MACFARLANES

BANKING AND FINANCE DISPUTE RESOLUTION

LITIGATION, ARBITRATION, INVESTIGATIONS AND FINANCIAL CRIME

QUARTERLY UPDATE: APRIL 2017

Welcome to the latest issue of our Quarterly Update, in which we look at some of the recent highlights and developments in banking and finance disputes and financial crime.

Of particular interest are two recent Court of Appeal decisions regarding standby letters of credit, which bring some helpful clarity and guidance to the law in this area. At the same time, the High Court has held that the doctrine of strict compliance does not apply to demand guarantees in the same way as it does to letters of credit.

In addition, there have been contrasting decisions under the old and the new Brussels Regulation, and the Court of Appeal has re-emphasised that implied terms must never be inconsistent with the express terms.

Finally, we comment on potential further corporate criminal offences designed to punish and prevent economic crime, and the recent Deferred Prosecution Agreement between the Serious Fraud Office and Rolls Royce.

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- International swap contracts - narrow application of article 3(3) of Rome Convention upheld
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NOTABLE CASES AND DEVELOPMENTS

COURT OF APPEAL CONFIRMS RELUCTANCE TO IMPLY TERMS

The Court of Appeal has helpfully confirmed the position on implied terms, reaffirming the current law that an implied term must not be inconsistent with the express terms. The Court must, therefore, interpret and give effect to the parties' intentions in relation to express terms before considering whether to imply a term. The decision in *Irish Bank Resolution Corp Ltd (In Special Liquidation) v Camden Market Holdings Corp and Ors* [2017] EWCA Civ 7 is interesting because it considered a situation where two terms, one express and one implied, were not inconsistent until they were considered substantively.

The parties entered into a facilities agreement whereby the Defendant bank agreed to provide finance to the Claimants for the purchase and development of properties. The agreement included an express term that the Defendant bank could transfer or assign its rights under the agreement and, as part of that, disclose information about the Claimants to potential assignees. The Defendant bank went into liquidation and sought buyers for its loans, marketing the Claimants' loan in a package containing distressed debt. The Claimants feared potential buyers might purchase the loans and enforce the security instead of buying the properties at full value. The Claimants, therefore, claimed that this breached an implied term that the Defendant bank would not do anything to hinder the marketing of properties to achieve the best price.

The Defendant bank's summary judgment application against the Claimants was dismissed and it appealed.

The Court of Appeal, considering the appeal in light of the decision in *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Limited and another* [2015] UKSC 72, allowed the appeal, and the Defendant bank was granted summary judgment. The Court found that although the implied term could be linguistically compatible with the express term (it was possible to market the loans without hindering the marketing of properties), it was inconsistent in substance as it restricted the express power to disclose information. The Court of Appeal applied Neuberger's 'cardinal rule' that an implied term must not contradict an express term, as well as the principle in *Reda v Flag Ltd* [2002] UKPC 38, that an express term cannot be circumscribed by an implied term.

DOCTRINE OF STRICT COMPLIANCE DOES NOT NECESSARILY APPLY TO DEMAND GUARANTEES

The High Court has held that the doctrine of strict compliance does not apply to demand guarantees in the same manner as letters of credit. The strictness of compliance is determined by the construction of the terms. In *MUR Joint Ventures BV v Compagnie Monegasque De Banque* [2016] EWHC 3107 (Comm), the Court upheld a demand guarantee despite a failure to comply strictly with notification requirements.

In this case, the Defendant bank guaranteed the performance of a third party pursuant to a joint operations agreement. The Claimant issued two demands when the third party failed to perform its obligations.

The guarantee required the Claimant to send demands by *"registered mail"*, and to be signed by "*duly authorised legal representatives"*. The Defendant bank refused payment on the grounds that the demands were only sent by courier, fax and email, and were only signed by one director (who was not confirmed by a notary to have been authorised to act on behalf of Claimant).

However, the Court disagreed with the Defendant. It ruled that demand guarantees should not necessarily be rejected for failing to comply strictly with requirements unless, on construction, the contract required it. The Court emphasised the need for terms to be clear and precise.

Unclear wording caused the Court to find against the Defendant bank on all the issues. Use of the plural form "representatives" was inconsistent throughout the document, but considered to be unimportant. The authentication requirements were judged to have been met. Registered mail, the prescribed means of communication, was found, on construction, to be merely directory (not mandatory) so that a demand could be made in other ways as long as it was *"effective"*. As there was no dispute that the bank had received the demand, the demand was, therefore, effective, and upheld.

SUMMARY JUDGMENT FOR BREACH OF JURISDICTION CLAUSE UPHELD BY THE COURT OF APPEAL

In *Barclays Bank Plc v Ente Nazionale di Previdenza ed Assistenza dei Medici e Degli Odontoiatri* [2016] EWCA *Civ 1261*, the Court of Appeal found that a court is not seised of a claim until it has been properly raised in the proceedings before that court.

The Claimant bank (B) commenced proceedings in the English Court against an Italian pension fund, Ente Nazionale di Previdenza ed Assistenza dei Medici e Degli Odontoiatri (ENPAM), for damages in respect of ENPAM's breach of a jurisdiction agreement in favour of the English Courts. The claim arose because ENPAM had brought proceedings against

B in Italy. The claim was brought prior to the recast Brussels Regulation coming into effect, and, therefore, the question of which court had priority to determine the issue of jurisdiction depended upon which court had been first seised. B made a successful summary judgment application against ENPAM in the English Court, and ENPAM appealed to the Court of Appeal.

ENPAM had, by the time of its appeal, amended its proceedings in Italy so as to argue that the jurisdiction agreement with B was invalid and of no effect. ENPAM then sought to rely on Articles 27 and 28 of the Brussels Regulation to challenge the English Court's jurisdiction. Article 27 requires that where the parties and proceedings are the same in both actions, any court other than the Court first seised must stay its proceedings until the Court first seised determines whether it has jurisdiction. Article 28 gives a discretion to any court other than the Court first seised to stay its proceedings where the proceedings are related, but not the same.

Since the Court of Appeal found that a court is not seised of a claim until it has been properly raised in the proceedings before that court, the Italian Court was not first seised of the claims raised by ENPAM's amendments. These were raised after the English proceedings had been commenced, and the English Court did not have to decline jurisdiction. The Court of Appeal also found that the amendments did not give rise to related proceedings, as the Italian proceedings were focused on the substance of the agreements between the parties, whereas the English proceedings were to recover damages for breach of the jurisdiction agreements.

ENPAM also argued that the granting of summary judgment was analogous to the granting of an anti-suit injunction, and should not, therefore, be allowed, as it would interfere with the jurisdiction of the Italian courts to determine the meaning and effect of the jurisdiction agreement. This interference would infringe the principle of mutual trust between the courts of Member States. The Court of Appeal rejected this argument, and held that it was bound by the earlier decision of The *"Alexandros T"* [2014] 2 Lloyd's Rep 554, where the same arguments were put forward and rejected by the Supreme Court.

ASYMMETRIC JURISDICTION CLAUSE IS AN EXCLUSIVE JURISDICTION CLAUSE FOR THE PURPOSES OF THE RECAST BRUSSELS REGULATION

In *Commerzbank Aktiengesellschaft v Liquimar Tankers Management Inc and another* [2017] EWHC 161 (Comm), the Commercial Court held that an asymmetric jurisdiction clause is an exclusive jurisdiction clause for the purposes of the recast Brussels Regulation.

In this case, the parties had agreed that the Defendants would submit to the exclusive jurisdiction of the English courts, whilst the Claimant was permitted to commence proceedings in any jurisdiction it wished.

Article 31 of the recast Brussels Regulation states that where a jurisdiction agreement confers exclusive jurisdiction on a particular Member State, proceedings commenced in any other Member State will be stayed in favour of the Member State referred to in the exclusive jurisdiction agreement. Under the old Brussels Regulation, a dispute about a jurisdiction agreement would be determined in the courts of the Member State first seised (whether or not that Member State was referred to in the relevant jurisdiction agreement). The new rule contained in Article 31 of the recast Brussels Regulation was intended to be an "anti-torpedo" provision, aimed at preventing the practice of parties racing to have a court in a particular jurisdiction first seised in order to gain a tactical advantage.

In this case, the Claimant bank brought claims in the English Court against the Defendants. Prior to those proceedings being commenced, the Defendants had already brought related proceedings against the bank in Greece. The Defendants sought a stay of the English proceedings in favour of the Greek proceedings.

The Commercial Court decided that asymmetric jurisdiction agreements are exclusive jurisdiction agreements and, therefore, can benefit from Article 31 of the recast Brussels Regulation. Accordingly, as the jurisdiction clause in this case conferred exclusive jurisdiction on the English courts where the defendants commenced proceedings against the Claimant, the Defendants failed in their attempt to "torpedo" the English proceedings, which would not be stayed.

INTERNATIONAL SWAP CONTRACTS - NARROW APPLICATION OF ARTICLE 3(3) OF ROME CONVENTION UPHELD

Banco Santander Totta SA v Companhia de Carris de Ferro de Lisboa SA & others [2016] EWCA Civ 1267, was the first appeal from the High Court's Financial List. The Appellant transport companies sought to escape from long-term interest rate swap transactions entered into with the Respondent bank (the Swaps). The Appellants relied on Article 3(3) of the Rome Convention (on the Law Applicable to Contractual Obligations) 1980, which provides that *"where all the other elements relevant to the situation at the time of the choice are connected with one country only",* mandatory provisions of that country's law cannot be derogated from by contract. On that basis, the Appellants argued, Article 437 of the Portuguese Civil Code (the PCC) applied to invalidate the Swaps (as unlawful "games

of chance"), notwithstanding the parties' choice of English law to govern the Swaps. The appeal centred on whether the judge at first instance had properly assessed whether Article 3(3) was engaged, when finding that Portuguese law was irrelevant.

The Appellants argued that the judge had erred in finding that Article 437 of the PCC did not apply to the Swaps: (i) by finding that elements pointing to an international situation were relevant, rather than only elements pointing to Portugal as a specific alternative jurisdiction; (ii) by taking account of such "international" elements instead of discounting them; and (iii) by finding that Article 3(3) of the Rome Convention can be disapplied by retrospective agreement (rather than by prior agreement only).

The Court of Appeal rejected these arguments, emphasising that Article 3(3) of the Rome Convention is a limited exception to the fundamental principle of contractual parties' autonomy. As such, Article 3(3) should be applied narrowly, and the judge had been correct to consider elements of the contractual arrangements that pointed to an international situation. These elements showed that (even excluding the choice of English law) the Swaps were not connected solely with Portugal. The appeal, therefore, failed on grounds (i) and (ii). It should be noted, however, that the Court of Appeal was divided in its opinions on ground (iii), namely whether contractual parties may retrospectively derogate from mandatory rules of law - Longmore LJ in particular preferred to reserve judgment on that issue pending a more suitable case.

STANDBY LETTERS OF CREDIT AFFIRMED AS INDEPENDENT ENFORCEABLE CONTRACTS

In *Petrosaudi Oil Services (Venezuela) Ltd v Novo Banco SA* [2017] EWCA Civ 9, the Appellant drilling company (POS) challenged a High Court injunction preventing it from calling on a standby letter of credit (SLOC). POS had entered into a contract to provide oil rig drilling services to a Venezuelan state related entity (PDVSA). The drilling contract was governed by Venezuelan law and included clauses requiring upfront payment by PDVSA, even when an invoice was disputed. A dispute subsequently arose and it went to arbitration. The arbitral tribunal ruled that, pursuant to mandatory provisions under Venezuelan law, PDVSA was prohibited from paying the disputed invoices until a specified verification process had been completed (or any dispute had been resolved in arbitration).

Despite that ruling, POS had sought to call upon the SLOCs, which required POS' certification that PDVSA was *"obligated to pay"*. PDVSA had sought and obtained an injunction to prevent payment, on the basis that the demand was fraudulent in light of the arbitral tribunal's ruling. In the High Court's view, the panel's ruling meant that no debt was currently due and payable *'in any real sense'*, pending final resolution of the dispute, and that POS should not have issued the required certification.

POS' challenge focused on the argument that whilst the mandatory Venezuelan provision may have restricted PDVSA from making immediate payment, it did not prevent the payment obligation from arising in the first place. The SLOC certification was directed to the latter point, and the SLOC itself was a separate contract between POS and a separate party (Novo Banco SA), under a different governing law. It was, therefore, unaffected by Venezuelan law considerations. Moreover, it was clear from the wording of the drilling contract and the commercial context that "*[The] drilling contractor needed, and PDVSA needed to offer, an assured source of regular payment."* The very purpose of the SLOC was to ensure that payment issues did not prevent POS from receiving the regular payments that it required. Further, POS, through its general counsel, had been entitled to give the certification, since being *"obligated to pay"* did not mean there was an obligation to pay "now".

REASSURANCE GIVEN TO STANDBY LETTER OF CREDIT BENEFICIARIES

In *National Infrastructure Development Company Ltd v Banco Santander SA* [2017] EWCA Civ 27, the Court of Appeal upheld a summary judgment requiring the Appellant bank (S) to honour a standby letter of credit. The Respondent, the National Infrastructure Development Company (NIDC), had engaged a construction company to build a highway in Trinidad. Under the construction contract, NIDC was provided with "retention security" to cover the risk of non-performance, in the form of standby letters of credit (SLOCs) issued by S. Construction work had subsequently ceased due to a payment dispute between the construction parties, and NIDC had therefore made a demand against the SLOCs.

S had refused to honour the SLOCs, and had defended the ensuing proceedings on various grounds relating to the allegedly dishonest nature of the demands. These arguments were dismissed at first instance, and summary judgment granted to NIDC. On appeal, S argued that: (i) the judge had applied the wrong test in considering whether its defence was *"seriously arguable"* - the correct test being whether the defence had a *"real prospect"* of success; (ii) no sums were actually *"due and owing"* to NIDC; (iii) factual evidence indicated NIDC's lack of genuine belief in the claim; (iv) the amount claimed was excessive; (v) S should be permitted to cross-examine NIDC witnesses; and (vi) proceedings should have been stayed in light of a contemporaneous Brazilian injunction.

The appeal was dismissed. The Court of Appeal agreed with S about the relevant legal test to be applied, but agreed with the judge that the relevant issue in relation to a SLOC was the beneficiary's belief in the validity of its demand. On that basis, the allegation that NIDC had acted fraudulently *"would be extremely difficult to establish*"; it was also noted that *"it cannot be fraudulent to make a demand [that] one is entitled to make".* Therefore, once a SLOC is issued, the issuing bank will be bound to honour it unless it can establish that the beneficiary lacked genuine belief that it was entitled to make a call for payment under it.

FINANCIAL CRIME

THE DPA BETWEEN ROLLS ROYCE AND THE SFO

We saw the third Deferred Prosecution Agreement (DPA) under the Bribery Act 2010 earlier this year concerning Rolls-Royce. The DPA is the largest of its kind and is the result of the largest single investigation carried out by the SFO. The judgment of the Court provides invaluable further guidance on the offences under the Bribery Act 2010 and how to deal with the SFO when such conduct is discovered or suspected.

The conduct in this case involved offences relating to bribery of foreign public officials, commercial bribery and false accounting of payments to intermediaries over the period 1989 to 2013. The offences were multi-jurisdictional, numerous and spread across Rolls Royce's defence aerospace, civil aerospace and energy businesses.

The DPA requires payments of £497,252,645 (comprising disgorgement of profits of £258,170,000, and a financial penalty of £239,082,645) plus interest. Rolls-Royce is also reimbursing the SFO's costs of approximately £13,000,000 in full.

This case represents by far the most significant enforcement action by the SFO in the UK. There is no doubt that the consequences of the DPA for Royce Rolls are extremely significant in financial terms, but the company can now draw a line under what the judge described as the most serious breaches of the criminal law in the areas of bribery and corruption. The message from the SFO and the courts remains clear and consistent: engaging openly and fully with the SFO from an early stage will significantly improve the outcome for companies that may be engaged in bribery and corruption, at home or overseas. For further detail, see our note here.

POTENTIAL REFORM FOR CORPORATE CRIMINAL LIABILITY IN ECONOMIC CRIME

On 13 January 2017, the Ministry of Justice issued a Call for Evidence concerning potential new criminal offences designed to punish and prevent economic crimes such as fraud, false accounting and money laundering committed on behalf of, or in the name of, companies.

The UK Anti-Corruption Plan, published in December 2014, charged the Ministry of Justice with the task of examining the case for a new offence of failure to prevent economic crime, and the rules on establishing corporate criminal liability more widely. That work stopped in the summer of 2015 because the "failure to prevent" offence under Section 7 of the Bribery Act 2010 had not been tested in an enforcement action, and there seemed to be little evidence of corporate wrongdoing going unpunished. This situation changed in light of the first Deferred Prosecution Agreement (Standard Bank) concluded by the Serious Fraud Office involving consideration of the failure to prevent offence.

Except where there is statutory provision, the attribution of corporate criminal liability for offences such as fraud and false accounting is determined by the identification doctrine under the common law. This doctrine requires prosecutors to prove that those who can be regarded as the "directing mind and will" of the company, knew about, actively condoned or played a part in the offending. Currently, the one exception to the applicability of the identification doctrine in the area of economic crime is the corporate failure to prevent bribery under the Bribery Act 2010.

The necessity of proving that the required intent of an offence was possessed by an individual occupying a senior position in the company management structure is not usually a problem for prosecutors when investigating small companies. It is argued, however, that this law makes the successful prosecution of a large modern multinational corporation difficult because many companies have complex management structures which have the effect of insulating those identified as the directing mind and will of the company from potential allegations of knowledge of or complicity in the crime.

The Government is concerned to establish the extent to which the identification doctrine may be hindering effective criminal enforcement, as shown in the recent Criminal Finances Bill under which the offence of failure to prevent tax evasion is to be introduced. This offence follows the model established in Section 7 of the Bribery Act 2010, by holding Section 7 of the Bribery Act 2010, by holding a company to account in circumstances where those "associated" with it have engaged in the criminal facilitation of tax evasion.

Before expanding the range of corporate economic crimes under statute, however, the Government has been keen to gather evidence from all interested parties on the extent of the problem, information on the principal issues involved, and views on the case for reform options, including: amendment of the identification doctrine; a strict, vicarious liability offence; a strict breach of statutory duty offence; failure to prevent as an element of the offence; and regulatory reform on a sector by sector basis.

The Call for Evidence ended on 24 March 2017, and the Ministry of Justice's report on the feedback which it has received is awaited with interest.

CONTACT DETAILS

If you would like further information or specific advice on any of the issues raised in this update please see the following page for details of our banking and finance dispute resolution team.

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This note is intended to provide general information about some recent and anticipated developments which may be of interest.
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