, based on an objective determination, in which the natural assumptions of the "*reasonable representee*" may be a helpful guide. But, the court can also consider what was "*reasonably apparent to both the representor and the representee*".
- A wide-ranging or complex representation is likely to require more in terms of words or conduct.
- The circumstances in which a "*duty to speak*" arises under English law are limited -and this was not such a case.
- Unless it can be proved that the representee "*gave any thought*" to the representations at the time they were made, it will be impossible to prove reliance.
- To prove reliance, a causal link must be shown as to how the representee would or might (in the case of fraud) have acted differently had the representations not been made.

In this case, the representations about EURIBOR alleged could not be implied, not least because there were no "*clear words or conduct*" and Marme was not aware of the alleged representations so could not be said to have relied on them.

This decision is likely to be welcomed by financial institutions facing claims arising from historic allegations of benchmark rate manipulation.

It makes it clear that for a misrepresentation claim to succeed, the representee must have given some "*conscious contemporaneous thought*" to the fact that a representation was being made. If that cannot be evidenced, the court will give short shrift to the idea of any reliance on a representation.

What really concerned the court in this case was the sense that the claim had been "*contrived*" or reverse-engineered to fit within the parameters established in the recent Court of Appeal decision in *Property Alliance Group and Royal Bank of Scotland.*

Effectively, the court was astute to the idea that claimants might seek to recoup market losses by pegging them to the discovery of wrongdoing within the banking system, without there actually being a connection between the two events.

Whether or not savvy claimants will now start testifying to the careful consideration they gave to the reliability and integrity of the benchmark rates they were offered at the time they entered into transactions, remains to be seen.

The decision provided further comfort by declining to find that an entity involved in coordinating or arranging financing and interest rate hedging was acting as agent for other banks in the syndicate.

Medsted Associates and Canaccord Genuity Wealth

The first instance decision attracted criticism for muddying the waters on the issue of whether a broker owed fiduciary duties to investors under an introducing agreement.

In 2009 the Claimant, Medsted, entered into an Introducing Agreement with the Defendant, then known as Collins Stewart, pursuant to which it would receive a commission and funding rebate in relation to contracts for differences or any other product placed with Collins Stewart by customers introduced by Medsted.

Investors were introduced to Collins Stewart under that agreement and Medsted was paid as agreed. However, in 2010 Collins Stewart entered into transactions with certain investors directly without Medsted's knowledge, on terms that would have otherwise entitled Medsted to a share of the commission and funding rebate.

Medsted had not disclosed to these investors the split in commission and funding rebate between itself and Collins Stewart; indeed, it had been keen to ensure that this information was withheld from them.

Collins Stewart alleged that when investors ultimately became aware of how the charges were being split between the two parties, they were unhappy at the level of remuneration being paid to Medsted, which was described by Collins Stewart as "*unusually high*" in circumstances where Medsted was not bearing any of the financial risk.

Medsted alleged that the so-called '*secret business*' directly between the investors and Collins Stewart constituted a breach of the Introducing Agreement and sought an account of the sums of the further commission to which it would, on its case, have been entitled.

The first instance decision found that the relationship between Medsted and the investors was fiduciary in nature and Medsted's remuneration under the agreement with Collins Stewart was, in effect, a '*secret commission*'. Since the root of the loss caused to Medsted was its own breach of fiduciary duty to the investors, it was entitled only to nominal damages for the breach by Collins Stewart.

Medsted appealed on grounds that it did not owe any fiduciary duties to the investors and, even if it did, it did not breach any such duties by failing to disclose the level of the commission it was receiving.

On appeal it was held that:

- Medsted had, at least impliedly, represented to the investors that the terms offered by Collins Stewart were competitive and to that extent "*the investors reposed trust and confidence in Medsted*" which gave rise to a duty which could be legitimately categorised as 'fiduciary'.

- However, Medsted had not breached any duty, whether fiduciary or otherwise, by failing to disclose the remuneration split.
- The investors must be taken to have realised that Medsted was being remunerated for its services; the investors themselves were not paying any fees to Medsted and so they must have assumed that Collins Stewart was.
- The first instance decision to classify the commission as *'secret'* was an overstatement of the position; a commission of which the existence but not the amount was known could not be '*secret*'.
- Even if the relationship between Medsted and the investors was fiduciary in nature, the scope of any fiduciary duty was limited where the investors were aware that Medsted was being remunerated by Collins Stewart.
- There was no duty on Medsted to disclose to the investors the actual amount of the commission that it was due to, and did, receive from Collins Stewart.
- In coming to this conclusion the level of sophistication of the investors, described as "*wealthy Greek citizens*" who were likely to have been "*experienced investors*", appears to have been a relevant factor.

It therefore followed that Medsted was not in breach of any duty and there was no basis on which damages could be denied on public policy grounds.

The appeal was allowed and damages were ordered to be assessed.

The Court of Appeal's decision will be welcomed by brokers to the extent that it found that Medsted did not have to provide full disclosure to investors of the commission payments it earned.

However, significant uncertainty remains. Without having to decide the point directly, the Court of Appeal was willing to accept that Medsted owed duties of a fiduciary nature to investors. The open question is the extent of such duties, and in particular, the level of disclosure of commission payments required.

Until the Courts give further guidance on this issue, it may be advisable for brokers to err on the side of caution when considering how open to be about the quantum of commission they are receiving, particularly where the investors concerned may be less sophisticated.

First City Monument Bank and Zumax Nigeria Limited

In June this year, the Court of Appeal considered whether a relationship of trust was created when money was transferred through a 'correspondent bank'.

In a decision which will be welcomed by the banks, the court found that no relationship of trust is created by an international money transfer between bank accounts that is executed by a clearing system or correspondent bank.

By way of background, Zumax Nigeria had its main bank account with a Nigerian Bank called First City Monument. First City maintained a correspondent account with Commerzbank which it used to facilitate foreign currency payments.

Between 2000 and 2002, a nominee company of Zumax- Redsear Limited- sought to make various transfers of US dollars to Zumax. It did this by instructing its London bank –Chase- to make transfers to First City's correspondent accounts at Commerzbank, to then be transferred on to Zumax. The wording on the transfers was for "*further/final credit*" to Zumax.

It was common ground that Chase made the transfers to Commerzbank. Zumax alleged, however, that it did not receive any funds from First City.

Zumax therefore sought a declaration that First City was liable to account to it as trustee for the value of the transfers it alleged never to have received – which totalled approximately 3.75 million US dollars.

At first instance, the court granted summary judgment to Zumax, finding that either First City was trustee under an express trust, or in the alternative that this was a "*Quistclose*" trust- where a trust arises when money or property is transferred to someone for a particular purpose and held at the free disposal of the transferee.

On appeal, the Court of Appeal overturned the first instance decision and made the following useful observations:

- Only in exceptional circumstances will a banking customer be able to establish that a bank holds funds under an express or '*Quistclose*' trust.
- The basic banker-customer relationship is that of debtor and creditor, not trustee and beneficiary.
- In this case, the court construed the execution of Redsear's payment through the correspondent bank, Commerzbank, as standard "*bookkeeping*" rather than an express segregation of funds.
- The fact that records were marked as "*for further/final credit*" to Zumax was not sufficient to establish that Redsear intended to create a trust. Identifying the person to whom payment should be made was routine practice in such transactions.

This reversal of the High Court's decision is a helpful decision for banks and re-states previous case law on the nature of the banker-customer relationship.

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