

Banking litigation e-bulletin

Banking litigation update

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1. The 1992 ISDA Master Agreement: Court of Appeal provides clarity on payment obligations owed to insolvent counterparties

Lomas v JFB Firth Rixson Inc [2012] EWCA Civ 419

In *Lomas*, the Court of Appeal heard four joined appeals concerning the interpretation of various provisions of the ISDA Master Agreement. The appeals were principally concerned with the construction and operation of the condition precedent clause found at section 2(a)(iii) of the Master Agreement. This clause provides that no payment obligations arise under the Master Agreement if an Event of Default or Potential Event of Default has occurred and is continuing.

Various counterparties have sought to rely on this condition precedent in order to avoid paying sums which might otherwise be payable to insolvent counterparties. Non-payment has been justified by those counterparties on the basis that Events of Default have occurred and therefore that the condition precedent to a payment obligation arising had not been satisfied under section 2(a)(iii).

Indefinite suspension of payment obligations

A number of decisions at first instance have considered the operation of section 2(a)(iii). One of the key questions has been whether the effect of section 2(a)(iii) is to extinguish payment obligations on the payment date or only to suspend them until such time as the Event of Default (or Potential Event of Default) has been cured. The Court of Appeal held that, if a party is subject to an Event of Default, then the non-defaulting counterparty's payment obligations are not extinguished but suspended. In reaching this decision, the Court noted the distinction between a debt obligation and a payment obligation. The debt obligation, once it arises remains undisturbed by the Event of Default and is always potentially payable – it is only the payment obligation that is affected and therefore suspended by section 2(a)(iii). Once the defaulting counterparty "cures" its default the payment obligation is revived and the debt must be paid. In making this decision, the Court noted that events such as underpayment due to a calculation error or a vexatious winding-up petition would constitute an Event of Default (or Potential Event of Default) and, in such circumstances, to treat payment obligations as extinguished for ever would be too drastic a remedy in favour of the non-defaulting party.

This finding was of limited practical assistance to the Administrators of Lehman

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19 July 2012
London

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Brothers, whose bankruptcy Event of Default was unlikely to ever be cured. It was therefore further argued that there were various terms implied into the Master Agreement to the effect that the non-defaulting party could only rely on section 2(a)(iii) for a "reasonable time" (after which the suspended payment obligation was revived) or, alternatively, that required the non-defaulting party to designate an Early Termination Date before natural maturity and pay all suspended payment obligations. These arguments were rejected by the Court as "hopeless". The Court held that the contracts worked perfectly well without any such implied terms and to find that such implied terms existed would be to re-write the contract for the parties which the Court had no business to do. For similar reasons, the Court found that there was no express or implied provision which caused the suspended payment obligations to become extinguished upon maturity of the transaction. Nothing was inherently wrong with the argument that the obligations should survive indefinitely.

It followed that where contracting parties have opted for Automatic Early Termination to apply in the case of certain Events of Default, all transactions entered into under the same Master Agreement will be subject to the close-out netting provisions, including transactions which have passed their final payment date.

Gross/Net

The Court also decided that, where the non-defaulting party was in the money under certain (but not all) transactions governed by the Master Agreement, it could only seek payment from the defaulting party on a net basis. The effect of section 2(c) of the Master Agreement was to require the netting of payments and, for these purposes, payment obligations otherwise suspended by section 2(a)(iii) were to be taken into account. The non-defaulting party could not seek payment from the defaulting party without giving credit for these sums.

However, there was a limit to which unpaid sums could be netted off against each other. The netting provisions of section 2(c) apply only in relation to contemporaneous payment obligations. Only amounts which were expressed to be payable on the same date in respect of the same two (or more) of the relevant transactions are capable of being netted. Section 2(c) cannot be utilised to net off sums arising on one date against sums which become due on a later date.

Application of anti-deprivation principle and pari passu rule of equal distribution

The Court had to decide whether its finding that contingent liabilities were suspended indefinitely offended either the anti-deprivation principle or the *pari passu* rule of equal distribution. In essence, the anti-deprivation principle is a common law rule which says that any contractual provision which attempts to remove assets from an insolvent estate is unenforceable. The Court followed the Supreme Court's 2011 decision in *Belmont v BNY Corporate Trustee Services* [2011] UKSC 38 and found that section 2(a)(iii) of the Master Agreement did not offend the anti-deprivation principle. The effect of the condition precedent suspending the payment of debts to an insolvent counterparty does no more than prevent the non-defaulting party from having to make those payments whilst the default is on-going. There was no suggestion that the provision was formulated to evade bankruptcy law – it was a legitimate hedging arrangement to mitigate counterparty credit risk. As to the *pari passu* rule whereby all creditors are to be treated proportionately, without any preference, the Court found that the rule is only engaged in respect of assets of the estate as at the commencement of the bankruptcy or liquidation. Section 2(a)(iii) does not infringe the *pari passu* rule because it operates to prevent the relevant debt becoming payable. There would, therefore, be no insolvency property capable of being distributed.

A team led by Herbert Smith's Damien Byrne Hill acted for Pioneer in the appeal.

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2. The Lehman client money judgment: Supreme Court upholds Court of Appeal decision

In the matter of Lehman Brothers International (Europe) (In Administration) [2012] UKSC 6

The Supreme Court handed down its judgment on 29 February 2012 in relation to the client money application relating to Lehman Brothers International (Europe) ("LBIE"). The judgment has a number of implications for firms which hold client money, and for firms which hold money with banks and other firms as clients themselves. The complicated and controversial nature of the appeal is reflected in the sharply opposing opinions of the Lords in relation to two of the issues considered (Lords Hope and Walker dissented on the second and third issues).

The majority dismissed the appeal and held that:

- Client money is held on statutory trust imposed by the FSA's Client Assets Sourcebook ("CASS") from the time of receipt by a firm, not upon segregation of client money.
- Provided it is identifiable, client money not segregated by the firm from its own accounts will nonetheless form part of the client money pool available for distribution to clients on insolvency.
- Participation in the client money pool is based on the amount which ought to have been segregated at the date of the primary pooling event (that is, the moment LBIE went into administration) (the 'claims basis') and not on the amount of client money which had actually been segregated on that date (the 'contributions basis').

Click [here](#) for our FSR group's briefing on the decision. The briefing includes a glossary of terms and a checklist which can be found on page 2.

3. Court of Appeal dismisses Lehman appeal in "RASCALS" litigation *Pearson and Ors v Lehman Brothers Finance SA* [2011] EWCA Civ 1544

In December 2011, the Court of Appeal dismissed Lehman Brothers Finance SA's ("LBF") appeal and Lehman Brothers International Europe's ("LBIE") cross-appeal in relation to the High Court's decision in *Pearson and others v Lehman Brothers Finance SA and others* [2010] EWHC 2914, more commonly known as the RASCALS decision. This case will be of particular interest to global banking groups as it concerns the importance of inter-company arrangements and the ownership of assets.

Background

LBIE acted as a central hub to purchase and hold securities on behalf of other Lehman affiliates, including LBF, for securities transactions between Lehman entities and third parties. The group considered that LBIE may have significant regulatory capital requirements (as it paid for the securities and was reliant on unsecured intercompany debt for the purchase price).

An intra-group custody and settlement system known as RASCALS (Regulation and Administration of Safe Custody and Local Settlement) was designed (at least in part) to minimise these perceived regulatory capital requirements. The system involved a combination of computer-generated daily repurchase (repo) transactions between LBIE and LBF (mainly in relation to fixed income securities) and manually entered stock loans between LBIE and LBF (mainly in relation to equity securities).

LBIE, LBF and their mutual parent Lehman Brothers Holding Inc ("LBHI") entered into an inter-company Funding Agreement (the "Funding Agreement"), four years after the implementation of the RASCALS process. The Funding Agreement provided that no transactions entered into between LBIE and LBF would result in LBIE being regarded as lending any sums to LBF and that any funding to LBF was to be treated as provided by LBHI. This was at odds with the inter-company accounting entries, which recorded the purchase price for the securities as a debt owing from LBF to LBIE, not LBF to LBHI.

The High Court decision

The High Court held that:

- upon acquiring certain securities for the account of LBF, and prior to those securities being subjected to RASCALS processing, LBIE held the securities on trust for LBF.
- once those securities were subjected to the "on leg" of the RASCALS process, beneficial title passed to (and remained with) LBIE.
- securities subjected to RASCALS processing were "self-funding". Therefore the Funding Agreement did not apply to them. Alternatively, LBF was estopped by convention from arguing that it did.

The Appeal

LBF appealed the High Court's decision that the Funding Agreement did not apply to securities subjected to RASCALS processing. On LBF's case, the Funding Agreement did apply and LBIE had not satisfied its liability to LBF for the price of the "on leg" of the RASCALS process; thus beneficial title to the securities remained with LBF.

LBIE cross-appealed, arguing that the affiliates never obtained beneficial title to the securities. It was not the parties' common objective intention that those securities would be held on trust for LBF and, in any event, such a trust failed for lack of certainty of subject matter.

The Court of Appeal's decision

The Court of Appeal held that:

- LBIE's cross-appeal should be dismissed. It was the parties' common objective intention that upon acquiring securities for the account of LBF, LBIE would hold those securities on trust for LBF and that such a trust did not fail for a lack of certainty. Nor did it fail for lack of certainty of subject matter.
- The High Court's decision was wrong in finding that the securities were "self-funding" and that the Funding Agreement did not apply to those securities. On its true construction the Funding Agreement covered all settlement acquisitions and, on its face, had the effect that LBIE was not to be treated as a lender to LBF.
- Notwithstanding its finding in relation to the Funding Agreement, LBF's appeal should be dismissed as the parties had proceeded on the basis of a convention that (a) LBF was a debtor to LBIE, rather than LBHI (as evidenced in inter-company accounts), and (b) due to LBIE's perceived regulatory requirements, it was required to hold beneficial title in the securities and the RASCALS process was set up to achieve this aim. In such circumstances, LBF was estopped from going back on the assumption of that position and therefore the RASCALS process was effective in transferring beneficial title in the securities from LBF to LBIE.

Comment

In terms of its possible implications on other similar global banking groups, the Court of Appeal judgment shows:

- The importance of inter-company arrangements being recorded accurately and consistently so as to avoid situations where inter-company agreements

conflict with what is done in practice within the group. When contractual relationships are tested on insolvency, the Court will look at both what the contract says and what the parties did in practice.

- Even where there are difficulties in identifying securities in non-segregated accounts (which are also used to satisfy short positions), long-established principles of trust law are still applicable to the modern investment banking business.

A team led by Herbert Smith's Tim Parkes acted for LBF in the appeal.

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4. Court dismisses second attempt by investor to establish misselling of Lehman product

Camerata Property Inc v Credit Suisse Securities (Europe) Ltd [2012] EWHC 7 (Comm)

In January 2012, the Commercial Court granted Credit Suisse Securities (Europe)'s ("Credit Suisse") application for summary judgment dismissing the claim of Camerata Property Inc ("Camerata").

Background

Camerata, an investment company owned by a trust with a sole beneficiary (Mr Ventouris ("V")), invested in structured products on the advice of Mr Siakotos-Konstantinidis ("S"), an employee of Credit Suisse. One of Camerata's investments was a \$12 million purchase of a Lehman Brothers Note (the "Note"). When Lehman Brothers collapsed in 2008, V's investment in the Note was lost.

Camerata issued proceedings against Credit Suisse in respect of the losses from the Note on the basis of breach of contract and/or negligence on the part of Credit Suisse pursuant to an investment advisory service agreement (the "Investment Agreement"). These proceedings took place in January 2011 ("the First Action"). Judgment was handed down in the First Action (*Camerata Property Inc v Credit Suisse Securities (Europe) Ltd* [2011] EWHC 479 (Comm)) in March 2011. The Court dismissed Camerata's claims holding that, amongst other things, Credit Suisse could only be liable under the relevant terms and conditions of the Investment Agreement if S was grossly negligent. The Court held that S had not been negligent, let alone grossly negligent, in failing to advise V of possible counterparty risk presented by Lehman in the months prior to its collapse. Further, the court determined that during the 'relevant period' between March and September 2008 when Camerata argued that S should have advised V as to the risk of Lehman's default, it was reasonable for S to believe that Lehman and institutions of similar standing would not default, and that an investment such as the Lehman Note did not carry a serious risk of counterparty default. The Court also rejected V's evidence that he was risk-averse, concluding that V was prepared to accept a degree of capital risk for higher returns, and would have retained the Lehman Note and suffered losses even if he had been advised of speculative reports on Lehman's solvency.

The instant proceedings

In August 2011, Camerata brought further proceedings against Credit Suisse. It alleged that Credit Suisse was negligent in recommending the note to V at the very outset of their relationship in 2007. Credit Suisse, it argued, was in breach of its contractual, common law and statutory duties, as V was advised the risk associated with the Note was negligible, when in fact the Note carried a medium risk level - making it an unsuitable investment. Camerata also claimed damages for breach of statutory duty under section 150 Financial Services and Markets Act 2000 ("FSMA"). The claim was based on breaches of the FSA's conduct of business rules (COB and its successor, COBS), specifically COB rule 5.3.5(a) which required firms to take reasonable steps to ensure investment advice was suitable for customers. Camerata argued the Note was an unsuitable investment given the information provided by Camerata to Credit Suisse in the risk profile and account opening information which indicated V was "extremely risk-averse" and/or had a low risk profile.

Credit Suisse applied for the allegations to be struck out or, alternatively for summary judgment. Credit Suisse argued that the findings of the Court in the First Action were the result of a full trial between the two parties and that there was no reason to conclude that the instant action would produce a different outcome. Credit Suisse also submitted that the instant proceedings were an abuse of process because the claims ought to have been brought in the First Action.

The judgment in the instant proceedings

The Court held that Credit Suisse was entitled to summary judgment on the basis that the claim had no real prospect of success. The Court considered that Camerata's case in this instance would have required V to give evidence contrary to the findings of the Court in the First Action. These included the Court's findings on V's attitude to risk from the outset of his relationship with Credit Suisse. There was no reason why the Court should accept such evidence and to do so would be a collateral attack on the first judgment. The Court held that Camerata's claim for damages for breach of statutory duty under section 150 FSMA was "hopeless" as Camerata was not a "private person" within the meaning of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 because it was carrying on business as an investment company.

Notably, Flaux J went on to agree with Credit Suisse's contention that Camerata's claim had no real prospect of success on the basis that even if negligence was proved it did not cause Camerata's loss (relying on Lord Hoffman's speech in "SAAMCO" [1997] AC 191). Flaux J accepted that even if Credit Suisse was negligent in wrongly advising Camerata to invest in the

Lehman Note, Camerata's loss was not a result of poor advice, but of Lehman Brothers' bankruptcy and the consequent issuer default; absent such events, Camerata would have made a "handsome profit". Flaux J concluded that at the time the relevant advice was given to Camerata in July 2007, the collapse of Lehman Brothers was unforeseeable, therefore any negligence or breach of contract claim against Credit Suisse could not be held to have caused Camerata's loss, and consequently the claims advanced had no prospect of success.

Flaux J did reject Credit Suisse's submission that the instant proceedings were an abuse of process or *res judicata*. He did so on the basis that Credit Suisse was made aware of Camerata's intention to bring separate suitability claims in the First Action and could have taken steps in that action to ask the Court to make a case management decision as to whether the suitability claim should be determined in the same action.

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5. Duties of brokers liquidating positions on behalf of clients in state of default

Euroption Strategic Fund Limited v Skandinaviska Enskilda Banker AB [2012] EWHC 584 (Comm)

In the current economic climate, brokers will find the decision of the High Court in *Euroption* of considerable interest, since it considers the duties of a broker which is conducting a close-out and liquidating the position of a client which is in a state of default.

The case concerned the timing of Skandinaviska Enskilda Banker AB (the "Broker")'s right to close out a portfolio where Euroption Strategic Fund (the "Client") had failed to provide sufficient margin as required by a formal mandate document. The Client claimed that the Broker's delay in exercising its right to close-out the Client's portfolio was negligent and incompetent, and resulted in losses for the Client.

The Court held that a tortious duty of care could not be implied into the relationship either via the terms of section 13 of the Supply of Goods and Services Act 1982 or otherwise. The Court held that the implied term requiring services to be carried out with reasonable care and skill (imposed by section 13 of the Supply of Goods and Services Act 1982) applies only to agreed services provided under a contract; it does not extend to the exercise of rights and obligations under the contract. The right to close out the portfolio was not a service that the Broker had contracted to provide and there was therefore no basis to imply a requirement of reasonable care and skill into how the close-out was conducted. The Court also determined that there was no need to imply such a term into the contract between the parties in order to give business efficacy to the contract.

The Court held that there was no general tortious duty for the broker to take reasonable care in closing out the client's position, absent express contractual provisions obligating the broker to do so. The Court did not consider that the relationship between a clearing broker and investment fund was one to which it would be appropriate to extend the scope of the existing law on duty of care. Further, the close-out rights gave the Broker considerable discretion as to how to act which was only subject to limitations of good faith and rationality.

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6. Court of Appeal dismisses claim of improper valuation following Lehman collapse

WestLB AG v Nomura Bank International Plc [2012] EWCA Civ 495

On 24 April 2012, the Court of Appeal dismissed an appeal by WestLB centering on the proper valuation of a fund in the weeks following Lehman Brothers' collapse.

Background

The fund at the centre of the dispute held a basket of exotic stocks and shares in multiple jurisdictions (the "Fund"). WestLB, the appellants, and original claimants, were the holders of variable redemption notes linked to the Fund at maturity (the "Notes"). The respondents, Nomura Bank and Nomura International, were respectively the issuer and the calculation agent of the Notes.

On 30 September 2008, WestLB mistakenly paid USD\$26 million to the Fund's end Investors (who held their investments via Certificates of Deposit linked to the Notes issued by WestLB) and retained the Notes rather than delivering them to the end Investors. The effect of this mistake was that WestLB had retained the Fund's risk exposure which should have been passed to the investors at this point. Subsequently, Nomura Bank, which was entitled to exercise a physical delivery option of the Fund's underlying share portfolio to the Noteholders upon maturity (28 October 2008), issued a physical delivery notice on 4 November 2008, nearly a month later than it should have (the "Invalid Notice"). The Invalid Notice stated that the share portfolio to be delivered equated to a redemption amount of over USD\$22 million.

WestLB brought proceedings in the Commercial Court ([2010] EWHC 2863 (Comm)) on the basis that Nomura International failed to determine the Fund's value on the maturity date (30 September 2008) and in such circumstances Nomura Bank was obliged to determine the amount pursuant to the terms of the Notes, and that it did so in its Invalid Notice. West LB alleged that the defendants owed it at least the USD\$22 million set out in the Invalid Notice which was a "conclusive and binding" determination of the Fund's value by Nomura Bank as issuer, on behalf of Nomura International as calculation agent.

The Commercial Court dismissed West LB's claim on the ground that it failed to prove Nomura caused it any damage. The Court held that even if Nomura International had carried out the valuation on the proper date of 30 September 2008, the Fund would have been deemed worthless (at best worth no more than a nominal hope value) or, at any rate, would have been valued at less than the funding fee (due to be paid by WestLB to Nomura Bank) of USD\$1.7 million.

The instant proceedings

WestLB, in their appeal, submitted that (1) in the absence of a valuation by Nomura International on 30 September 2008, Nomura Bank was entitled to determine the value of the Fund and had done so in its Invalid Notice; and (2) that the judge at first instance erred in law in refusing to find that the Fund's assets had some material (albeit discounted) value as at 30 September 2008, as the judge failed to address separately the existence of loss and its assessment. Nomura Bank and Nomura International submitted that the Commercial Court had been correct in its reasoning and dismissal of WestLB's claims.

The Court of Appeal's decision

Examining WestLB's first ground of appeal, the Court held that neither Nomura Bank nor Nomura International had attempted to determine the value of the Fund under the terms of the Notes. The Court was of the opinion that Nomura Bank's decision to tender physical delivery of the Fund's underlying share portfolio was made on the basis that the Fund's assets could not be properly valued and that Nomura Bank did not know what was in the Fund.

The Court then addressed the issue of the supposed valuation made by Nomura Bank in the Invalid Notice. The Court held that the figure of USD\$22million stated in the Invalid Notice was not a valuation, but merely a "mathematical exercise" relating to the funding fee. Additionally, the Court held that the obligation to value the Fund had not been passed from Nomura International to Nomura Bank at any point. This was important because it meant that Nomura Bank was not the party responsible for valuing the Fund, and could not have done so in the Invalid Notice. Consequently, WestLB's first ground of appeal was dismissed.

With regard to the second ground of appeal, the Court stated that the premise of West LB's claim was fundamentally defective as it asked the Court to make an objective valuation of the Fund. The Court of Appeal echoed the judge at first instance to emphasise "*the decision maker is not the court, with or without expert or other evidence to assist it: the decision maker, with an absolute discretion, is Nomura (be it Nomura Bank or Nomura International)*". The Court then turned its attention to the issue of what it believed Nomura would have honestly and rationally valued the Fund at on 30 September 2008, following the principles set in *Socimer International Bank Limited v Standard Chartered Bank London Limited* [2008] EWCA Civ 116. The Court was of the opinion that, given the nature of the portfolio, and the nature of the global markets in the ensuing liquidity crisis, there would have been no basis for Nomura to have valued the portfolio at any more than a five per cent "hope value".

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7. The battle over swap agreements entered into by foreign local authorities continues

Depfa Bank Plc v Provincia Di Pisa and Dexia Crediop SpA v Provincia Di Pisa [2012] EWHC 687 (Comm)

In the most recent decision in *Depfa Bank Plc v Provincia Di Pisa* in March 2012, the English court refused Depfa Bank Plc and Dexia Crediop SpA's (the "Banks") application to make a referral to the ECJ under Article 267 of the Treaty on the Functioning of the European Union. This has resulted in an increased risk of conflicting judgments from the English and Italian courts regarding the validity of swap agreements entered into by Italian public authorities.

This matter relates to two swap agreements entered into by the local authority in Pisa ("Pisa"). Pisa had challenged the validity of the swaps on the basis that its decisions to enter into the swaps were invalid due to the lack of competence of its Director of Finance Services or due to the fact that they were *ultra vires*.

In 2010, the Banks brought proceedings in the English courts seeking declaratory relief and payment under the swaps (which contained exclusive English jurisdiction clauses). Pisa challenged the English court's jurisdiction on the basis of Article 22(2) Council Regulation 44/2001 (the "Brussels Regulation"), arguing that the proceedings were concerned with the validity of the decisions of its organ to enter into the swaps and were therefore subject to the exclusive jurisdiction of the Italian courts. Article 22(2), which deals with the exclusive jurisdiction of courts regardless of domicile states "*in proceedings which have as their object the validity of the constitution, the nullity or the dissolution of companies or other legal persons or associations of natural or legal persons, or of the validity of the decisions of their organs, the courts of the Member State in which the company, legal person or association has its seat. In order to determine that seat, the court shall apply its rules of private international law*".

However, the English court dismissed the challenge and held that the proceedings were not "principally concerned" with the validity of the decisions made by Pisa, but with the question of whether the swap agreements were invalid, for whatever reason (*Depfa Bank plc v Provincia Di Pisa* [2010] EWHC 1148 (Comm)). This decision is very much in line with the later judgment of the ECJ on the same issue in *Berliner Verkehrsbetriebe (BVG), Anstalt des öffentlichen Rechts v JPMorgan Chase Bank NA* (Case C-144/10, 12 May 2011). In that case, the ECJ confirmed that the grounds for exclusive jurisdiction contained in Article 22 Brussels Regulation are to be given a narrow

interpretation, and that Article 22(2) does not apply in a contract claim in which the validity of an entity's decision to enter into that contract was "at best an ancillary issue". (See our [2011 Banking Litigation Update](#) for further details on the ECJ judgment.)

In the English proceedings in September 2010, Pisa challenged the validity of the swaps on the basis that it exercised its power of self-redress under Italian law and as a consequence the local authority's resolutions and decisions to enter into the swaps had been cancelled with retrospective effect. Pisa served a Defence and Counterclaim in the English proceedings asserting that the swaps are not binding on it and are unenforceable due to the cancellation of the decisions of the Director of Financial Services.

Separately, in December 2010, Pisa brought proceedings in the Administrative Court in Italy seeking a declaration on similar bases - ie the validity of the swaps and retrospective cancellation. The Consiglio di Stato (on appeal from the Administrative Court), in September 2011, held that the administrative courts in Italy had the power under Articles 121 and 122 of the Code of Administrative Procedure to decide on the effect of the cancellations upon the swaps. The Banks appealed the decision to the Italian Supreme Court and have argued that the English courts have exclusive jurisdiction (in accordance with the exclusive jurisdiction clauses contained in the swaps) to decide upon the validity of the swaps. The Banks have argued that Articles 121 and 122 of the Code of Administrative Procedure are potentially incompatible with the Brussels Regulation (in particular Article 23).

Pending resolution of the Bank's appeal in Italy which is not due to be heard until the end of 2012 (at the earliest), the Banks, in the instant proceedings, asked the English court to refer the matter to the ECJ. The question the Banks want resolved is whether proceedings in which a public authority alleges that swaps are invalid (and where that authority has sought to annul the decisions to enter into those swaps), fall within the scope of the Brussels Regulation as "civil and commercial matters".

The English court refused to make the requested referral as the question was not one which was in issue between the parties in the English proceedings. The English court has acknowledged that it is unsatisfactory that both the English (civil) and the Italian (administrative) courts have decided that they have jurisdiction to determine the validity of the swaps, and that a risk of irreconcilable judgments in two Member States has consequently arisen. However, the Court held that it is for the Italian court to refer the question as to whether Articles 121 and 122 of the Code of Administrative Procedure are incompatible with the Brussels Regulation to the ECJ. It will have to be awaited whether the Italian court refers the matter to the ECJ, failing which there is a real risk of incompatible judgments and possibly a Pyrrhic victory for the Banks in the English courts.

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8. Jurisdiction battles: the importance of issuing proceedings swiftly in bank's preferred forum

UBS Limited & UBS AG v Regione Calabria [2012] EWHC 699 (Comm) QBD

In a further dispute over interest rate swaps between financial institutions and foreign local authorities, the English Court has stayed two sets of proceedings brought by UBS Ltd and its parent UBS AG for declarations of non-liability, on the basis of Articles 27 and 28 of Council Regulation (EC) No 44/2001 (the "Brussels Regulation"). The case exemplifies the need for banks to ensure that when a dispute arises with potentially competing bases for jurisdiction and the bank has a preferred jurisdiction, it should act swiftly in commencing proceedings in its preferred forum.

Background

In 2002 Calabria entered into an Advisory Contract with UBS Limited to provide services with regards to the public authority's regional debt. It was agreed that the Advisory Contract would be governed by Italian law. Subsequently, UBS Limited and its parent company, UBS AG, entered into multiple interest rate swap transactions with Calabria governed by an ISDA Master Agreement (agreed by UBS AG and Calabria, and later novated to UBS Limited) providing that the governing law of the agreement was English law.

In April 2010, as a result of Calabria's dissatisfaction with the transactions, Calabria commenced proceedings in the Court of Cantazaro against UBS Warburg AG, a non-existent entity. In December 2010, UBS Limited and UBS AG brought separate proceedings in the English High Court requesting declarations of non-liability with respect to the swap transactions which were subject to the claims being brought by Calabria in the Italian courts. The Defendant, Calabria, issued an application in the English proceedings challenging the jurisdiction of the English court. It argued that the English court did not have jurisdiction, or alternatively should not exercise jurisdiction, over the claims brought against it by the UBS entities on the basis that the proceedings fell within Article 27 or alternatively Article 28 of the Brussels Regulation.

Articles 27 and 28 Brussels Regulation

Article 28 provides that, where related actions are pending in the courts of different Member States, any court other than the court first seised may stay its proceedings. Actions are deemed to be related where they are so closely connected that it is expedient to hear and determine them together to avoid the risk of irreconcilable judgements resulting from separate proceedings. This contrasts with Article 27 which provides that, where proceedings involving the same cause of action and between the same parties are brought in the courts of different member states, any court other than the court first seised must stay its proceedings until the jurisdiction of the first court is established. Where the jurisdiction of that first court is then established, any subsequent court is to

decline jurisdiction in favour of the first court.

The Judgment

UBS argued that there were no proceedings against either UBS Ltd or UBS AG in Italy of which the Italian court was first seised, or indeed seised at all for the purposes of Articles 27 or 28. It argued that the Italian proceedings were commenced against and served upon a non-existent entity – UBS Warburg AG, and that by virtue of the Italian Code of Civil Procedure both the summons and its service were invalid. The English court rejected this argument and held that UBS Ltd was the counterparty to the Advisory Contract referred to in the Italian court summons. The body of the summons referred to UBS Ltd and further by appearing before the Italian court to challenge, *inter alia*, the validity of the summons and the Italian court's jurisdiction, it was clear that the summons reached the intended recipient. For such reasons, service was deemed valid under the Italian code. Consequently, the English court stayed the English proceedings on the basis that the proceedings in England by UBS Ltd involved the same cause of action as the proceedings in Italy, and in accordance with Article 27 the Italian court was first seised.

The English court also held that although the Italian court was not seised of proceedings against UBS AG, the UK and Italian proceedings were considered related within the meaning of Article 28. The English court chose to exercise its discretion under Article 28 to stay proceedings. It did so because it was of the opinion that the potential degree of overlap between the two sets of proceedings was such that there was a substantial and acute risk of irreconcilable judgments.

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9. General litigation items

Costs consequences of settlement offers made outside Part 36

The Court of Appeal has held that the court was not entitled to apply the Part 36 costs consequences "by analogy" to award indemnity costs and enhanced interest where a party failed to beat an opponent's settlement offer which was not made under Part 36: *F & C Alternative Investments (Holdings) Limited & Ors v Barthelemy & Anor* [2012] EWCA Civ 843.

The decision illustrates the courts' strict approach to the application of Part 36, and therefore the need for careful drafting to ensure that an intended Part 36 offer complies with the formal requirements set out in the Civil Procedure Rules. Where an offer falls outside Part 36, whether intentionally or otherwise, the court will not simply apply the Part 36 costs consequences as if it had been a valid offer.

Legislation bringing in Jackson reforms becomes law

The Government's Legal Aid, Sentencing and Punishment of Offenders Bill, which (among other things) implements key aspects of the Jackson reforms, received Royal Assent on 1 May 2012 and so has become law. The changes being introduced under the Act, and which are expected to come into force in April 2013, include:

- removing restrictions on contingency fees or "damages-based agreements" (DBAs) for civil litigation;
- abolishing the recoverability of conditional fee agreement (CFA) success fees and after the event (ATE) insurance premiums; and
- introducing additional sanctions for defendants who fail to accept a claimant's reasonable Part 36 offer to settle.

Note, however, that the Government has delayed implementation of some of the reforms in insolvency cases. The Government announced in May 2012 that CFA success fees and ATE insurance premiums will continue to be recoverable in insolvency proceedings until April 2015, despite recoverability being abolished for other cases from April 2013. Click [here](#) to read more.

New "Handy client guide to privilege" published

We have published a new guide to legal professional privilege under English law, comprising:

- A decision tree: intended as a quick reference to help determine which documents can legitimately be withheld on grounds of privilege; and
- Practical tips for maintaining privilege: aimed at minimising the risks of unhelpful, non-privileged material being produced.

The guide is available both as an interactive PDF, with links to more detailed information and articles, and as a hard copy guide. Click [here](#) to access the "Handy client guide to privilege" home page on our "litigation notes" blog, or contact [Christina Southgate](#) if you would like a hard copy.

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