

THE BANKING
LITIGATION
LAW REVIEW

THIRD EDITION

Editor
Deborah Finkler

THE LAWREVIEWS

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PREFACE

This year's edition of *The Banking Litigation Law Review* demonstrates that the increase in litigation involving banks shows little sign of slowing.

Although disputes arising from the 2008 financial crises are reaching their end, what might be termed 'normal' banking litigation has resumed, and is in no short supply. This crosses the full spectrum from claims by consumers against banks (relating to losses incurred either to the bank or to third parties) to claims by banks for the recovery of loans and the enforcement of guarantees. In all these cases, cross-border issues frequently arise, and banking litigation remains an important source of developments in the conflicts of laws in international commercial litigation.

The context for much of the consumer litigation is the growing – and increasingly complex – range of consumer protection regulation in the various jurisdictions under review. However, while the courts appear content to apply that legislation in order to hold banks to account, its existence – together with the more extensive rights it affords to consumers – has meant that in many parts of the world the courts are less willing to expand consumer rights beyond the context of that regulation, instead preferring to enforce the contractual rights between banks and customers strictly.

In those circumstances, we have seen a growth in the use of class actions and representative claims, often where consumers can take advantage of friendly regulation. These mechanisms are being adopted in countries where they did not previously exist, in some cases by changes in legislation, and in others by changes to court procedure. At the same time, courts in different jurisdictions are reacting very differently to this new or growing type of litigation. In some cases this is by seeking to restrict the circumstances in which such claims can be made but in others by promoting their use. It therefore remains to be seen whether the growth of class actions and representative claims against banks is really a worldwide phenomenon.

These novel forms of litigation, and other more conventional claims, are also subject to a global trend towards making both the courts and, importantly, alternative forms of dispute resolution more available to litigants. We continue to see parties encouraged to settle their claims out of court, by way of general mechanisms such as mediation or by way of specialised banking ombudsmen. Further, some jurisdictions are promoting the use of class or group settlements, which can resolve major disputes with limited court involvement.

At the same time, the impact of data protection legislation, including the General Data Protection Regulation (GDPR) in the European Union, has opened a further means by which claimants can bring claims against banks, which are inevitably major holders of personal data. The use of the GDPR both as a tool in litigation and as a source of complaint or damages in itself is, therefore, a concern for banks, both in a regulatory and in a litigation context. This concern is only likely to grow.

One bright spot for banks is a general trend in favour of upholding assertions of secrecy, confidentiality and privilege on the part of banks and their advisers against claimants. This is especially important in the context of investigations against banks. In common law jurisdictions in particular, courts now tend to treat such investigations as akin to adversarial litigation and after the concerns raised over the past year or two, now largely accept that many documents created during investigations should be protected by privilege.

Finally, the general political and economic uncertainty around the world remains a probable source of banking litigation, especially where that uncertainty negatively affects investors. Nobody is any closer to being able to say what the political or economic impact of Brexit will be either to the United Kingdom's banking sector or to that of the European Union. It would be dangerous to predict when clarity in this regard will be available.

Deborah Finkler

Slaughter and May

London

November 2019

AUSTRIA

Holger Bielez, Paul Krepil and Florian Horak¹

I OVERVIEW

In terms of sheer numbers of cases, litigation proceedings in Austria have decreased over recent years. Banking litigation was no exception in this regard. While there is no unanimous perception as to what reasons lie behind this development, it is fair to say that the complexity of the pending cases has increased and has made court proceedings more cost- and time-consuming. At the same time, the continued activities of the Austrian legislature impose more extensive and detailed duties on financial institutions in particular. In this chapter, some of the significant recent developments in case law and legislation will be summarised and show that banking disputes will likely remain a key driver of the case law development in Austria, both in the field of civil procedure and substantive law.

II SIGNIFICANT RECENT CASES

The following noteworthy cases have recently been dealt with by the Austrian courts.

i Jurisdiction for prospectus liability claims: decisions by the European Court of Justice of 12 September 2018² and the Austrian Supreme Court of 24 October 2018³

In September 2018 the European Court of Justice (ECJ) rendered a preliminary ruling on jurisdiction with regard to prospectus liability damage claims.

The defendant, a London-based credit institution, issued index certificates through its branch in Frankfurt in the form of bearer bonds, which were subscribed by institutional investors and subsequently resold to consumers in Austria on the secondary market. The certificates were issued on the basis of a German base prospectus. Ms Löber, a consumer, who is domiciled in Vienna invested in the certificates through two separate Austrian banks, one with its seat in Salzburg and the other with its seat in Graz. Ms Löber subsequently filed a damage claim with the Commercial Court of Vienna, inter alia, based on prospectus liability.

By way of an order dated 18 July 2016, the Commercial Court declined jurisdiction and dismissed that action on the ground, inter alia, that, with regard to the conditions for the application of Article 5(3) of Regulation No. 44/2001, Ms Löber had not submitted that the damage at issue had occurred directly in a bank account that could be associated with her at

1 Holger Bielez is a partner, Paul Krepil is an associate and Florian Horak is a consultant at Wolf Theiss.

2 ECJ 12 September 2018, C-304/17 (*Löber*).

3 OGH 24 October 2018, 3 Ob 185/18d.

a bank in Vienna. According to that court order, since Ms Löber had acquired the certificates through banks in Graz or Salzburg, the damage had, therefore, arisen in Graz and Salzburg and not in one of the areas for which that court had jurisdiction. Ms Löber brought an appeal against that order before the Higher Regional Court in Vienna. The Austrian Supreme Court then decided to stay the proceedings and to refer to the Court of Justice the following question for a preliminary ruling:

Under Article 5(3) of [Regulation No 44/2001], in non-contractual claims based on prospectus liability where the investor took his investment decision caused by the defective prospectus at the place where he is domiciled, and, on the basis of that decision, he transferred the purchase price for the security acquired on the secondary market from his account held with an Austrian bank to a clearing account held with another Austrian bank, from where the purchase price was subsequently transferred to the seller by order of the applicant,

- a) *does jurisdiction lie with the court within whose area of jurisdiction the investor is domiciled,*
- b) *does jurisdiction lie with the court within whose area of jurisdiction the seat/the account-keeping branch of the bank with which the applicant has his bank account from which he transferred the amount invested to the clearing account is located,*
- c) *does jurisdiction lie with the court within whose area of jurisdiction the seat/the account-keeping branch of the bank which keeps the clearing account is located,*
- d) *does jurisdiction lie with one of those courts at the choice of the applicant,*
- e) *does jurisdiction lie with none of those courts?*

The ECJ subsequently issued the following ruling:

Article 5(3) of Council Regulation (EC) No 44/2001 [...] must be interpreted to the effect that in a situation, [...], in which an investor brings, [...], a tort action against the bank which issued that certificate, the courts of that investor's domicile, as the courts for the place where the harmful event occurred [...], have jurisdiction to hear and determine that action, where the damage the investor claims to have suffered consists in financial loss which occurred directly in that investor's bank account with a bank established within the jurisdiction of those courts and the other specific circumstances of that situation also contribute to attributing jurisdiction to those courts.

In its ruling the ECJ does not stipulate a general rule determining strict connecting factors to a certain jurisdiction. In contrast to earlier decisions,⁴ which merely clarified which courts do not have jurisdiction and which connecting factors are not sufficient, the ECJ affirms jurisdiction in the present case and bases its decision on 'certain circumstances'. The ECJ, however, does not define these circumstances in a strict sense. Rather, the ECJ explicitly justifies jurisdiction on the basis of an overall assessment of the 'specific circumstances of the proceedings'.⁵

Based on the ECJ ruling the Austrian Supreme Court⁶ subsequently concluded that the ECJ considers the courts of the claimant's domicile as competent to deal with the tort claims, if certain additional preconditions are met. These preconditions could be summarised as meaning that the acts, which are typical for these kinds of investments, giving rise to

4 ECJ 10 June 2004, C-168/02 (*Kronhofer*), ECJ 28 January 2015 (*Kolassa*).

5 See also *Schacherreiter*, ÖBA 2019/85.

6 OGH 24 October 2018, 3 Ob 185/18d.

the damage, took place within the jurisdiction of the domestic courts and other specific circumstances do not point to the domicile of the defendant. In particular, according to the ECJ, in the present case these facts are the following: the domicile of the claimant lies within Austria, all payments in respect of the investment process were made from Austrian bank accounts, the claimant entered into the obligation which reduced her assets in Austria and the claimant acquired the certificates on the Austrian secondary market on the basis of the prospectus information notified to the Austrian supervisory bank. With its ruling the ECJ basically established another *forum actoris* for claimants' tort claims. It remains to be seen how future cases will be decided when the above acts, which can be considered typical for certain investments, are conducted in different jurisdictions and there is no clear indication for specific circumstances pointing in the direction of one jurisdiction.

ii Internal commissions to be disclosed to investors: decision by the Austrian Supreme Court 26 February 2019⁷

In February 2019 the Supreme Court rendered a decision on the liability of investment advisers due to the violation of duties to disclose internal commissions.⁸

In 2006 the claimant decided to invest €350,000 in an investment fund after two extensive counselling interviews with an investment adviser who was an employee of the defendant, an Austrian-based credit institution. The adviser informed the claimant that a commission had to be paid to the credit institution. However, the adviser did not point out to the claimant that another 3 per cent of the investment sum paid by the claimant would be returned to the defendant by the respective investment funds. The adviser, however, was unaware of this (additional) commission payment as within the organisation of the defendant only a few people were informed about this internal commission.

The Supreme Court based its decision on the following assumptions: (1) if the defendant had not received any further remuneration from the investment funds in addition to the 3 per cent commission, it would not have included these investments in its product portfolio and consequently an investment in the respective investment funds would not have been recommended to the claimant; and (2) if the claimant had been aware of this additional commission payment, he would not have acquired this product but rather would have sought a different investment instead.

In its ruling the Supreme Court pointed out that in terms of undisclosed internal commissions a claim for damages is established, unless the credit institution can prove that there is no conflict of interest and, consequently, in respect of the credit institutions' breach of duty the acquisition of the investment does not lie within the causal nexus between the unlawful act and damage (*Rechtswidrigkeitszusammenhang*). The fact that the acting adviser had no knowledge of internal commissions is, however, irrelevant in cases where the credit institution through special sales-promoting measures had influence on the advisory activities of its employees and, therefore, also on the investment decisions of its customers.⁹

7 OGH 26 February 2019, 8 Ob 166/18x; ÖBA 2019/85.

8 According to the Austrian Securities Supervision Act (WAG) and Supreme Court Jurisprudence (RS0131382) internal commissions are to be disclosed to potential investors irrespective of the fact that the investor can trust that the investment adviser would not receive any commissions from third parties.

9 OGH 26 February 2019, 8 Ob 166/18x; ÖBA 2019/85.

iii Investment consultancy has no duty to inform about the general risk of insolvency: decision of the Supreme Court of 24 October 2018¹⁰

In this recent decision the Supreme Court clarified that when providing investment advice, there is no general obligation of advisers to draw attention to the general insolvency risk of an issuer. The decision was triggered by way of an action brought by the Chamber of Labour to which claims arising from alleged incorrect investment advice by the defendant, a financial services provider, had been assigned.

The investors of the bonds in question were willing to acquire investments in the medium risk range. The adviser working for the defendant then presented to the investor's corporate bonds and subsequently, in respect of possible risks, pointed out that 'something can happen' respectively that 'higher interest rates are associated with a little more risk'. Apart from that, the bond was basically described as safe and secure. In July 2013 insolvency proceedings were opened over the issuer's assets. At the time the bonds were acquired, there were no indications of impending insolvency.

The Supreme Court pointed out that while, in general, an investment adviser is obliged to inform his or her clients about the risk potential of the envisaged investment; the obligations of conduct to be followed in this regard can, however, only be assessed on the basis of the specific circumstances of the individual case. According to the Supreme Court, the concrete elaboration of the advisory duties, therefore, depends on a whole series of factors, which refer on the one hand to the person of the customer and on the other hand to the investment project. There is, however, no general obligation to inform an investor about the general risk of insolvency of the issuer of certain investment products. Furthermore, the Supreme Court stated that there is no obligation for advisers to inform about their ignorance of a risk that they did not have to be aware of in the first place. Eventually the Supreme Court confirmed in its decision that in the event of a breach of duties by investment advisers in terms of providing information to potential investors, it is up to the injured party to maintain and prove the causal link between the breach of duty and the occurrence of the damage.

iv Liability due to incorrect brokerage of life insurance policies: decision of the Supreme Court of 21 November 2018¹¹

In this decision the Supreme Court pointed out that the principles on liability for incorrect investment consultancy can be applied in cases of incorrect brokerage of life insurance policies due to similar interests.

In the case at hand the claimant acquired a blended unit-linked endowment and life term insurance policy through his adviser, who sold insurance products on a commission basis for the defendant, an insurance brokerage house. In this regard the policies transmitted to the claimant always referred to the defendant as broker. In July 2007 the adviser recommended to the claimant the product 'X certificate', whereby it was clear to both that the claimant wanted to acquire exclusively a product equipped with a capital guarantee. The consultant subsequently assured the claimant that the recommended product was equipped with a capital guarantee at the end of the fixed term of 15 years. In June 2010 the claimant then received a letter by the insurance brokerage house, which informed the claimant that the issuer of the certificate had stated that the published price of the certificate was 'zero' due to the opening of

¹⁰ OGH 24 October 2018, 3 Ob 187/18y.

¹¹ OGH 21 November 2018, 7 Ob 196/17z; ÖBA 2019, 451.

insolvency proceedings against the hedge fund. Furthermore, the defendant terminated the insurance contract with the claimant. The claimant then found out that that when setting up the insurance contract the adviser had made a mistake. As a result, the claimant in fact did not acquire a capital-guaranteed product.

In its decision the Supreme Court then pointed out that the principles on liability for incorrect investment consultancy are to be applied to cases of incorrect brokerage of life insurance contracts in respect undesired characteristics of an acquired product (here: unit-linked endowment and life term insurance policy without capital guarantee instead of with capital guarantee) because of the similar state of interests. In the Supreme Court's opinion, as long as claims of the policyholder against the insurer arising from the contract can still exist (such as rights of withdrawal), the situation is comparable to that of the investor who retained the unwanted financial product.

III RECENT LEGISLATIVE DEVELOPMENTS

i Beneficial Owner Register Act

The Beneficial Owner Register Act (BORA) was introduced in Austria by way of implementation of Articles 30 and 31 of Directive (EU) 2015/849¹² into national law and provides for a register of ultimate beneficial owners (UBOs) of all legal entities listed in Section 1 of the BORA.¹³ Reportable entities must notify their beneficial owners to a register, observe various due diligence requirements and, in the case of violations, face strict sanctions. The register aims to support those professional groups that are subject to stringent anti-money laundering and terrorist financing rules (i.e., financial institutions).¹⁴ The BORA entered into force on 15 January 2018.

Reportable entities

In general, all relevant company structures with their registered seat in Austria are required to register their UBOs. Reportable entities include unlimited liability partnerships, limited liability partnerships, limited liability companies, public limited companies and Societas Europaea, etc. In addition, trusts managed in Austria and trust-like agreements are also included.

UBOs

UBOs are all natural persons who own or control a registering entity (irrespective of the domicile of such entity). UBOs can be divided into three groups (capital ownership percentage, voting interest and factual control) on the basis of which ownership and control is determined. In general, the Act distinguishes between three types of economic owners:

- a direct economic owners: these are natural persons who:
 - hold 25 per cent plus one share, or more than a 25 per cent participation of the registering entity or the respective votes; or

12 Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

13 Mainly, the entities listed in Section 1 of the BORA are registered with the Austrian Commercial Register.

14 Barbist/Gassner, 'The new register for beneficial owners', *Ecolex* 2017, p. 1,170.

- exercise control over the management of the registering entity, whereby ‘control’ is defined as holding – either directly or indirectly – 50 per cent in shares plus one share, or more than a 50 per cent participation of the registering entity or the respective votes. Control is further assumed under the circumstances applicable for drawing up consolidated annual financial statements pursuant to Section 244, Paragraph 2 of the Austrian Enterprise Act;¹⁵
- b indirect economic owners as UBOs: these are natural persons who ‘control’ (see above) an entity that directly or indirectly holds 25 per cent plus one share, or more than a 25 per cent participation in the registering entity or the respective votes. If more than one registering entity is controlled by the same natural person or the same natural persons, either directly or indirectly, and cumulatively exceed the thresholds of 25 per cent plus one share, or more than a 25 per cent participation in another entity, then such natural person shall be regarded as the economic owner of such entity; and
- c *ex lege* economic owner: if no economic owner can be determined according to the above framework (i.e., the top entity is a listed company with widely held stock), the management of the registering entity is determined as the UBO by operation of law.¹⁶

Special provisions apply for partnerships, cooperatives, (foreign) trusts and foundations.

Exceptions

In certain cases, exceptions from mandatory registration apply. This is the case for partnerships and limited liability companies, for example, if the personally liable direct partners or shareholders consist only of natural persons and, thus, the relevant data for the register can easily be taken from the commercial register. However, these exemptions only apply if no person other than the legally registered person exercises direct or indirect control over the management of the legal entity.

Due diligence

According to Section 3 of the BORA, an entity subject to mandatory registration has to ascertain and verify the identity of its ultimate beneficial owners at least once a year. Therefore, there is the requirement for entities to undertake regular investigations and to store the relevant corresponding documentation. In order to fulfil this due diligence duty, all necessary measures to understand the ownership and control structure need to be taken by the registering entity. As indicated above, the UBO can, in any case, only be a natural person.¹⁷

15 Section 244 of the Austrian Enterprise Act includes parent companies having in another company (subsidiary): (1) the majority of voting rights of shareholders; (2) the right to appoint or remove the majority of management or supervisory bodies, in the case the parent company is also a shareholder; (3) the right to exercise a controlling influence; or (4) the right to decide, on the basis of an agreement with shareholders of one or more subsidiaries, comparable to voting rights of a shareholder, on the appointment or revocation of the majority of the administrative, management or supervisory body.

16 See Section 2, Paragraph 1(b) BORA.

17 Kühne, ‘The determination of the beneficial owner according to the Beneficial Owner Register Act’, *Ecolex* 2018, p. 205.

Right to inspect the register

Unlike the commercial register, the UBO register is not publicly available. Section 9 of the BORA provides for a list of entities that are granted a right to inspection. Besides certain authorities, this list, inter alia, includes the following persons and organisations: financial institutions, attorneys at law and public notaries. However, inspections are only permissible in the context of applying due diligence to prevent money laundering and terrorist financing in relation to customers or to advise clients on the identification, verification and reporting of their UBOs.

Sanctions

Violations of the mandatory registration or incorrect reports are considered financial offences and can lead to a fine of up to €200,000 (for intent) or €100,000 (for gross negligence). For unauthorised inspections of the register, a fine of up to €100,000 may be imposed in the case of deliberate conduct.

Deadline for registration

Initial filings have to be made before 15 August 2018. This deadline, originally proclaimed for 1 June 2018, was extended by decree of the Federal Ministry of Finance owing to the high number of registrations.

ii The Fifth Money Laundering Directive

Although Directive (EU) 2015/849 (Fourth Money Laundering Directive) had only to be implemented into national law by EU Member States by 26 June 2017, which took place in Austria by way of implementing the Financial Market Money Laundering Act,¹⁸ there is already a new requirement for action on part of the national legislature. In June 2018, the Fifth Money Laundering Directive,¹⁹ amending Directive (EU) 2015/849, was enacted, and must be implemented by EU Member States by 10 January 2020.

In Austria the Fifth Money Laundering Directive will be implemented by the EU Financial Adaptation Act 2019, which will, inter alia, amend the Financial Market Money Laundering Act (FMMLA) and BORA. The Fifth Money Laundering Directive will implement several innovations, as outlined below.

Enhancement of the scope to obliged entities

In addition to auditors, external accountants and tax advisers, the scope of the Fifth Money Laundering Directive will be extended to any other person who undertakes to provide material aid, assistance or advice on tax matters as principal business or professional activity. Furthermore, activities of estate agents, when acting as intermediaries in the letting of immovable property in relation to transactions with a monthly rent of €10,000 or more are also included within the extended scope of the Fifth Money Laundering Directive. To meet the growing market for cryptocurrencies and online currency platforms, providers engaged in exchange services between virtual currencies and fiat currencies, as well as custodian wallet

18 Bieleisz/Krepil/Horak, *The Banking Litigation Law Review* – Edition 2, Chapter II.ii.

19 Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU.

providers, have been included in the extended scope. Finally, the trade of works of art has been included, where the value of the transaction or a series of linked transactions amounts to €10,000 or more, even when the trading is carried out by art galleries or auction houses.

Increased customer due diligence

With respect to electronic money the Fifth Money Laundering Directive will also increase transparency for e-money products. Thus, the maximum monthly payment transaction limit for reloadable payment instruments was reduced to €150, whereas the possibility for Member States to increase the maximum limit to €500 was deleted. Further, the existing thresholds for general purpose anonymous prepaid cards was lowered to €50 and for transactions exceeding this amount customer identification was established, which results in stricter know-your-customer (KYC) rules.

With respect to business relationships involving high-risk third countries, enhanced KYC measures have been implemented to achieve a harmonised treatment of such countries within the EU Member States, for example as follows: (1) obtaining additional information on the customer and on the beneficial owner or owners; (2) obtaining additional information on the intended nature of the business relationship; (3) obtaining information on the source of funds and source of wealth of the customer and of the beneficial owner or owners; (4) obtaining information on the reasons for the intended or performed transactions; (5) obtaining the approval of senior management for establishing or continuing the business relationship; and (6) conducting enhanced monitoring of the business relationship by increasing the number and timing of controls applied, and selecting patterns of transactions that need further examination.

Enhanced transparency for the UBOs

Currently, the UBO register is not publicly available.²⁰ However, implementing the Fifth Money Laundering Directive will allow any ‘member of the general public’ to access at least the name, the month and year of birth and the country of residence and nationality of the UBO as well as the nature and extent of the beneficial interest held. In addition, it will become mandatory to access the UBO register, whenever entering into a new business relationship with a corporate or other legal entity, which may be subject to the UBO register.

iii Possible class action provisions

It seems that the Ministry of Justice has abandoned its plans to implement real class action provisions in Austria.²¹ In contrast, the European Commission presented a draft proposal for its ‘New Deal for Consumers’ in April 2018, aiming to strengthen citizens’ rights by allowing the filing of class-action suits. The European Commission is working on rules for two categories of lawsuits: one for situations in which a limited group of people suffered comparable harm and would collectively sue the defendant; and the other for low-value cases in which many consumers only suffered a small loss. In the latter case, the benefit would go to a public cause benefiting consumers. Separately, the European Union is proposing harsh fines of up to 4 per cent of a company’s annual turnover for firms found guilty of

20 See Section II.i.

21 www.ots.at/presseaussendung/OTS_20171124_OT0028/liste-pilzkolba-vw-geschaedigte-brauchen-rasch-die-sammelklage (last visited on 26 June 2018).

widespread infringements. The latest initiative of the European Commission is perceived as a consequence of the diesel scandal, which may not – according to some – be adequately addressed within the European Union.²²

IV INTERIM MEASURES

i General

In Austria, it is possible to request a preliminary injunction to secure a monetary claim in cases of subjective endangerment in the course of pending civil proceedings or before filing a claim. The relevant provisions are regulated within the Austrian Enforcement Act (AEA).²³ The precondition for such a preliminary injunction is the existence of subjective endangerment respective to the recovery of the claim. A case of subjective endangerment may be argued successfully if it is obvious that without a preliminary injunction the opposing (and likely to be liable) party will make it difficult for the other party to pursue its claim, for example, by damaging, destroying, hiding or moving away assets²⁴ (see Section 379, Paragraph 2, No. 1 of the AEA).

With regard to banking litigation, the abusive demand of bank guarantees is a very common ground to file a request for a preliminary injunction. In such cases, the bank, which issued the guarantee, is prohibited from paying a debt to the opposing party by court order. If a bank violates the court order, it becomes liable for damages.²⁵ To secure monetary claims, the court is limited to specific measures depending on the respective object. The following measures are regulated in the AEA (Section 379, Paragraph 3):

- a* A prohibition addressed to third-party debtors not to pay a debt to the opposing party. This is a frequently used method to secure funds. For example, the bank holding an account for the opposing party is prohibited by way of court order to make any payment upon the opposing party's instruction or to make payments owing to an abusive demand of a bank guarantee.
- b* Movable objects including money: if it is possible to put the object into judicial custody, or administration or management, the court may further render an order to the opposing party to refrain from giving away, selling or pawning the movable object.
- c* Immovable objects: if it is possible to put the object into judicial custody, or administration or management, the court may further render an order to the opposing party to refrain from giving away, selling, hypothecating or registering any encumbrances in the Land Register.

ii Cross-border interim measures

It is also possible to enforce an external freezing order or an injunction in Austria. The enforceability and recognition of an external freezing order depends on whether the court decision was rendered in an EU Member State or in a non-EU or foreign country.

22 id.

23 RGeBl 1896/79, in its applicable version.

24 Kodek in Angst/Oberhammer, EO3, Section 379, AEA, Paragraph 7ff.

25 Kodek in Angst/Oberhammer, EO3, Section 379, AEA, Paragraph 34.

EU Member States

In general, the regime of the Brussels Ia Regulation²⁶ is also applicable to freezing orders and requests for interim measures, such as injunctive relief. As a result, freezing orders and injunctive relief by another Member State's court are automatically recognised and enforceable in Austria without any further procedure on recognition required.²⁷ However, since recognition and enforcement can be rejected by other EU Member States if the opponent was not granted a hearing (or the injunction was not at least served on the opponent before) – *ex parte* injunctions are frequently not recognised and enforced – only those freezing orders and injunctions where the defendant has been granted a hearing in the Member State of origin can subsequently be recognised and enforced in another Member State.

With regard to bank accounts within the European Union (except Denmark and the United Kingdom), Regulation (EU) No. 655/2014²⁸ establishes a European Account Preservation Order procedure to facilitate cross-border debt recovery in civil and commercial matters.

Foreign/non-EU countries

Freezing orders and interim injunctions that have been rendered in a foreign country outside the European Economic Area (EEA) are enforceable in case bilateral or international treaties are in place, which foresee mutual recognition and enforcement. In principle, freezing orders or interim injunctions must be formally declared enforceable, before enforcement may be sought. The following general requirements for the issuance of a declaration of enforceability are set forth in Section 406 of the AEA:²⁹ (1) a foreign judgment is enforceable in the state in which it was rendered; and (2) reciprocity with the state of origin is established by way of bilateral treaties or other instruments (actual reciprocity by way of judicial 'practice' does not suffice).

The party seeking to receive the declaration of enforceability needs to file such request to the competent Austrian court. According to the AEA, the district court of the opposing party's domicile has jurisdiction. In addition, the party is required to enclose certified copies of all relevant documents with such request. The application for enforcement may be combined with the request.

According to Section 408 of the AEA, the declaration of enforceability may be refused if:

- a* pursuant to Austrian rules on jurisdiction, the foreign court could not, under any circumstances, have jurisdiction over the legal matter;
- b* the opposing party was not properly served with the document that initiated the foreign proceeding;
- c* the opposing party could not properly participate in the foreign proceeding owing to irregularities in the proceeding; or
- d* the judgment violates basic principles of Austrian public policy.

In practice, interim relief is typically sought before the Austrian courts if Austrian assets will be secured. This is because most of the creditors want to make use of the surprise effect of

26 Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012.

27 Thomas Garber in *Angst/Oberhammer*, EO3, Section 79, AEA, Paragraph 11.

28 Regulation (EU) No. 655/2014 of the European Parliament and of the Council of 15 May 2014.

29 Before 1 December 2016, the respective provisions were included in Section 79, AEA.

ex parte injunctions, which can normally be obtained faster in the country where they shall be enforced (and for the limitations of recognition of foreign injunctions). Applications for enforcement of injunctions from non-EEA countries in Austria are extremely rare.

iii Procedure in Austria

With the request for a preliminary injunction, the applicant must provide available evidence, such as documentary evidence and affidavits that can be immediately examined by the court. Foreign-language documents should be presented with German translations. Generally, a decision on a request for a preliminary injunction is rendered within several days or weeks. Regarding appellate proceedings, a time frame of one to three months for the second instance proceeding and a further two to four months in third instance proceedings should be expected.

V PRIVILEGE AND PROFESSIONAL SECRECY

Section 9, Paragraph 2 of the Austrian Lawyers Act (ALA) sets forth the lawyer's duty of confidentiality regarding all matters that were disclosed to him or her in his or her function as counsel whose non-disclosure is in the interest of the client. Therefore, a lawyer has the right to deny testifying in court or before any other authority according to the respective procedural provisions. Section 9, Paragraph 3 of the ALA prohibits circumventing this principle by, for example, interrogation of employees of the lawyer or seizing communications. The procedural implementation of these principles has led to several not entirely identical provisions in the various codes of procedure.³⁰

Regarding criminal proceedings, the attorney's right to deny testifying as a witness is stated in Section 157 of the Austrian Code of Criminal Proceedings (ACCP).³¹ As mentioned above, owing to the prohibition on circumventing, seizing communications between attorneys and defendants is also prohibited. An amendment of the provision means that this is now also applicable in cases where these communications are located outside the attorney's office (e.g., at the defendant's apartment). However, there is the requirement that all documents and data must have been created either by the attorney or the defendant. Documents that have been created by another person (e.g., a legal expert) and later handed to the defendant or the attorney do not fall within the provision.

In addition to those already mentioned, similar provisions can be found in: Section 321 of the Code of Civil Procedure, Sections 89 and 104 of the Finance Criminal Code, Section 49 of the Code of Administrative Procedure and Sections 171 and 143 of the Austrian Fiscal Code.

30 Prunbauer-Glaser, '*Legal Professional Privilege*' v. *Schutz der anwaltlichen Verschwiegenheit*', AnwBl 2013, p. 56.

31 Owing to the implementation of Directive 2013/48/EU, an amendment of Section 157 of the ACCP entered into force on 1 November 2016.

VI JURISDICTION AND CONFLICTS OF LAW

There are, generally speaking, no specific rules on jurisdiction and conflicts of law regarding banking institutions, therefore the general rules set forth below apply.

i Domestic rules on jurisdiction

The Austrian judicial system differentiates between local jurisdiction and competence of the courts. The competence of a court mainly depends on the amount in dispute. District courts are the first instance to decide in civil law cases with a maximum amount in dispute of €15,000. In addition, the district courts have competence irrespective of the amount in dispute on certain types of cases, for example, family and rent law cases. Regional courts as courts of first instance are responsible for rulings in all matters not assigned to district courts.

In the Austrian Court Jurisdiction Act,³² there are several provisions regulating jurisdiction. As a basic principle, the court at the defendant's place of residence has jurisdiction. For consumer-based claims, the Austrian Consumer Protection Act (ACPA)³³ also stipulates that according to the basic principle on jurisdiction, the court at the defendant's place of residence has jurisdiction. Consumer-based claims are matters relating to a contract concluded by a person for a purpose that can be regarded as being outside his or her trade or profession.

According to Section 104 of the Austrian Court Jurisdiction Act, for non-consumer-based claims, the parties may agree on a forum clause. The forum clause has to be in writing and to be valid it must specify a specific litigation or any legal dispute that may arise from a specific contractual relationship. Choices of forum clauses for consumer-based claims that violate the special jurisdiction for consumer-based claims are null and void.

ii International jurisdiction

International jurisdiction – except where the defendant is not domiciled within the EU (see Article 6 of the Brussels Ia Regulation) – is regulated by the Brussels Ia Regulation. According to the Regulation, in principle, the court of the Member State of the defendant has jurisdiction.

Article 7 of the Brussels Ia Regulation constitutes a supplement to the general principle of jurisdiction. In matters relating to a contract, a person domiciled in a Member State can be sued in the courts of the place of performance of the obligation in question (Article 7, Paragraph 1a). In matters relating to tort, delict or quasi-delict, a person domiciled in a Member State can be sued in the courts for the place where the harmful event occurred or may occur (Article 7, Paragraph 3). This is deemed to also include the place where the damage occurred. In other words, a forum can be established both in the place where the event triggering the damage took place and the place where the damage actually occurred. The provision plays a crucial role with regard to cross-border banking disputes as it enables claimants to sue a bank in their home jurisdiction, provided that the place of performance or the place of the damaging event is there. However, the provision regularly gives rise to interpretation issues, which lead to disputes on jurisdiction and may prolong the dispute.

32 RGGI, No. 111/1895, in its applicable version.

33 BGBl, No. 140/1979, in its applicable version.

According to Article 25 of the Brussels Ia Regulation, the parties of a contract may agree on the jurisdiction of a court of a Member State. There does not have to be a connection between the parties and the forum. Unless agreed otherwise, the chosen forum has exclusive jurisdiction. A choice of forum clause must fulfil one of the following conditions to be valid:

- a the forum clause must be in writing or evidenced in writing;
- b the choice of forum is according to practices that the parties have established between themselves; or
- c the choice of forum is according to international commercial customs.

Last but not least, the rules on consumer jurisdiction pursuant to Articles 17 and 18 of the Brussels Ia Regulation must be borne in mind in particular with respect to banking disputes. Generally, the provisions allow for consumers to sue their counterparty at the place of their domicile or at the defendant's domicile. However, lawsuits filed by the consumer's counterparty may only be filed at the consumer's domicile.

iii Conflicts of law

In Austria, conflicts of law are generally regulated by the International Private Law Act.³⁴ Further, in relation to contractual obligations, the Rome I Regulation³⁵ is relevant and regards non-contractual obligations in the Rome II Regulation³⁶ (including obligations derived from *culpa in contrahendo*).

In principle, the parties, both in business-to-business and business-to-consumer contracts, are free to choose the applicable law. Failing a choice of law, the Rome I Regulation provides that depending on the circumstances, either the law of the place where the service provider is resident applies or the law of the party that performs the characteristic obligation applies (Article 4 of the Rome I Regulation). More complex rules apply to international consumer contracts. Pursuant to Section 13a of the ACPA, certain sets of rules cannot be altered by way of a choice of law, if the choice of law leads to the application of the law of a non-EEA Member State (Paragraph 1). In addition, the Austrian law provisions governing the application and validity of general terms and conditions of a consumer contract are mandatory in all cases where the consumer contract was concluded because the counterparty expanded its commercial activity to Austria, and the consumer contract was concluded as a result of such activity (Paragraph 2). This means that the general terms and conditions of any foreign bank directing its retail business to Austria must comply with the mandatory Austrian rules governing application and validity of such general terms and conditions.

The Rome I Regulation also allows the courts of the Member States to apply 'its overriding mandatory' rules, irrespective of which law applies to the contract (Article 9 of the Rome I Regulation).

The application of foreign law has to be established *ex officio*. In such cases, the court that has to apply foreign law will consult with the Austrian Ministry of Justice and has to rely on expert opinions. If foreign law cannot be established within a stipulated time frame despite considerable efforts, Austrian law will be applied.

34 BGBl No. 304/1978, in its applicable version.

35 Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), OJ 2008, L 177, p. 6.

36 Regulation (EC) No. 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II), OJ 2007, L 199, p. 40.

VII SOURCES OF LITIGATION

Banking litigation in recent years has revealed that banks are more likely to be defendants in lawsuits than plaintiffs. Nevertheless, a few cases with high amounts in dispute were initiated by banks, for example, a case filed by a well-established Austrian bank against an Austrian community seeking redress for the closing costs of derivative instruments with negative market value, which had been purchased by the public administration in order to improve its debt management.

With regard to banks as defendants, numerous cases were triggered following the start of the financial crisis in 2008, which concerned alleged breaches of advisory duties in the context of the marketing and sale of certificates. These included claims based on prospectus liability if the bank was involved in the issuance or control of prospectus information. These cases reached four-digit sums at various Austrian courts and were responsible for a significant statistical increase in lawyers' caseloads.

Such cases are now in decline as they are being resolved by way of final judgment or settlement. However, nowadays banks seem to be increasingly exposed to representative actions filed by consumer protection associations, primarily the Austrian Consumer Association (VKI), seeking the removal of terms and conditions used by banks for alleged non-compliance with transparency and *contra bonos mores* rules, as provided for in Austrian consumer law. The most recent example is the issue of negative interest loan agreements (including FX loans), which focuses on the extent to which banks are obliged to pass on the economic benefit of negative interest in loan arrangements to the customer.

VIII EXCLUSION OF LIABILITY

According to Austrian law, a total exclusion of liability is prohibited. Provisions to that effect are therefore null and void. Consequently, exclusion of liability for intentional or conscious violations is not possible. Whether this also applies for certain cases of gross negligence is often discussed by scholars. Generally, exclusion of liability for gross negligence is – even though there are some exceptions – not permissible. Exclusion of liability for slight negligence is largely permissible,³⁷ but not for personal injury.³⁸

The Austrian Consumer Protection Act (ACPA) provides for certain provisions limiting the entrepreneurs' right to exclude or limit their liability for damages. For other damages (e.g., financial loss) exclusion of liability is not possible for gross negligence and intentional damages according to the ACPA.³⁹ Moreover, any contractual provision included in the general terms and conditions or contractual form shall be ineffective if it is unclear or unintelligible.

Regarding gross negligence, the Supreme Court distinguishes between gross negligence and extreme gross negligence, which implies conduct that cannot be expected on the basis of usual daily life experience. According to the Supreme Court, exclusion of liability for extreme gross negligence contradicts good manners and is, therefore, considered equal to intentional damaging conduct. Thus, exclusion of liability for extreme gross negligence is prohibited

37 Krejci in Rummel/Lukas, ABGB4 Section 879, Civil Code, Paragraphs 122 to 130.

38 Reischauer in Rummel, ABGB3 Section 1298, Civil Code, Paragraph 10a.

39 Reischauer, 'Contractual exclusion of liability for culpable conduct, in particular gross negligence', ÖJZ 2009/114.

in any case. Agreements that exclude liability for extreme gross negligence are, therefore, null and void. The circumstances in which conduct can be considered grossly negligent or extremely grossly negligent constitutes a difficult normative question that, to a great extent, depends on the facts of each case.⁴⁰

i Credit reports

Regarding credit reports, the Supreme Court ruled (7 Ob 666/84)⁴¹ that exclusion of liability for gross negligence – but not for extreme gross negligence – was justified and valid owing to the fact that companies could largely pass on their general business risks (i.e., their relevant credit risk (owing to the insolvency of their customers) onto the financial or credit institutions.⁴² In the Supreme Court's view, providing credit reports is a big business that has high risks as the conditions subject to the assessment are, in some cases, very complex. The Supreme Court argued that credit and financial institutions generally have little self-interest in this regard as they do not usually receive any compensation for providing such credit reports. Therefore, financial institutions have a legitimate interest in restricting their liability. For this reason, it seems possible to restrict liability to extremely grossly negligent and intentional conduct.

ii Consulting on funding opportunities

The Supreme Court's jurisprudence on exclusion of liability concerning credit reports is, however, not applicable with regard to consulting on funding opportunities in connection with the financing of a company. The specific issues in one underlying decision (6 Ob 541/92)⁴³ were whether exclusion of liability was permissible for miscounselling in connection with funding opportunities. In this respect, the Supreme Court argued that credit and financial institutions generally have self-interest in the conclusion of the business transaction especially when the consulting services are closely linked to credit accommodations.⁴⁴ Therefore, a legitimate interest to restrict one's liability is not predominant. For this reason, an exclusion of liability for grossly negligent conduct would be null and void.

IX REGULATORY IMPACT

Generally, the increasing pressure applied to banks by the regulator makes financial institutions cautious as to whether they are ready to introduce new products of higher complexity. This conduct reduces the risk of getting exposed to litigation. Currently, financial institutions are still prioritising getting in line with constantly evolving regulatory requirements, regarding, for example, the updated anti-money laundering rules (see Section II.ii) and the changes incurred through the future implementation of the Markets in Financial Instrument Directive (MiFID) II.

40 Krejci in Rummel/Lukas, ABGB4, Civil Code, Section 879, Paragraphs 122–130.

41 OGH 22 November 1984, 7 Ob 666/84; SZ 57/184; EvBl 1985/98 p. 495; RdW 1985, p. 73; JBl 1986, p. 168.

42 Reischauer, 'Contractual exclusion of liability for culpable conduct, in particular gross negligence', ÖJZ 2009/114.

43 OGH 11 June 1992, 6 Ob 541/92; ÖBA 1993, p. 325 (Jabornegg); JBl 1993, p. 397; RdW 1992, p. 399.

44 Reischauer, 'Contractual exclusion of liability for culpable conduct, in particular gross negligence', ÖJZ 2009/114.

At the same time, we expect the latest regulatory developments, such as MiFID II, to continue influencing the case law of the civil law courts. More so than before, breaches of the regulatory rules will be construed as breaches of contractual or pre-contractual duties enabling the customer to adapt or rescind a contract or seek damage compensation. Banks are therefore likely to continue focusing primarily on their internal processes, implementing the increased regulatory duties of care not only to avoid administrative sanctions, but also to reduce the risk of exposure in civil litigation.

X OUTLOOK AND CONCLUSIONS

In the years following the 2008 financial crisis, banking litigation played a significant role before the Austrian courts, especially in Vienna. In particular, damage claims filed by retail investors for wrongful advice or wrongful prospectus information were responsible for capacity restraints before the courts. The sheer number of these lawsuits and their complex nature contributed to the significance of these banking litigation cases in Austria after 2008. Nowadays, such claims are in decline as many cases not yet filed with the court are under increased risk of being rejected as time-barred. This decline does not seem to have been compensated by new cases.

However, representative lawsuits filed by consumer associations (dealing with the application and validity of general terms and conditions towards banks' customers) will continue as the banks are under competitive pressure and cannot afford to relent, especially in cases where the dispute with the consumer organisation will have an impact on the income of the bank. The latest disputes regarding the 'negative interest' cases serve as an example. Further, we anticipate an increase in litigation cases against former management board members of financial institutions based on breaches of professional duties of care.

BRAZIL

José Luiz Homem de Mello, Pedro Paulo Barradas Barata and Sasha Roéffero¹

I OVERVIEW

Brazil is a highly litigious country. The number of civil lawsuits related to financial and banking litigation is significant and involves all financial institutions, such as banks, payment agencies, credit card companies, banking correspondents, investment funds and insurance companies.

Banking litigation typically arises from contractual default or disputes on financial transactions, interest rates, loans, improper charges, pricing and products, or services defects. The principal matters related to banking litigation currently under discussion before Brazilian courts are discussed below.

II SIGNIFICANT CASES

Monetary stabilisation plans

From 1986 to 1994, the Brazilian federal government implemented several consecutive monetary stabilisation plans (MSPs), to combat hyperinflation. To implement these plans, the federal government enacted several laws based on its power to regulate the monetary and financial systems as granted by the Brazilian Federal Constitution (the Constitution).

Holders of savings accounts during the periods when the MSPs were enacted have challenged the constitutionality of the laws that implemented those plans, claiming additional amounts of interest from the banks where they held their savings accounts based on the inflation rates applied to savings accounts under the MSPs. As a result, Brazilian financial institutions became defendants in numerous standardised lawsuits filed by individuals, consumer protection associations or public attorneys' offices in respect of the MSPs. Holders of savings accounts may collect any amount owing on account of a final decision.

The Federal Supreme Court (STF) has issued a number of decisions in favour of such holders, but has not issued a final ruling with respect to the constitutionality of the MSPs as applicable to savings accounts. In relation to a similar dispute with respect to the constitutionality of the MSPs as applicable to time deposits and other private agreements, the STF has decided that the laws were in accordance with the Constitution. In response to this discrepancy, the National Confederation of the Financial System, an association of Brazilian

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financial institutions, filed a special proceeding before the STF² arguing that holders of savings accounts did not incur actual damages and that the MSPs, as applicable to savings accounts, were in accordance with the Constitution.

At the time of writing the matter is pending a final decision. All actions on the subject without a final judgment have been suspended since the STF recognised the general repercussion of the disputes and decided to judge four appeals assigned as ‘leading cases’.³ This means that what is decided with regard to these appeals will be valid for all similar lawsuits, presently suspended.

At the end of 2017, consumer protection associations – including the Brazilian Consumer Defence Institute (IDEC), the Brazilian Association of Consumers’ Rights and the Brazilian Savers’ Institution – jointly with the Brazilian Bank Federation and the National Financial System Confederation, reached a collective settlement agreement with the purpose of solving disputes related to MSPs.

The settlement agreement, which was mediated by the Federal Attorney General, provides for the payment, by the financial institutions, of the amounts corresponding to the inflationary purges of savings on behalf of consumers, according to the limits and criteria set forth in the instrument.

In March 2018, the STF’s plenary session ratified the collective agreement within the appeals assigned as ‘leading cases’, to produce legal effects based on Article 487(III)(b) of the Code of Civil Procedure.⁴ According to the STF, the agreement will close collective actions related to the matter, as well as solve thousands of individual lawsuits filed by consumers who choose to adhere to its terms.

The STF also determined the stay of the appeals for a period of 24 months, so that consumers that meet the criteria established under the agreement may voluntarily adhere to its terms, by means of an electronic platform.⁵ Hence, consumers’ adherence to the agreement is not mandatory. If a consumer opts in, the Court will dismiss the individual lawsuit with prejudice.

If, however, a consumer chooses not to adhere to the agreement within the 24-month period, it will no longer be possible to do so. In this case, the individual lawsuit will continue in its normal course.

Note that the STF expressly established that the ratification of the collective agreement signed by consumer protection associations and financial institutions does not imply any commitment of the STF to the juridical thesis contained in the appeals affected as leading cases. This means that the STF has not decided on the merits of the matters under discussion.

2 ADPF No. 165.

3 Extraordinary appeals Nos. 626.307, 591.797, 631.363 and 632.212.

4 ‘Adjudication on the merits will occur when the judge: III. certifies: (...) (b) a settlement.’

5 www.pagamentodapoupanca.com.br.

III RECENT LEGISLATIVE DEVELOPMENTS

i Regulatory

In 2001, in order to improve the relationship between market participants and foster additional transparency, discipline, competition and reliability on the part of financial institutions, the National Monetary Council (CMN) established and consolidated a new set of procedures regarding the settlement of financial transactions and services provided by financial institutions to customers and the public in general.

These rules have been revised and are now consolidated in Resolution 3,694 of 26 March 2009, which were substantially amended in 2013, in 2016 and again in 2019. The aim of the regulations is to prevent risks of litigation in the contracting of transactions and rendering of services to clients. The CMN and the Central Bank have also been issuing regulations with respect to operational risk, in order to have stricter control and avoid litigation risks, following Basel Accord guidelines.

In Resolution 3,694, financial institutions must ensure that the following is provided in their transactions and services to customers:

- a* the products and services being offered or recommended are adequate for the needs, interests and objectives of clients and users (suitability);
- b* the transactions are carried out in a comprehensive, reliable, safe and confidential manner, and the transactions and services rendered are legitimate;
- c* the necessary information to allow for the client's and user's free choice and decision-making processes, including rights, duties, responsibilities, costs or advantages, penalties and possible risks when carrying out a transaction or rendering a service, is provided in a timely fashion;
- d* the client or user is provided with agreements, receipts, statements, advice and other documents related to the transactions and services, as well as the possibility of timely cancellation of the agreements in a timely fashion;
- e* clear, objective and adequate wording is being used, in relation to the type and complexity of the transaction or service involved, in contracts, receipts, statements, vouchers and other documents intended for the public, thus allowing for a clear understanding of the content and terms, values, charges, fines, dates, places and other conditions involved;
- f* an adequate instrument has been put in place to set out the rights and obligations concerning the opening, use and maintenance of a post-paid payment account;
- g* payment instrument is forwarded to the client's or user's residence or to enable the respective instrument only upon express request or authorisation; and
- h* the identification of final users' beneficiaries of payments or transfer in statements and bills of the payer, including in situations in which the payment service involves institutions participating in different payment arrangements.

With regard to point (c) above, when a deposit account or payment account is opened, it must be accompanied by a booklet containing essential information and it must, at minimum, explain the basic rules, existing risks, contracting and termination procedures, safety measures (including in case of loss, theft or hacking of credentials), and the method and timing for updating of record data by clients.

Financial institutions must disclose, on their own premises and at the establishments where their products are offered, in a visible place and in legible form, adequate information on the circumstances that give rise to refusal of payments or acceptance of checks, payment slips, documents (including collection documents), bills, etc.

Financial institutions are prohibited from refusing or impairing access to ordinary customer service channels (including cashiers) by clients and users of their products and services. These provisions do not apply to virtual establishments or to the provision of collection and receipt services arising from contracts or agreements that provide for specific customer service channels.

The option for providing services through alternative means is permitted, provided that the necessary measures have been taken to safeguard the integrity, reliability, security, safety and confidentiality of transactions carried out, as well as the legitimacy of services provided, with regard to the rights of clients and users, who shall be informed by the institutions about the existing risks.

All of these rules are set forth in a generic nature, and there is no specific guidance on their implementation, except for the day-to-day contact between the financial institutions and the Central Bank as the supervising entity.

In the event such regulations are not observed, financial institutions are subject to administrative penalties issued by the Central Bank, in addition to liabilities in the civil sphere already discussed.

ii E-payments Law

Over the past decade, the volume of transactions using payment instruments in the wholesale market increased significantly. In view of this, in 2013, the federal government enacted the E-payments Law,⁶ which provides the legal framework for 'payment arrangements' (i.e., the set of rules governing a payment scheme, such as credit or debit card transactions), and 'payment agents' (i.e., any agent that issues a payment instrument or acquires a merchant for payment acceptance), which became part of the Brazilian Payment System and subject to oversight by the Brazilian Central Bank (the Central Bank). Note that payment agents are not deemed to be financial institutions and are prohibited from engaging in activities that are exclusive to these institutions.

The E-payments Law brought within the scope of the CMN and the Central Bank supervision the entire market of credit, debit and prepaid cards that were not previously regulated.

Following the E-payments Law, the CMN and the Central Bank enacted a set of rules on payment arrangements and payment agents, which became effective in May 2014. This set of rules encompasses, among others: (1) consumer protection and anti-money laundering compliance and loss prevention rules that should be followed by payment agents and payment arrangers; (2) the procedures for incorporation, organisation, authorisation and operation of payment agents, as well as for the transfer of control, subject to the Central Bank's prior approval; (3) payment accounts, which are broken down into prepaid and post-paid accounts; and (4) a liquidity requirement for prepaid accounts by which their balance must be allocated to a special account at the Central Bank or else invested in government bonds, starting at a lower rate and rising gradually to the total account balance.

⁶ Law 12,865 of 9 October 2013.

Following discussions with market players and industry representatives, the Central Bank has been adjusting and improving the regulations over time, mainly to include operational and non-discriminatory tools to foster competition in the payments market.

IV CHANGES TO COURT PROCEDURE

In Brazil, banking litigation is not subject to a specific law. Disputes involving banks and other financial institutions are governed by the provisions of the Code of Civil Procedure.

On 18 March 2016, the Code of Civil Procedure⁷ (the Code) came into effect, which brought changes to the procedure rules in force since 1973.⁸ The Code aims to simplify the procedural action, as well as to favour the celerity of disputes and effectiveness of the result of the proceeding. One of the Code's main purposes is the granting of greater autonomy to the parties to manage how to pursue the lawsuit (i.e., setting deadlines, hearings, acceptable evidence).

The main changes brought about by the Code are outlined in the following subsections.

i Promoting mediation

Litigation is common in Brazil, and in view of the increasing number of lawsuits filed before national courts, the Code strives for stimulation of settlements, by strengthening mechanisms such as mediation and conciliation, in order to decrease the number of claims.

In this scenario, the Code makes mandatory a conciliation or mediation hearing at the beginning of the proceeding, even before the defendant presents his or her answer to the complaint. There may be as many sessions designed for conciliation and mediation as necessary for the parties to settle, during a period not exceeding two months from the date when the first session is held (Article 334).

ii Procedural transactions

The Code sets forth crucial measures to give autonomy to the parties to decide on their dispute. If the suit deals with rights that are open to settlement, parties may lawfully provide for changes in the proceeding to adapt it to the specificities of the case and to stipulate procedural obligations, powers, privileges and duties, before or in the course of the proceeding (Article 190).

Contenders set such changes through 'procedural transaction', which may consider, among other matters, the burden of proof, production of evidence, forum selection, waiver of the right to appeal, deadlines and arbitration agreement.

iii Standardising judicial precedents

The Code requires that higher courts (i.e., state courts and regional federal courts) standardise their precedents and keep them stable, fair and consistent, and issue guiding precedents based on their prevailing court rulings (Article 926).

It also provides that, when judging disputes, judges and courts shall observe (1) the STF's decisions rendered under the model of centralised constitutional review; (2) binding precedents; (3) appellate decisions rendered in incidental proceedings for assumption

7 Federal Law No. 13,105 of 16 March 2015.

8 Federal Law No. 5,869 of 11 January 1973.

of jurisdiction or for resolution of same subject-matter suits, and, in the judgment on extraordinary and special appeals on the same matter of law; (4) guiding precedents set by the STF and the Superior Court of Justice (STJ); and (5) the stand of the full bench or special body to which they report (Article 927).

iv Resolution of repetitive lawsuits

Brazil has an excessive number of lawsuits in progress before national courts, many of which have similar legal issues under discussion. In view of this, the Code shaped a measure named ‘incident for resolution of repetitive demands’ that enables appellate courts to simultaneously solve different cases that contain controversy regarding the same legal matter, provided that they pose risk to equality and legal certainty (Article 976).

When a certain legal issue is highly recurrent, the judge, the parties or the Public Prosecutor’s Office may request an incident for resolution of repetitive demands to the court’s president. Once the incident is assigned, the reporting justice orders the suspension of all pending individual lawsuits or class actions on the same matter, in the state or region.

After the incident is ruled, the decision shall be applied to (1) all individual or class actions dealing with an identical matter of law and being processed in the jurisdiction of the respective court; and (2) future cases that deal with an identical matter of law and are processed within the territorial jurisdiction of the court.

With regard to banking litigation, currently, there is one main incident pending judgment, regarding the level of abuse of interest rates involving bank contracts.⁹

v Interim measures

Interim measures are granted by the court to provide urgent relief, in order to avoid any harm to the effectiveness of the process or damages that may result from its delay.

The Code of Civil Procedure 1973, repealed in March 2016, used to provide for different types of provisional measures, referred to as ‘typical provisional measures’ (i.e., anticipated discovery motion, precautionary measure for disclosure of documents, seizure precautionary measure), to prevent, preserve or defend the parties’ rights before the conclusion of the lawsuit.

The (new) Code has simplified the legal system previously in force, henceforth stipulating that the party may request a provisional relief based on urgency or evidence (Article 294), entered before the lawsuit is filed or incidentally.

The court will grant a relief based on urgency when there are elements evidencing the likelihood of an asserted right and a risk of injury or risk to the practical result of the proceeding. The court may enforce this relief through seizure, sequestration, inventory of assets, registration of protest against disposal of assets, and any other valid measure to assure the asserted right.

When the condition of urgency is concurrent with filing of the suit, the complaint may be limited to a request for advance relief, specifying the claim for final relief and detailing the dispute, the right sought, and the risk of damage or the risk to the ultimate outcome of the case. Should the court grant the relief, the opposing party must file an interlocutory appeal against the relevant decision (Article 303). If the defendant fails to appeal, the advance relief becomes permanent, causing the dismissal of the case.

9 Lawsuit No. 0872123-67.2016.8.13.0000 – Minas Gerais State Higher Court.

In addition, the interested party may plead relief based on evidence, regardless of proof of any risk of damage or risk to the case's practical result, when, among other cases, the defendant is manifestly abusing its right of defence or making use of delaying tactics; or the statements of fact may be evidenced only by documents, and a legal principle has been settled in a judgment on same subject-matter suits or in a binding precedent (Article 311).

Furthermore, although the Code has extinguished the typical provisional measures set forth by the previous Code, it expressly authorises judges to apply any measures that they consider appropriate to enforce provisional relief (i.e., seizure, sequestration and inventory of assets), regardless of the parties' request, including in collection actions, which frequently involve financial institutions.

In respect to collective actions, legal doctrine recognises that judges may also apply measures of psychological pressure on the defendant or debtor to guarantee compliance with financial obligations (e.g., suspension of driver's licence, restriction of passport, cancellation of the debtor's credit card), even though these measures do not ensure the immediate satisfaction of the debt.

V PRIVILEGE AND PROFESSIONAL SECRECY

The Constitution provides protection to lawyers in the exercise of their profession. Such protection is reflected in the Lawyers and Brazilian Bar Association's Statute,¹⁰ which guarantees the inviolability of lawyers' offices or place of work, as well as of their working instruments; and written, telephonic and telematic mail, as long as they are related to the performance of the profession.

Regarding professional secrecy, the Ethics Code of the Brazilian Bar Association¹¹ sets forth that lawyers have the duty to keep confidential all facts of which they become aware as a result of the profession. Communication of any nature between lawyers and their clients is presumed to be confidential.

Lawyers are also not obliged to testify, in judicial or administrative proceedings, on matters to which they must maintain professional secrecy. Moreover, when applying on behalf of third parties, against ex-clients or former employers, lawyers must safeguard professional secrecy.

Professional secrecy is a public policy principle. Thus, it is not dependent on the client's confidentiality request. Notwithstanding, professional secrecy might be disregarded in exceptional circumstances for justified reasons, such as in cases of serious threat to the right to life and honour, or in situations of self-defence. In addition, Brazilian courts recognise that professional secrecy might be disregarded in cases where the lawyer is suspected of unlawful behaviour (i.e., the lawyer becomes an accessory to the crime that is being investigated).

10 Law No. 8,906 of 4 July 1994.

11 Resolution No. 02/2015.

VI JURISDICTION AND CONFLICTS OF LAW

Brazilian courts have exclusive jurisdiction to decide on actions relating to real property located in Brazil; to examine and decide on probate proceedings of a deceased person's Brazilian estate, even in cases where the deceased was a foreigner and resided abroad; and in divorce, judicial separation or dissolution of cohabitation, to provide for distribution of property located in Brazil, even if the owner is a foreigner or is domiciled abroad.

In addition, filing a lawsuit before a foreign court does not prevent Brazilian courts from ruling the same case if the defendant, regardless of his or her nationality, is domiciled in Brazil; the obligation is to be performed in Brazil; the actions result from an event that occurred or an act that was performed in Brazil.

Brazilian courts have jurisdiction to adjudicate lawsuits arising from consumer relations, when the consumer is resident or domiciled in Brazil. Accordingly, Brazilian courts shall have concurrent jurisdiction to rule claims involving clients of financial institutions resident or domiciled in Brazil even if a lawsuit is filed abroad.

Article 25 of the Code provides that Brazilian courts have no jurisdiction to process and adjudicate on a lawsuit when there is a clause electing an exclusive foreign forum in an international contract. Nevertheless, such provision does not apply to the principle of exclusive jurisdiction, mentioned above in this section.

To that extent, financial contracts might provide for a contractual clause selecting the jurisdiction to which eventual disputes between the contracting parties will be submitted, regardless of any specific connecting factor to Brazil. Nonetheless, courts may render the forum selection clause ineffective, especially in cases involving consumers.

This is because consumer relations in Brazil are ruled by the Consumer Protection Code,¹² a law issued to protect the consumers. Section 101(I) of the Code provides that consumer disputes will be processed and judged in the jurisdiction of the consumer's domicile.

Nevertheless, the rules of the Consumer Protection Code apply only to agreements entered into between suppliers and users to supply products or services. Brazilian law does not present a clear concept of 'end user', however.

Currently, there are two different schools of thought regarding the concept of 'end user'. The first, known as the maximalist school, advocates that 'end user' refers to a practical perspective, meaning that if an entity or person acquires a product or service and is not going to resell such product or service to a third party, it should be considered the end user of such product or service, for legal purposes.

That is to say that, even if the person or entity acquires the product or service as supplies entering into its manufacturing process, it should be considered the end user of the supplies. Thus, the Consumer Protection Code would rule the relation existing between such end user and the supplier of the goods or service.

The second school of thought, the finalist school, understands that the concept of 'end user' has an economic nature. To that extent, if the person or entity acquires supplies that will be used in its manufacturing process, it should not be considered the end user of the supplies. This concept should also be considered to have a commercial nature as it is ruled by the Civil Code. This is the standing adopted by most Brazilian scholars.

After a number of conflicting decisions on the matter, the STJ reached the conclusion that the individual that acquires goods or services to be used in its manufacturing chain

12 Law No. 8,078 of 11 September 1990.

in a for-profit activity, is not a consumer in the legal sense of the word (finalist school). Notwithstanding this, the STJ allows exceptions to this rule in cases where the end user is vulnerable compared with the supplier, allowing the application of the Consumer Protection Code.

Specifically concerning financial products and services, after extensive debates, Brazilian courts held that they are subject to the Consumer Protection Code,¹³ as long as the counterparty to the agreement is regarded as an end user, that is, a person acquiring the products and services but not using them for profit-making purposes.

Consequently, Brazilian courts may deem a forum selection clause invalid when provided under a financial contract involving a consumer (end user). In this case, the dispute will be processed and ruled in the jurisdiction of the consumer's domicile, pursuant to the Consumer Protection Code.

In any event, if the financial contract does not involve a consumer, the financial institution and the counterparty may elect a foreign court to settle any disputes that may arise from such contract, in accordance with Article 25 of the Code.

VII SOURCES OF LITIGATION

There are a substantial number of lawsuits involving financial institutions in Brazil.

Lawsuits engaging financial institutions as plaintiffs most commonly concern credit collections arising from clients' default. On the other hand, disputes engaging financial institutions as defendants are usually related to consumer matters, such as lawfulness of MSPs; improper registration of consumers in credit protection agencies; and irregularities related to the integrity, reliability, security, secrecy or legitimacy of operations and services offered to clients.

There are also several lawsuits filed by consumers against financial institutions claiming the reduction of interest rates set forth in financial contracts. Such lawsuits derive from the fact that, in Brazil, there is no legal provision limiting interest rates in banking transactions. Thus, the contracting parties are free to negotiate interest rates that are convenient.

Based on the Consumer Protection Code, however, courts may review the agreements already signed and determine a reduction in the agreed-upon interest rate if it holds that said interest rate causes unreasonable disadvantage for the consumer. On this subject, the STJ also stated that it may review a banking agreement entered into by a consumer if the financial institution charges blatantly excessive interest rates.

Within this context, financial institutions face mass litigation because of consumer claims, pleading the reduction of charged interest rates in defaulted agreements. Nevertheless, as a rule, only when the agreed-upon interest rate is higher than the average market rate should the contractual revision occur.

VIII LIABILITY

Brazil's civil liability system is based on the general provisions of the Civil Code. According to this system, a person will be held civilly liable in case it carries out an illicit act and there is causation between such illicit act and the loss caused to the aggrieved party.

13 Precedent 297. The Consumer Protection Code is applicable to financial institutions.

In principle, there is no separate legal framework for financial institutions when it comes to civil liability. Nevertheless, as mentioned above, the STJ has already decided that the Consumer Protection Code, which provides for specific rules on suppliers' liability, is applicable to the relationship between financial institutions and consumers.

Therefore, as outlined in subsections i and ii, below, Brazil has a dual system of liability for financial institutions: (1) for corporate clients, the basic principles of civil law liability established in the Civil Code; and (2) for consumers, a more protective system based on the Costumer Protection Code.

i The Civil Code

The general rule of civil liability under Brazilian law arises from Sections 186 and 927 of the Civil Code, by which a person is liable to redress the damage caused to another person resulting from its fault or wilful misconduct.

Brazilian law divides civil liability into at-fault liability and strict liability. Sections 186 and 927 (main section) of the Civil Code set forth the general rule of at-fault liability. According to the doctrine, in order to characterise at-fault liability, the agent must carry out an illicit act, for the purposes provided in Section 186.¹⁴

Section 927, sole paragraph, of the Civil Code sets forth the general rule of strict liability. According to this provision, an agent may be held liable independent of fault when such agent is subject to strict liability, regardless of whether there has been an error in conduct.

Strict liability is, therefore, liability grounded on risk, which consists of:

*the obligation to compensate for the damage caused as a result of activity developed concerning the agent's interest and under its control, without any questioning on the behaviour of the aggrieving party, setting such liability as strict, that is to say, in the relationship of cause and effect between the damage itself and the conduct taken by the party causing such damage.*¹⁵

Hence, at-fault liability differs from strict liability to the extent that at-fault liability requires the existence of fault in the conduct of the agent, while strict liability depends only on the existence of a causal relationship between the conduct and the damage.

Most of the relationships between financial institutions and their clients are subject to at-fault liability. That is to say that the client has the burden of proof to show the illicit act (fault), the damage and the causation between both.

Nonetheless, court precedents have shown situations in which there is strict liability of financial institutions, based on the understanding that a financial institution's activities can cause risk to the rights of other parties, as provided under the sole paragraph of Section 927 of the Civil Code.

14 As per Section 186 of the Civil Code, anyone who, by voluntary act or omission, negligence or recklessness, violates law and causes damages to others, including non-pecuniary damages (i.e., moral damages), commits an illicit act.

15 Maria Helena Diniz. *Curso de Direito Civil Brasileiro: Responsabilidade Civil*, seventh volume. São Paulo: Saraiva, 2002, p. 49.

Based on this rule, the STJ has issued interpretative rulings to standardise the interpretation of courts to some specific situations of strict liability (i.e., financial institutions are strictly liable for damage caused by force majeure events that are the result of fraud and misdemeanour activities carried out by third parties in banking transactions).¹⁶

There is no legal provision in the Civil Code that forbids financial institutions to include contractual clauses that provides for the exclusion of liability if (1) the financial institution does not act with grave fault or wilful misconduct; and (2) the other contracting party is not considered a consumer under Brazilian law, as detailed in Section VII.ii.

ii The Consumer Protection Code

Generally, the Consumer Protection Code assumes that the consumer is always the weakest party in the relationship between supplier and consumer. Within this context, application of the Consumer Protection Code will be, as a rule, more favourable to the victim because it not only imposes strict liability on the offender, but also encompasses a whole set of rules that favour the consumer.

A special chapter in the Consumer Protection Code is devoted to consumer protection under contracts. A section of this chapter focuses on abusive clauses, which are considered null and void by operation of law.¹⁷ This section deems invalid any contractual clause that prevents, disclaims or reduces the supplier's liability for defects of any kind in the products and services, or entails a waiver or disposal of right.

The Consumer Protection Code also provides that parties may limit the amount of indemnification suppliers may pay to consumers in case of consumer agreements entered into with corporations (i.e., non-individual consumers), in justifiable situations. Although the law does not provide for a concept of 'justifiable situation', legal doctrine holds that it may be reasonable to limit indemnification in case there is a clear upside to the consumer as a trade-off to such limitation (i.e., the price paid for the product or service is reduced owing to such limitation).

iii Liability regime and exclusion of liability applicable in banking litigation

Given the above-mentioned considerations, financial institutions' liability regimes may vary depending on the nature of the relationship maintained with the counterparty.

16 Interpretative ruling No. 479 of STJ.

17 As per article 51 of the Consumer Protection Code, clauses are generally regarded as null and void whenever they prevent, disclaim or reduce the supplier's liability for defects of any kind whatsoever in the products and services, or entail a waiver or disposal of rights (in a consumer relationship between the supplier and a corporate consumer, indemnification may be limited in justifiable situations); deprive consumers of the option of receiving a refund of what was already paid, in the events provided for in the Consumer Protection Code; transfer liability to third parties; establish obligations considered inequitable or abusive that place the consumer at an unreasonable disadvantage, or that are incompatible with good faith or equitable practices; reverse the burden of proof to the detriment of consumers; provide for compulsory use of arbitration procedures; require a representative to conclude or perform another legal transaction by the consumer; leave the supplier with an option of whether to conclude the contract, while binding the consumer; permit the supplier to directly or indirectly vary the price in a unilateral manner; allow the supplier to cancel the contract unilaterally without conferring the same right on the consumer; obligate the consumer to reimburse any charges for collection of what is owed, without the same obligation for the supplier; authorise the supplier to unilaterally modify the contents or quality of the contract, after execution thereof; and contravene the consumer protection system.

In 2006, the Federal Supreme Court acknowledged that consumer relations of a banking or financial nature are subject to the rules provided under the Consumer Protection Code.¹⁸ In this sense, when it comes to consumer relations, financial institutions are strictly liable for damages caused to consumers due to defects in the service provided, based on the provisions of the Consumer Protection Code. Financial institutions shall not be held liable only when it proves that (1) there is no defect after performing the service; or (2) the exclusive fault of the consumer or a third party.

Moreover, in consumer relations, contractual provisions or terms of business restricting financial institutions' liability shall be considered null and void by Brazilian courts. As described above, however, in a relationship between the supplier and a corporate consumer, civil liability may be limited in justifiable situations.

Conversely, there being no consumer relation between the contracting parties, the case will be governed by the Civil Code, which does not prohibit the insertion of clauses that exclude or limit financial institutions' liability, provided that it does not limit financial institutions' liability in case of grave fault or wilful misconduct.

IX OUTLOOK AND CONCLUSIONS

The Code changed the procedural rules to favour the efficiency of disputes and effectiveness of the result of judicial proceedings. Among other changes, the Code strengthens alternative methods of conflict resolution, such as mediation and conciliation, aiming to reduce the number of claims.

Considering the new legal system introduced by the Code, and the high rate of recurrence of judicial complaints involving financial products and services, financial institutions, along with the courts, are likely to take internal measures to promote the amicable resolution of conflicts and celerity of disputes.

Examples of such measures are the creation of conciliation centres to promote conciliation exclusively in banking disputes – as established by the São Paulo State Higher Court in 2016 – and fostering administrative actions within financial institutions to internally solve consumer complaints and avoid judicial disputes.

In addition, the above-mentioned ratification by the STF of the collective agreement regarding MSPs entered into by consumer protection associations and financial institutions shows that courts are promoting and prioritising the consensual solution of conflicts, in accordance with the guidelines of the Code.

As stated, the execution and ratification of the collective settlement agreement will resolve thousands of lawsuits involving the matter, and bring better balance and stability to the National Financial System.

Finally, the CMN and the Central Bank have been acting on a preventive basis, through regulations that aim to avoid conflicts with clients and reduce operational risks facing Brazilian financial institutions. Despite all of this, Brazil continues to have a highly litigious banking system, so all these efforts must continue to increase customer satisfaction and reduce the level of litigation.

18 Direct Unconstitutionality Action No. 2,591.

CANADA

Graeme A Hamilton, Mathieu Lévesque and D Ross McGowan¹

I OVERVIEW

The Canadian legal system is characterised by the coexistence of both civil and common law provinces within a federal parliamentary system. Civil law is exclusively applicable in the province of Quebec, whereas common law applies in Canada's other nine provinces and three territories. The civil law tradition in Canada finds its origins in France. The common law tradition originates from British colonisation of what is now the rest of Canada.

Under the Canadian Constitution, each provincial legislature has general jurisdiction over property and 'civil law' (meaning commercial law and commercial transactions), while the federal parliament has an exclusive or paramount jurisdiction over certain private law matters, including banking, issuance of currency, bills of exchange and bankruptcy and insolvency. The country's legal system leaves open a concurrent jurisdiction between provincial and federal powers over certain legal matters. This leads to a challenging regulatory compliance landscape for those entering or operating in Canada's financial services industry. Examples of these challenges include compliance issues with an array of provincial consumer protection laws, various federal and provincial privacy laws, differential laws for issuing securities, provincially unique requirements for loan and mortgage security and a broad array of other areas of overlapping jurisdiction. There is a particular interdependence between federal and provincial legislation. This tends to cause significant challenges in terms of regulatory compliance for businesses needing to harmonise their legal compliance for operations across Canada.

The federal parliament legislates federal laws that seek to reconcile the coexistence of two fundamentally different legal systems, all within a bilingual (English and French) context. Federal statutes generally operate throughout Canada, such as the Criminal Code, the Competition Act and the Bills of Exchange Act. Further, certain commercial statutes, such as the Bank Act and the Trust and Loan Companies Act create the framework to regulate Canada's federally incorporated financial institutions.

At the provincial level, financial services businesses and financial institutions may be incorporated under applicable provincial laws for money services businesses, certain savings and loan institutions, payment processing and other related endeavours. Generally, provinces have legislative and regulatory authority limited to those entities incorporated or doing business within the provincial boundaries. Provincially incorporated entities that operate across provincial boundaries may thus be subject to the jurisdiction of multiple regulatory authorities.

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The main purpose of the Bank Act and its related statutes and regulations is to provide a legislative framework that promotes the efficiency and security of the financial system in Canada, and to set national standards applicable to banking products and services. The federal authorities further regulate the ‘business of banking’ and related services directly or indirectly through regulators and rule-makers such as the Office of the Superintendent of Financial Services (OSFI); the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC); the Financial Consumer Agency of Canada (FCAC); Canada Mortgage and Housing Corporation (CMHC); and the Canada Deposit Insurance Company, as well as other entities within federal jurisdiction.

While some of the regulatory agencies have express authority to make and impose rules on entities operating in the area of financial services (OSFI and FINTRAC), others, such as the FCAC, have a hybrid regulatory power, applied in part by way of rights to investigate, enforce and fine for non-compliance, and in part by way of creation of ‘voluntary’ compliance codes that have been adopted by the Canadian financial services industry as business standard operating protocols, ignored at their peril. Regulation of the financial services industry in Canada is also accomplished by rules created by statutory corporations. One example is CMHC, for mortgage rules applicable to requirements for qualifying for mortgage insurance and securitisation of mortgage pools. Similarly, the Canadian Payments Association (now known as Payments Canada) sets the automated clearing and settlement system rules and large value transfer system rules for clearing as between members for payment items ranging from cheques and bank drafts to electronic funds transfers.

At the provincial level, each province has many similar, parallel (and sometimes overlapping) regulatory authorities for matters within provincial legislative jurisdiction.

Territorial governments for Canada’s three territories have been granted similar legislative powers as conferred on the provinces.

In addition to the host of laws, regulations and rules, touched on above, Canadian businesses of all sorts must comply with an array of privacy laws, both federal and provincial, Canada’s anti-spam laws that limit and prescribe requirements for commercial electronic messages and competition laws that are aimed at ensuring fair and accurate marketing of financial products and services.

Financial institutions and those entities seeking to engage in financial services in Canada will require legal advice to ensure regulatory compliance for the jurisdictions engaged and the operations undertaken.

II RECENT LEGISLATIVE DEVELOPMENTS

Consumer protection legislation

Consumer protection provisions are contained in the federal Bank Act,² the Cooperative Credit Associations Act,³ the Insurance Companies Act,⁴ the Trust and Loan Companies Act⁵ and the Payment Card Networks Act.^{6,7}

2 Statutes of Canada (SC) 1991, Chapter 46.

3 SC 1991, Chapter 48.

4 SC 1991, Chapter 47.

5 SC 1991, Chapter 45.

6 SC 2010, Chapter 12, Section 1834.

7 www.canada.ca/en/financial-consumer-agency/services/industry/laws-regulations/legislation.html.

The key Bank Act provisions (which apply to major Canadian retail banks) include disclosure provisions regarding charges and provisions governing retail deposit accounts,⁸ disclosure regarding borrowing costs associated with loans⁹ and credit cards,¹⁰ restrictions on tied selling¹¹ and the establishment of complaints resolution procedures.

Compliance with federal consumer protection procedures is overseen by the FCAC.

At the provincial level, each province has its own consumer protection legislation. In Quebec, for instance, the Consumer Protection Act¹² provides for several types of protection for consumers. On 15 November 2017, the government of Quebec adopted the Act, otherwise known as Bill 134 (the Bill), mainly to modernise rules relating to consumer credit and to regulate debt settlement service contracts, high-cost credit contracts and loyalty programmes, in order to modernise the Consumer Protection Act (Quebec). The Bill came into force on 25 July 2019.

Consumer protection legislation is often the source of the complaints and proceedings by consumers against financial institutions.

III CHANGES TO COURT PROCEDURE

Each province has its own legislative and procedural regime applicable to whether and how multiparty claims may be brought. There are many procedural similarities across the provinces and frequently, multi-jurisdictional class actions dealing with the same foundational claims are coordinated by plaintiffs' legal counsel seeking to take advantage of the most advantageous legal and procedural jurisdiction for the claim being brought.

i Class actions

In Ontario, British Columbia and Quebec particularly, class actions against banks are becoming more common and broad. The class action procedure in Quebec varies from the procedures in force in the common law provinces.

ii Quebec-based class actions and their criteria

When compared to the certification process in common law provinces, Quebec procedure is streamlined and designed to avoid lengthy contestations. In fact, Quebec is perceived across the country as a friendly forum for plaintiffs, as well as for the counsel acting on their behalf in class actions.

For example, the plaintiffs' motion for authorisation for certification does not have to be supported by an affidavit. For authorisation purposes, the facts alleged in the motion are deemed to be true and hearsay evidence is usually allowed (though its probative value may be limited). Moreover, the defendant can only contest the authorisation orally (i.e., without written pleadings) and must obtain the court's permission to present any evidence (e.g., deposition of the plaintiff or relevant documentary evidence). Finally, plaintiffs have a direct right of appeal if the authorisation is denied by the court of first instance; whereas the defendant, on the other hand, must obtain leave before appealing authorisation.

8 Bank Act, Sections 439.1 to 447.

9 Bank Act, Section 450.

10 Bank Act, Section 452(1.1) and (2).

11 Bank Act, Section 459.1.

12 Revised Statutes of Quebec, Chapter P-40.

To be authorised, the proposed class action must satisfy the following four cumulative criteria set out under Article 575 of the Code of Civil Procedure:

- a The court authorises the class action and appoints the class member it designates as representative plaintiff if it is of the opinion that:
- the claims of the members of the class raise identical, similar or related issues of law or fact;
 - the facts alleged appear to justify the conclusions sought;
 - the composition of the class makes it difficult or impracticable to apply the rules for mandates to sue on behalf of others or for consolidation of proceedings; and
 - the class member appointed as representative plaintiff is in a position to properly represent the class members.

The burden is on the plaintiffs to show that the criteria are satisfied. That said, Quebec courts have set a low threshold for each criterion. Moreover, any doubt as to whether a criterion has been met will be resolved in favour of the plaintiff.

The first criterion will generally be met as long as the proposed action raises a single issue that is common to the class and is not negligible.¹³ The second criterion will be met if the plaintiffs can make out an ‘arguable case’ on a *prima facie* basis, no matter how slim the chances of success may be on the merits.¹⁴ The third criterion will commonly be met if there are at least a few dozen class members. As for the fourth and final criterion, a representative plaintiff should only be excluded if its interest or competence is such that the case could not possibly proceed fairly.¹⁵

iii Recent application by the court of the criteria

Through the recent case, *Asselin v. Desjardins Cabinet de Services Financiers Inc*, the Quebec Court of Appeal has further lowered the threshold at the authorisation (certification) stage, by reversing once again a Quebec Superior Court decision that had refused to authorise a class action.

In doing so, the appellate court criticised the lower court judge for permitting the parties to present a substantial evidentiary record, as it led to a more detailed analysis than was appropriate at the authorisation stage. However, on 27 June 2019, a motion for leave to appeal before the Supreme Court of Canada was granted. The outcome will be of great interest, as it should set the level of in-depth analysis that judges should apply in the review of grounds of defence.

In the interval, in 2019, BLG,¹⁶ representing several banks, was able to obtain the dismissal of two separate certification motions against its clients pertaining to overlimit transactions and fees on credit cards as well as to mortgage prepayment fees based on interest

13 See *Vivendi Canada Inc v. Dell’Aniello*, 2014 SCC 1; *Sibiga v. Fido Solutions Inc*, 2016 QCCA 1299.

14 See *Infineon Technologies AG v. Option consommateurs*, 2013 SCC 59; *Charles v. Boiron Canada Inc*, 2016 QCCA 1716; *Sibiga v. Fido Solutions Inc*, 2016 QCCA 1299; *Asselin v. Desjardins Cabinet de Services Financiers Inc*, 2017 QCCA 1673.

15 See *Infineon Technologies AG v. Option consommateurs*, 2013 SCC 59; *Sibiga v. Fido Solutions Inc*, 2016 QCCA 1299.

16 Borden Ladner Gervais LLP.

rate differential (IRD) calculations that exceed three months' interest.¹⁷ As plaintiffs benefit from an appeal as of right, both cases have been submitted to the Court of Appeal of Quebec, and it will be interesting to see how the Court will review these judgments in the permissive authorisation context mentioned above.

iv A call for change in the industry: settlement process and class counsel fees

On 23 January 2017, the Superior Court of Quebec rendered an important judgment on settlement approval motions in four related class actions.¹⁸ The actions involved unilateral credit limit increases, over limit fees, cash advance fees and interest calculations, with plaintiffs alleging various violations of Quebec's Consumer Protection Act. Similar or related settlements with other banks had been previously approved for each cause of action involved. The Superior Court's decision to refuse approval of the proposed settlements came as a surprise to many.

In its review of the traditional seven criteria, the Court moved to refuse to approve the settlements largely based on the disproportion between the fees payable to class counsel and the compensation to be granted to members.

On 1 March 2018, the Court of Appeal dismissed the appeals and confirmed the decision of the Superior Court.¹⁹ The decision reiterates the important role of the courts to carefully review the fairness of any class action settlements, and that it is not bound in any way by their terms and conditions. As the approval of the legal fees by the Court was a precondition of validity and enforcement of the settlement agreements, the Court of Appeal confirmed that the Superior Court was constrained to refuse approving them.

IV PRIVILEGE AND DISCLOSURE

The presumptive rule in Canadian litigation is that every document in the possession or control of a party must be produced, if it is relevant or material to a fact at issue, unless covered by some privilege. The actual test, whether 'relevance' or 'materiality', differs slightly across the provinces. In addition, entities that are not party to the litigation can be compelled to produce documents in their possession or control.

The most important exception to the obligation for the production of documents in the possession of parties jointly contemplating litigation arises from solicitor–client or litigation privileges. Such privileges allow the parties to seek legal advice in relation to the strengths and weaknesses of their case, strategies for pursuing or defending the claim and to conduct investigations in furtherance of the litigation, all without the obligation to disclose the documents created or the advice or information received. However, privilege can be lost or waived through disclosure of the documents, information or advice to parties outside of the directing minds of the relevant parties or through other means.

Solicitor–client privilege applies to communications between lawyer and client, including certain third parties as experts or agents. The communication must involve the

17 *Brook v. Toronto–Dominion Bank* (CS, 2019-07-15), 2019 QCCS 2898; *Pilon v. Option Consommateurs* (C.A., 2019-08-12), 2019 QCCA 1361.

18 *Option Consommateurs v. Banque Amex du Canada*, 2017 QCCS 200.

19 *Option Consommateurs v. Banque Amex du Canada*, 2018 QCCA 305.

giving or seeking of legal advice and must intend to be kept confidential. However, the communication does not need to relate to a 'specific' request for legal advice. Such privilege is permanent.

Litigation privilege applies to communication or documents that have been created or gathered for the 'dominant purpose' of litigation. The test of the dominant purpose requires that proceedings were a reasonable possibility at the time of communication and that the communication was made for that proceeding. One of the key differences with the solicitor–client privilege is that the litigation privilege ends with the litigation for which the documents were prepared, unless related proceedings ensue.

V SOURCES OF LITIGATION

Banks, financial institutions and other financial services providers are frequently the targets of litigation claims, all based on the confluence of potential for large value claims and the perception of 'deep pockets'.

In Canada, the banker–customer relationship is fundamentally contractual. Historically, a contract governing a bank account consisted mainly of implied terms.²⁰ Those terms were developed by the common law courts from the late 1600s onwards, and some of them were later codified in what is now the Bills of Exchange Act. Most bank account agreements are standard form contracts of adhesion. However, terms may still be implied.²¹

The banker–customer relationship is primarily one of debtor and creditor and is not fiduciary in nature. A fiduciary relationship arises only in special circumstances of vulnerability, duty and a reasonable expectation of paramount loyalty. It is the rare exception between a banker and customer that such a relationship ever arises. Further, the banker–customer relationship does not establish a trust over the funds on account. Simply put, under Canadian law, when a customer deposits money in an account at its bank, the customer is loaning money to the bank, and the bank becomes indebted to and obliged to repay the customer in accordance with the customer's directions, subject to any defences that arise from the terms of the contract between the bank and customer.

As at 2019, cheques and other paper-based payment items remain common. Nearly a billion cheques are issued and processed in Canada each year.

The negotiation of cheques is governed by the Bills of Exchange Act. Banks commonly face claims relating to the misuse of cheques, including claims relating to cheque forgery, conversion, counterfeits, and material alterations.

i Forged signature (front of cheque)

A cheque is a direction to pay, written by the drawer or customer, directing the drawer's banker to pay a sum certain to the payee.

When a cheque is issued by an individual, then it is a simple question of whether the drawer authorised or signed the cheque and whether they intended to have it issued. The question of forgery of the signature in these circumstances is a question of fact and not legally

20 *Canadian Pacific Hotels Ltd v. Bank of Montreal* [1987] 1 SCR 711, 1987 CanLII 55 (SCC).

21 *BMP Global Distribution Inc v. Bank of Nova Scotia* [2009] 1 SCR 504; *Chriss v. The TD Bank Financial Group*, 2013 ONSC 7508 (CanLII).

complex. If the signature on the cheque was forged, the item is a nullity, and then there is no actual mandate by the customer to their banker, and the banker is presumptively liable to its customer for paying on the cheque without mandate.

When a cheque is issued by a corporation, the simple question above becomes more complex. Who were the ‘authorised signatories’ of the corporation? Did the corporation intend to issue the cheque to the named payee or someone else?²² What if an authorised signatory forges the signature of a second signatory when two must sign or causes a cheque to be issued to someone who is not owed money by the corporate drawer?²³ Under Canadian bills of exchange law, these simple questions have led to some very complex law.²⁴ The general rule remains that a forged signature of the drawer, with respect to a bill payable to order is a nullity that shifts the loss to the drawee bank. Yet the general rule is riddled with exceptions that flow from subtle factual differences that purport to be based on the intentions of the drawer as a corporation, or revert the loss back upon the corporate customer based on contractual preclusion defences.²⁵

ii Forged endorsement (back of cheque)

When a cheque is delivered from the drawer to the payee, the payee becomes the holder of the cheque. The cheque can then be further negotiated by endorsement, transfer or delivery. If negotiated for value, then the next party to the cheque becomes a ‘holder in due course’ with a presumptive right to enforce the cheque for payment. However, what happens when the endorsement of the payee has been forged? This simple question again has multiple answers, each of which depend on subtle differences between whether the endorsement was a necessary element for negotiation of the item. If the cheque was drawn to ‘order’, meaning a specific intended payee, then a forged endorsement breaks the chain of validity of negotiation and the parties to the cheque after the forged endorsement are presumptively liable for the tort of conversion.²⁶ In contrast, if the cheque was originally drawn to ‘bearer’, meaning it was drawn to a fictitious payee, then the endorsement by the payee was not necessary, and it is irrelevant that the endorsement was forged.²⁷

iii The tort of conversion

The strict liability tort of conversion is used to allocate losses for misappropriated cheques. A conversion is a wrongful interference with goods, such as by taking, using or destroying them in a manner inconsistent with the owner’s right of possession. To constitute the injury there must be some act of the defendant repudiating the owner’s right, or some exercise of dominion inconsistent with it. The wrongful act may be done in all innocence, but this is no defence. Any negligence on the part of the drawer or the banks in preventing the fraud is irrelevant.²⁸

22 *Teva Canada Ltd v. TD Canada Trust* [2017] 2 SCR 317, 2017 SCC 51 (CanLII).

23 *D2 Contracting Ltd v. The Bank of Nova Scotia*, 2015 BCSC 1634 (CanLII) 2016 BCCA 366 (CanLII).

24 *Canadian Pacific Hotels Ltd v. Bank of Montreal* [1987] 1 SCR 711, 1987 CanLII 55 (SCC).

25 *D2 Contracting Ltd v. The Bank of Nova Scotia*, 2015 BCSC 1634 (CanLII) 2016 BCCA 366 (CanLII).

26 *Boma Manufacturing Ltd v. Canadian Imperial Bank of Commerce* [1996] 3 SCR 727, 1996 CanLII 149 (SCC).

27 *Fok Cheong Shing Investments Co Ltd v. Bank of Nova Scotia* [1982] 2 SCR 488, 1982 CanLII 57 (SCC).

28 *Arrow Transfer Company Ltd v. Royal Bank of Canada et al* [1972] SCR 845, 1972 CanLII 135 (SCC).

This tort claim is a common method by which to allocate cheque fraud losses up to the collecting bank or to any other parties that negotiated the cheque after the item was issued. There are a few limited defences to these types of claims,²⁹ but under Canadian law (unlike UK legislation) contributory fault of the drawer is not a basis for apportionment of the loss.³⁰

iv The tort of knowing receipt

The cause of action in knowing receipt arises simply because the defendant has improperly received property that belongs to the plaintiff. This type of claim remains common against financial institutions on the asserted basis that the bank has received funds that were fraudulently taken from an innocent victim. The plaintiff's claim amounts to nothing more than, 'You unjustly have my property. Give it back'. Unlike the similarly named tort of 'knowing assistance', there is no finding of fault, no legal wrong done by the defendant and no claim for damages. It is, at base, simply a question of who has a better claim to the disputed property. In order to recover the disputed property, the plaintiff must prove the following: (1) that the property was subject to a trust in favour of the plaintiff; (2) that the property, which the defendant received, was taken from the plaintiff in breach of trust or breach of fiduciary duty; and (3) that the defendant did not take the property as a bona fide purchaser for value without notice. The defendant will be taken to have notice if the circumstances were such as to put a reasonable person on inquiry, and the defendant made none, or if the defendant was put off by an answer that would not have satisfied a reasonable person.³¹

Claims of this nature are brought against banks and other financial service businesses on the basis that they were or should have been put on notice about the suspicious circumstances by which the bank's customer delivered funds and that the bank failed to investigate owing to negligence or wilful blindness. A proliferation of Ponzi scheme claims have used this legal theory against banks to advance claims for the victims of the scheme, yet very few claims have successfully demonstrated bankers' liability for such.

v Customer impersonation – misdirected payments

Cheques and the law of bills of exchange evolved in an era when 'banks were taken to know the signature of their customer'. Thus, it was reasonable that the presumptive loss allocation for forged signature was directed at the drawer's bank for paying without mandate and that the loss allocation for forged endorsement situations flowed to the collecting bank that allowed itself to deal with a rogue. In contrast, the world of payments and banking has evolved considerably with mobile payments, internet banking and the expectation of 24/7 financial access, anywhere, anytime. As payment systems have evolved to meet customer expectations, customer safety and security for their personal access devices, and the modes used to instruct the bank, have become a target for identity thieves, whether by hacking, phishing, sniffing or stealing the devices used. In consequence, customer losses and claims against banks are on the rise in relation to said evolving issues and questions about litigation

29 *National Holdings Ltd v. CIBC et al*, 2005 BCSC 369 (CanLII).

30 *GE Capital Canada v. Bank of Montreal*, 2003 BCSC 1180 (CanLII).

31 *Vancouver Coastal Health Authority v. Moscipan*, 2019 BCCA 17 (CanLII).

proliferates over loss allocations suffered by customers that have been fraudulently induced to misdirect payments by third-party hacking (social engineering impersonation frauds) or customer internal employee fraud losses through misuse of electronic banking authorities.³²

In one recent claim scenario, a bank customer sued his bank for losses owing to fraudulent email instructions that caused a wire transfer to be issued to his detriment. The terms of the application and the account agreement entitled the customer to provide instructions to his bank by email address and the customer previously did so without complaint to effect a wire transfer. The bank was contractually entitled to rely on those instructions. The customer had the sole ability and responsibility to control the security of the email account that was the source of the impugned instructions, yet the customer's email account was hacked and fraudulent instructions were issued. The court held that the contractual exclusions in favour of the bank were valid, that the bank had not been grossly negligent by failing to follow up and enquire of the instructions and as such allocated the loss to the customer.³³

While the loss allocation in *Du v. Jameson Bank* is supportable on the circumstances of the case, this decision further illustrates the importance of ensuring clear, unambiguous terms and conditions in the customer account agreement. A well-drafted account agreement that defines and limits the mutual expectations for fraud prevention, detection and allocation will go a long way to limit losses owing to claims.

Recently, the Court of Appeal of Quebec in *Compagnie d'assurances générales Co-Operators v. Coop Fédérée* held that electronic funds transfers do not constitute bills of exchange or instruments within the meaning of the Bills of Exchange Act.³⁴ Electronic funds transfers are only payment orders containing the conditions triggering the electronic transfers of funds. The notion of negotiability is foreign to funds transfers, since they do not imply any procedure for presentation for acceptance or payment as is the case with bills of exchange. On the contrary, the transfer of funds is immediate and definitive and its beneficiary has no title or document allowing him to demand payment.

vi Privacy and data breach

Canadian financial institutions have long had traditional duties of customer confidentiality for personal information. The obligations for customer confidentiality are now further codified in legislation, such as the Personal Information Protection and Electronic Documents Act, applicable to federally regulated institutions (i.e., banks), and at the provincial level by substantially similar provincial laws where such are enacted. They set out principles regarding how organisations must handle the collection, use and disclosure of personal information in the course of their commercial activities. The overarching principle is that collection, use and disclosure of personal information collected by financial institutions in respect of customers requires the consent of the individual except in narrowly defined circumstances set forth in the legislation.

32 *St Lawrence Testing & Inspection Co Ltd v. Lanark Leeds Distribution Ltd*, 2019 ONSCSM 69697 (CanLII) and *Malcolm Silver et al v. State Farm Fire and Casualty Company*, 2019 ONSC 4264 (CanLII).

33 *Du v. Jameson Bank*, 2017 ONSC 2422 (CanLII).

34 *Compagnie d'assurances générales Co-Operators v. Coop Fédérée*, 500-09-026586-172; 500-09-026587-170 (CA).

VI EXCLUSION OF LIABILITY

In both common law and civil law, courts have recognised that an explicit and clear stipulation to exclude liability of the financial institution is valid when such stipulation specifies the acts for which an exoneration applies. Such clauses are normally interpreted restrictively by courts, against the financial institution, but always in a manner that best reflects the common intention of the parties.

In the context of fraudulent signatures, for example, banks are deemed to know the signature of their clients and are responsible for all unauthorised payments made from a cheque on which the signature has been forged. Nonetheless, courts have frequently recognised the validity of agreements requiring the customer to verify the signature of the cheques signed or to notify the bank of any erroneous debits within a certain delay.³⁵

VII OVERVIEW

Canadian business leaders are facing an economy that is increasingly complex and unpredictable. They are not only affected by the policies of Canada's federal and provincial governments, but also by international changes, such as the rise of populism and protectionism. This combination is bound to raise the level of uncertainty for all businesses. Trade agreements, cross-border commerce and the market implications of legalising cannabis are, for instance, topics that may have serious impacts on the Canadian economy.

As for the topics covered above, it remains that all signs indicate that the trend of litigation and of class actions becoming more common and broader in scope will continue. With large-scale data breaches dominating headlines, expect to see numerous proceedings aimed at financial institutions related to privacy and cybersecurity issues.

35 *Arrow Transfer Company Ltd v. Royal Bank of Canada et al* [1972] SCR 845; *Productions Mark Blandford Inc v. Caisse populaire St-Louis de France*, 2000 CanLII 10274 (CA); *Aliments C&C Inc. v. Banque Royale du Canada*, 2014 QCCA 1578.

GERMANY

*Marcus van Bevern*¹

I OVERVIEW

In the aftermath of the 2008 financial crisis, the financial industry in Germany continues to struggle with the economic environment and particularly with the policy of low interest rates enforced by the central banks to fight the crises. In light of low or even negative interest rates impacting their business models, banks are trying to terminate high-yield long-term saving contracts and, at the same time and corresponding with requests by the banking supervisory agency (BaFin),² to strengthen their fee income, thus making their income basis more independent from interest rates. In view of German courts' traditional support of contract compliance and scepticism towards the lawfulness of fees, all these attempts often result in disputes, keeping courts occupied. On an individual basis and despite their overall economic importance, these disputes often concern rather small amounts in dispute. However, there is an increasing tendency for more collective actions supported by the legislature.

II SIGNIFICANT RECENT CASES

i Termination of long-term saving contracts

In a judgment rendered in May 2019, the Federal High Court (BGH) decided that a savings bank had a right to terminate a long-term high-yield savings contract after a contractual term of 15 years had expired.³ The bank had entered into a savings plan with its customer providing for a graduated interest premium continuously increasing until the 15th anniversary of the contract after which the interest payments remained on the last level and the contract continued for an unlimited period. The BGH decided that the bank's ordinary right of termination was implicitly excluded until the 15th anniversary of the contract, because the customer had the unilateral right to decide whether or not he wanted to reach the highest premium stage. However, after the 15th anniversary, the bank would be entitled to terminate the contract with three months' notice, as the customer had no contractual right for a term exceeding the 15-year period.

The case is in line with two decisions from 2017 in which the BGH had decided that a savings bank with the specific purpose to provide funding for house building was entitled to terminate the contract with a customer 10 years after same customer had fulfilled its

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2 *Die Welt*, dated 15 January 2015, pg 13.

3 BGH, judgment of 14 May 2019, court reference: XI ZR 345/18.

saving obligation without demanding his or her right to be granted a loan for building a house.⁴ Savings banks in the above-mentioned sense are mutual benefit societies offering their customers a right to be granted a building loan after a certain amount of equity has been saved. While in normal times the building loan would be granted at reduced rates (compared to market rates), the current economic environment results in market rates being lower than those for building loans. This is the reason why a lot of savers do not exercise their right to be granted a building loan but use the instrument as a mere savings contract. Thus, the savings banks are under pressure to get rid of such costly deposits.

ii Arrangement fees and charges

Following its landmark decision of 2017,⁵ the BGH upheld in a number of decisions that arrangement fees provided for in commercial loan agreements are invalid, if the fee arrangement is to be considered a pre-formulated standard term of business and has not been individually negotiated. According to the law on standard business terms, courts may scrutinise the content of pre-formulated standard business terms and declare such business terms to be invalid if they find that the user of the terms, who wants to unilaterally deviate from what is provided for respective situation in the relevant code, unreasonably disadvantages the other party.

In the above-mentioned decisions, the court clarified a number of follow-up questions. Inter alia, it decided that the rule on the invalidity of the fee arrangement also applies to guaranteed credits where the amount the borrower is ultimately going to draw is uncertain at the beginning.⁶ Further, the court held that both the mere denomination for the fee as well as a standard clause containing the borrower's confirmation that the fee had been individually negotiated, are irrelevant for the classification of the clause as an (invalid) pre-formulated standard business term. The court held that such confirmation also violates the law on standard business terms, which prohibits factual confirmations and shifting the burden of evidence to the customer in standard terms. Rather, the bank would have to provide evidence that the clause was actually negotiated individually, which would require the customer to have an actual alternative for conditions without a fee.⁷ Attempts to circumvent the economic effects of these decisions range from concluding separate fee agreements governed by another law to concluding waiver agreements providing for a waiver of the right to claim the repayment of the fee. However, as far as can be seen, these type of agreements have not yet been scrutinised by the courts. As a result, there remains a significant risk that any kind of fee arrangements in the context of loan agreements are invalid and must be paid back to the borrower if the borrower demands it.

iii Cum-ex transactions

The number of civil and criminal court proceedings in connection with cum-ex transactions that took place particularly between 2005 and 2009 is likely to increase. There are multiple variants of cum-ex trades. What all trades have in common is that the parties agreed on a share purchase shortly before or on the dividend record date and, therefore, 'cum' dividend. The settlement of the trade, however, occurred after the dividend declaration, so that the

4 BGH, judgments of 21 February 2017, court reference: XI ZR 185/16 and XI ZR 272/16.

5 BGH, judgment of 4 July 2017, court reference: XI ZR 562/15.

6 BGH, judgment of 17 April 2018, court reference: XI ZR 238/16.

7 BGH, judgment of 19 February 2019, court reference: XI ZR 562/17.

share was delivered 'ex' dividend. This structure made it possible to obtain multiple returns of capital yields tax that had only been paid to the German tax authorities once. Estimates suggest that the damage for European tax authorities amounts to approximately €55 billion.

On the civil law side, a German Higher Regional Court confirmed a ruling holding Swiss bank Sarasin liable for approximately €45 million in damages to an individual investor because of incorrect investment advisory services. The investor had suffered losses after investing into a fund based on the cum-ex trading strategy. The court held that the parties had entered into an implied investment advisory agreement and that Sarasin had failed to properly inform the investor of the functioning and risks of the cum-ex trading strategy.⁸

Another German civil court awarded a €22.9 million damage claim to German bank Helaba. Helaba had invested in a cum-ex product by acting as buyer. However, the tax office retrospectively denied the originally received tax benefit and required Helaba to return the payment.⁹ The defendant, a bank that had sold the shares, was at the same time the custodian bank on the seller's side and, therefore, required to pay capital yields tax. The court argued that the defendant not only had violated its obligations towards the tax authorities but also its obligations with regard to Helaba. Not paying the capital yield tax ultimately had led to the tax office denying Helaba its tax benefits. Consequently, the defendant was liable for Helaba's damage. Generally, however, this judgment does not offer a lot of guidance regarding the liability of custodian banks on the seller's side in cum-ex constellations, as the custodian bank on the seller's side often was not the same as the seller of the shares.

On the criminal law side, it is to be expected that the trial before the Bonn district court against two individuals charged with tax evasion in a particular serious case only marks the tip of the iceberg of more criminal proceedings to come. In the event that the behaviour of the accused constitutes a crime, the court may order the confiscation of profits not only from the convicts but also from other natural or legal persons in whose interest the convicts had acted.¹⁰ Accordingly, the court included five financial service providers in the trial and is going to examine whether it is possible to confiscate potential pecuniary benefits from them. In terms of 'deep pockets', this option may appear more favourable to the court than confiscating the profits from the accused.

III RECENT LEGISLATIVE DEVELOPMENTS

i Payment Services Directive 2

As of 13 January 2018, the Revised Payment Services Directive (Directive (EU) 2015/2366 – PSD2) has been implemented into German law. It came fully into effect on 14 September 2019. PSD2 updates the first EU Payment Services Directive of 2007 and extends its scope to all kind of payment services (other than physical or paper-based transactions) provided within the European Union in currencies of the EU member states or the European Economic Area (EEA) as well as – partially – to payment transactions in non EU/EEA currencies (e.g., US dollars), provided that one of the payment service providers is located within the EU or EEA and only with respect to those parts of the payment transaction that are carried out in the Union. Further, the PSD2 introduces strict security requirements for the initiation and processing of electronic payments and data protection.

8 Higher Regional Court Stuttgart, judgment of 14 September 2018, court reference: 5 U 98/17.

9 Reginal Court Frankfurt, judgment of 25 April 2018, court reference: 2-12 O 0262/16.

10 Section 73b German Criminal Code.

The PSD2 requests transparency of conditions and implements a prohibition of surcharges meaning that extra fees for all kind of transactions, such as credit card payments, wire transfers and debit notes are forbidden. Further, the payer's liability for unauthorised payment transactions is limited to a maximum of €50.

The PSD2 also gives authorised and registered third-party providers (TPP) the right – subject to consent of the account holder – to have access to credit institutions' payment accounts services, which must be granted on an objective, non-discriminatory and proportionate basis (Articles 35 and 36). According to the PSD2 such access shall be extensive enough to allow the TPP to provide payment services in an unhindered and efficient manner. Account access must not be restricted unless it is necessary to safeguard against specific risks. Where a credit institution rejects a request for access, it shall provide the competent authority with duly motivated reasons for the rejection. These provisions aim at promoting technical payment innovation and, at the same time, maintaining the safety of payment transactions and payment services as well as consumer safety.

ii Payment Account Directive

Although the Payments Account Directive (Directive (EU) 2014/92) has already been implemented into German law in 2016, certain information obligations first came into force as of 31 October 2018. Since then, financial institutions are obliged to provide their customers with a stand-alone fee information document and glossary, which must be easily comprehensible and must be presented in a way that is clear and easy to read.

iii New bill on group bankruptcy

On 21 April 2018 the Act on the Facilitation of Group Bankruptcies came into force. The act aims at preventing the rupture of a group of companies in case of insolvency in order to preserve the possibility of reorganisation. Although there is no substantive consolidation and the principle of one proceeding for each insolvent company remains applicable, the act introduced the possibility of having one insolvency forum for the entire group and one single administrator for all insolvent companies plus a special procedure for coordination of the single insolvency proceedings.

iv Initiative for modernisation of the law on standard business terms

In recent years, the BGH frequently held in a number of decisions that pre-formulated standard business terms arranging and handling fees in loan agreements are invalid. Originally, the BGH had developed these principles in connection with consumer cases. Since 2017, the Court has expanded the same view to B2B cases.¹¹

In the eyes of the BGH, the only valid consideration owed by the borrower for a loan facility is the interest payment. All these cases left great uncertainty in the financial industry as to the validity of any kind of fee arrangements under German law, such fee arrangements being customary in the financial markets and particularly necessary in the current economic environment. The decision caused fierce criticism, with banks and banking associations claiming that the German financial industry had been disadvantaged in comparison to its international competitors and requesting a differentiation between B2C and B2B business. As a result, there have been various initiatives for a modernisation and liberalisation of the

¹¹ BGH, judgment of 4 July 2017, court reference: XI ZR 562/15.

existing law. However, consumer protection agencies also strongly support the existing legal situation. In its coalition agreement of 2018, the government promised to scrutinise the law on standard terms of business and its application to B2B businesses. So far no draft bill has been introduced.¹² For the time being the situation regarding the validity of fee agreements remains unsatisfying.

IV CHANGES TO COURT PROCEDURE

On 1 November 2018 the Act on the Determination of Model Proceedings came into effect. It allows specially qualified non-governmental consumer protection associations to initiate model proceedings against private companies in order to determine certain preliminary questions (e.g., whether or not a company acted illegally) with binding effect for the claims individual consumers may have against the company. Consumers may register their claims with an official register administrated by the Federal Ministry of Justice and Consumer Protection. The model proceeding as such will be conducted between the consumer protection association and the company without a direct participation of the consumers. The proceeding ends with a declaratory judgment, which constitutes a binding basis for each subsequent individual claim initiated by the consumers against the company.

The new act completes recent attempts by the German legislature to implement elements of collective redress to the civil procedure in Germany, which has traditionally been strictly bipartisan, and combines various instruments. In 2005, the legislature had adopted the Act on Model Case Proceedings in Disputes under Capital Markets Law, which also aimed at determining preliminary questions for a multitude of parties. Contrary to the new act, model case proceedings in capital markets disputes are admissible for all kinds of parties only if the matter in dispute concerns damage claims resulting from false, misleading or omitted public capital markets information, or is based on a contract under the Securities Acquisition and Takeover Act. This limited scope has been widened significantly under the new act but at the same time the parties admitted to such proceedings have been limited.

The new act was not specifically designed for claims against the financial industry. The immediate cause was Diesel-gate and the wave of claims against the automobile industry. Nevertheless, model proceedings may also be filed against banks. In fact, one out of five model proceedings currently pending with German courts was brought by the consumer organisation of Saxony against the savings bank of Leipzig. The consumer organisation blames the bank of paying too low interest rates and requests a declaration that contractual interest rate fixing clauses used by the bank are invalid.¹³

Also in 2018, the Higher Regional Court of Saxony rendered a judgment in favour of the same consumer organisation declaring fees requested by a Saxon credit institution invalid and ordering the bank to inform its customers about the invalidity as well as to repay the fees to the concerned customers.¹⁴ While the judgment was based on existing law allowing consumer organisations to request a declaration of nullity of standard business terms, it exceeded the legal consequences beyond such declaration, thereby creating a virtual possibility for collective relief.

12 [www.bundesregierung.de › blob › 2018-03-14-koalitionsvertrag-data](http://www.bundesregierung.de/blob/2018-03-14-koalitionsvertrag-data).

13 OLG Dresden, court reference: 5 MK 1/19.

14 OLG Dresden, judgment of 10 April 2018, court reference: 14 U 82/16.

V INTERIM MEASURES

In general, there are two instruments of interim relief under German law: seizure and injunction. A seizure can be *in rem* in order to secure subsequent enforcement of a monetary claim against movable or immovable property if such enforcement may be jeopardised. Also, a personal seizure can be available by arresting a debtor to ensure compulsory enforcement against the debtor's property when such enforcement is at risk. An injunction can be available to either preserve the status quo or provide for a temporary status of a legal relationship that is in dispute, if such preservation or temporary relief is necessary to avoid the frustration of a party's rights or otherwise to avert significant disadvantages. In all cases, seizure and injunction must not result in a final decision of the dispute. At the discretion of the courts, orders containing seizures or injunctions may be granted *ex parte* or after hearing the counterparty. If the proceedings are not already pending, the court, having rendered the order, is legally obliged to order, upon application by the debtor, that court proceedings have to be commenced within a period to be determined.

In banking law disputes, interim relief is frequently an issue in cases concerning standby letters of credit and similar forms of bank guarantees. This is particularly true when these cases concern cross-border transactions where the applicant suspects that the money, once disbursed to the beneficiary, cannot be successfully reclaimed, because a repayment had to be claimed for and enforced in another jurisdiction. In these constellations, it is undisputed that the applicant (i.e., the debtor in the underlying transaction) may apply for an injunction against the beneficiary (i.e., the creditor in both, the underlying transaction and the letter of credit (LoC)) enjoining him or her from drawing the LoC issued in the beneficiary's favour if the prerequisites for an injunction are met, in particular when there is *prima facie* evidence that the drawdown would be a misuse of the creditor's rights in the underlying transaction.¹⁵ However, neither the issuing nor the nominated bank are obliged to respect an injunction that has been issued against the beneficiary. The BGH held that an injunction issued against the beneficiary does not provide sufficient evidence of obvious misuse by the beneficiary to call his rights under the LoC, so that the issuing and the nominated bank are not obliged to respect the injunction against the beneficiary.¹⁶

Applicants often attempt to directly apply for interim relief against the issuing bank enjoining the latter to disburse the LoC towards the beneficiary. On the merits, it is clear that a disbursement of the LoC may only be refused by the bank, if it is obvious and blatantly provable that the beneficiary commits an abuse of contract in drawing the LoC. However, it is disputed whether, even in the case of an abuse by the beneficiary an injunction against the bank is available at all. In the past, courts held that the applicant may hinder its bank from disbursing the LoC to the beneficiary.¹⁷ More recent judgments, however, deny the availability of this measure in general. The courts argue that the issuing bank, when disbursing the LoC, would be acting on its own risk and that the question, whether or not it was entitled (and obliged) to honour the LoC, only had to be decided subsequently when the bank claims recourse against the applicant.¹⁸

15 OLG Stuttgart, judgment of 20 January 2015, court reference: 10 U 102/14; *Vollkommer in: Zöller* Commentary on the Civil Procedure Code, 32nd edition 2018, Section 940, margin No. 8.

16 BGH, judgment of 10 October 2000, court reference: XI ZR 344/99.

17 OLG Frankfurt, judgment of 3 March 1983, court reference: 10 U 244/82.

18 OLG Stuttgart, judgment dated 14 November 2012, court reference: 9 U 134/12; *Vollkommer in: Zöller*, Commentary on the Civil Procedure Code, 32nd edition 2018, Section 940, margin No. 8.

As an alternative to the aforementioned interim measures under national German law, the Regulation (EU) No. 655/2014 allows for the possibility of a European Account Preservation Order (EAPO) in order to ensure the subsequent enforcement of a creditor's pecuniary claim by freezing the debtor's bank accounts in cross border cases. With the exception of certain claims (family, inheritance, insolvency and social security law as well as arbitration), the EAPO applies to pecuniary claims in civil and commercial matters, provided either the competent court or the creditor are located or domiciled in another Member State than the one where the bank account is maintained. The preservation order is available in all cases where a judgment has already been rendered or proceedings are pending or even when they shall be initiated. It requires a real risk that the subsequent enforcement of the creditor's claim could be jeopardised and – unless a judgment has already been rendered – sufficient evidence of the likelihood that the creditor will succeed on the merits.

VI PRIVILEGE AND PROFESSIONAL SECRECY

Under the German code of civil procedure there is no general pretrial discovery or disclosure obligation. Each party of a proceeding has to submit the facts and documents supporting its claim. Only under restricted circumstances a court may direct one of the parties or a third party to produce documents, records or any other material in its possession, namely that (1) one of the parties made specific reference to the details of such documents in the course of the proceedings and its relevance for the case and (2) set forth the reasons why the party itself cannot produce the document but believes that the other party is in its possession. In general, the third party could also be an attorney. However, an attorney may not be directed to produce documents, if he or she is entitled to refuse to testify (which is usually the case).

As a result of these restricted rules, document production is scarcely applied for in civil proceedings and the question of privilege and professional secrecy is rarely raised and, therefore, often of no importance in civil proceedings. The BGH recently upheld the very restricted approach to pretrial discovery and document production: The case concerned a consumer credit agreement in which the borrower had exercised its right of withdrawal. Although the law generally provides that, in case of revocation, the contractual performances received by each party as well as the emoluments taken are to be returned, the court rejected a claim by the borrower for disclosure of the bank's specific emoluments taken from the credit amount in dispute. The court argued that there is no specific obligation by the bank to disclose its business secrets, because the consumer could rely on the general assumption that the bank had taken emoluments in the amount of the legal default interest rate.¹⁹

However, there may be a loophole and the situation may be different, if a civil claim can also be based on criminal offences. In general, attorneys are bound to secrecy and a breach of such duty may constitute a criminal offence. To enforce and protect such duty to secrecy, attorneys also have the right (and obligation) to refuse testimony on matters covered by their duty to secrecy in both, civil and criminal proceedings. Despite this duty to secrecy, criminal investigators have recently confiscated documents and reports held by external lawyers in a number of high-profile cases. For example, Jones Day has been raided in relation to the VW emission scandal and Freshfields has been raided in relation to the near bankruptcy of (former) HSH Nordbank AG. In these cases, the external firms had been hired to conduct internal investigations and have submitted internal investigation reports to their clients.

19 BGH, judgment of 17 April 2018, court reference: XI ZR 446/16.

Although the criminal procedure code provides that in cases where criminal charges have been brought against a defendant, certain documents – including documents in the possession of the attorney as well as all documents relating to attorney–client communications – are exempted from confiscation by the investigating authorities, the investigators argued that there is no general prohibition to seize such reports and any related documents but that the question of seizure would depend on the individual content of the documents. In particular, the questioning and hearing of employees would not be subject to the ‘bond of trust’ between the attorney and his or her client, which is protected under the law. Lower courts upheld these decisions.²⁰ Unfortunately, the question remains unclear and has not yet been decided by higher courts. Though Jones Day filed a constitutional complaint, the constitutional court refused to decide on the merits, arguing that Jones Day as a US-based law firm could not claim a violation of the basic rights under the German constitution.²¹

Once documents have been seized by the investigation authorities, any person having a legitimate interest may demand access to the records and could then also make use of them in civil proceedings. This is also a frequent tactical strategy of claimants in banking litigation cases.

VII JURISDICTION AND CONFLICTS OF LAW

Banking disputes are typically based on contract law. Contracts usually contain choice of law clauses as well as forum clauses usually complying with the Brussels Ia Regulation. Jurisdiction and conflicts of law issues, therefore, rarely play a role in banking law disputes. Only in rare cases are the admission of a party to court and its right to sue discussed. These cases concerned parties that had been founded and had their seat in a jurisdiction outside the European Union but were, in fact, administered in another jurisdiction.

The number of cases dealing with jurisdiction and conflicts of law issues could increase in the case of a hard Brexit, in particular with respect to private limited companies under English law being administered in Germany. In the past, due to lower founding requirements and advantages regarding liability, a significant number of companies that had their administrative seat in Germany made use of English company law. These companies were either limited companies under English law or a combination of a German private limited company with an English private limited company as its general partner (Ltd & Co KG). Despite a number of legal questions and disputes that have arisen in the context, courts tended to generally see these forms of corporations as admissible in accordance with EU law and the freedom of establishment. However, should the UK leave the EU without any treaty, such companies could no longer rely on the freedom of establishment. Instead, German autonomous conflict of law rules would apply providing for the real seat theory instead of the incorporation theory recognised under Anglo-Saxon law. As a result, companies founded and registered in the UK but with their real (administrative) seat in Germany could face serious problems in court disputes, as they could probably be denied admission to the courts. This would not apply, however, to English law companies that also have their administrative seat in the UK.

Further, in case of a hard Brexit, it is to be expected that UK companies filing a lawsuit in Germany could be requested to provide collateral for the defendant’s legal expenses, according to the German code of civil procedure. In general, only plaintiffs from outside the

20 LG Hamburg, resolution of 15 October 2010, court reference: 608 Qs 18/10.

21 BVerfG, resolution dated 27 June 2018, court reference: 1287/17, 2 BvR 1583/17.

European Union or the European Economic Area have to provide a security deposit (e.g., a bank guarantee) for the costs of the proceedings, should the defendant demand so. Exceptions apply if, due to international treaties, no such security deposit may be demanded. Germany and the United Kingdom entered into the Convention for the Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters on 14 July 1960 (the German– British Convention). The convention excluded the provision of security deposits from parties domiciled in either state and was applicable until the Brussels I Regulation came into effect. It is unclear whether the German–British Convention will be automatically reinstated in case of a hard Brexit.

VIII SOURCES OF LITIGATION

Typical scenarios in banking disputes concern mis-selling cases and prospectus liability when the customer relied on incorrect information or flawed advice by the bank, or both. German law provides for an informed investor concept: according to the BGH, the commencement of discussions between a bank and its client concerning the recommendation and purchase of securities or other investments constitutes an implied advisory agreement.²² This contract imposes a number of secondary obligations on the bank. In particular, the bank has to inquire about the customer's practical expertise and knowledge in the envisaged investment measures as well as his or her risk awareness and financial circumstances including the purpose and intended duration of the envisaged investment. Further, the bank's recommendation has to be based on up-to-date public information and has to reveal all relevant risks. A negligent misstatement is considered a breach of contract resulting in a damage claim for unwinding the sale. Similarly, prospectus liability requires a prospectus to fully, completely and correctly disclose all risks and circumstances relevant for the investment decision.

Mis-selling cases, however, typically follow the cycles in the stock exchange markets with a tendency to increase in bear markets. After a decade of prices on the rise, published cases seem to indicate that German courts are currently not occupied with a lot of mis-selling cases. For the same reason, prospectus liability is currently not playing a big role in the courts' practice. It is to be expected that this may change in a recession.

In recent years, a number of cases for revocation and reversal of consumer loan agreements occupied the courts. While such claims were legally based on the alleged non-compliance of reversal instructions issued by the banks with consumer protection laws, the economic reason behind them was the policy of low interest rates that induced consumers to reverse existing high interest rate loan agreements and secure lower market rates instead. Whereas there are still cases that have been decided recently, the total number of cases seems to decrease after a decade of low interest rates (bearing in mind that the usual fixed interest term is 10 years). Nevertheless, further cases could still be submitted to the courts as a reversal may even be claimed after the loan had been fully repaid.

Given the current economic environment, a number of cases concerning fee and interest issues are pending. The question in dispute is either whether fees requested by the banks are invalid due to a breach of the law on standard business terms or whether and how long banks are bound to long-term high-yield interest rates.

22 BGH, judgment dated 6 July 1993, court reference: XI ZR 12/93.

IX EXCLUSION OF LIABILITY

Clauses excluding a bank's liability or narrowing the scope of contractual duties in order to reduce the risk of liability are frequently used in contracts. Still, they rarely prevent customers from bringing a case to court. The reason for this is that such clauses are frequently considered general terms of business and are as such, often held invalid by the courts according to the law on standard business terms. Notably, German courts frequently hold that a restriction of liability for a party's main contractual obligation is void.

X REGULATORY IMPACT

Despite increasing regulation, regulatory law has almost no impact on civil law banking disputes. Most disputes are based on contract or statutory provisions under German civil law, (e.g., the German Civil Code). The reason is that German courts frequently hold that regulatory law has no general direct effect in civil law contracts as it serves a different purpose. Only in cases the law explicitly orders so is there a direct effect.²³ Without such explicit order the BGH even refuses to take regulatory law into consideration when only interpreting a civil law contract (unless such contract directly refers to provisions under regulatory law).²⁴

Exceptions may apply under the law of torts, which provides for a damage claim in case of a breach of statutory law, provided however, such statutory law is intended to individually protect another person.²⁵ Whether or not a tort damage claim can be based on a breach of regulatory law depends on the individual statutory provision in dispute. In this respect, German courts are also rather reluctant to grant individual claims, again arguing that regulatory law serves different purposes, in particular to protect the banking system or the public in general but not each individual. For example, whereas the offering of banking services without licence was considered a violation of individual protection, the prohibitions on insider trading, as well as ad hoc publicity and market manipulation, were not considered individual protection laws.²⁶ Thus, a tort action can only rarely be based on regulatory law.

However, the legislature only recently expanded the scope of action for the BaFin. In 2015 the act for the protection of small investors came into effect. Inter alia, this act allows BaFin to intervene against the sale and distribution of individual financial products causing concerns regarding the protection of investors or considered to be dangerous for the normal course or integrity of the financial markets. Based on this law, the BaFin issued two general decrees in 2019 aiming at the prohibition of binary options and contracts for difference (CFD).²⁷ According to the German Civil Code, contracts violating these decrees will be held void.²⁸

23 BGH, judgment dated 29 April 2014, court reference: II ZR 395/12.

24 BGH, judgment dated 29 April 2014, court reference: II ZR 395/12.

25 Section 823 Paragraph 2 German Civil Code.

26 BGH, judgment dated 7 July 2015, court reference VI ZR 372/14; judgment dated 13 December 2011, court reference: XI ZR 51/10; Wagner in Munich Commentary on the German Civil Code, 7th edition 2017, margin No. 505 et seq.

27 see www.bafin.de; references: VBS 7-Wp 5427-2018/0046 and VBS 7-Wp 5427-2018/0057.

28 Section 136 German Civil Code.

XI OUTLOOK AND CONCLUSIONS

It is to be expected that the overall economic situation will remain difficult in the upcoming months and that ECB's policy of low interest rates will continue. In such a market setting the banks will keep on struggling with long-running high-yield contracts and trying to raise their fees.

It can be expected that collective action will further be on the rise. This is not only because there is a general trend for more collective action in continental legal systems aiming for more (cost-) efficient court proceedings. As outlined above, one of the recent developments is that consumer protection agencies increasingly try to use instruments for collective relief. Furthermore, international law firms entered the German market and are also trying to foster collective action. In summary, it is to be expected that such cases will increasingly occupy courts.

HONG KONG

*Mark Hughes*¹

I SIGNIFICANT RECENT CASES

Perhaps unsurprisingly, the more notable decisions in the past year have tended to focus on banks' terms and conditions of business and the enforcement of unpaid debts.

The courts have largely upheld the express terms of the contracts that banks have entered into with their customers. This has included upholding limitations and exclusions of liability, where the banks have been challenged for advice they allegedly gave or for failing to comply with their obligations as trustees, and declining to imply terms into contracts or to accept that a customer's subjective understanding of a pre-contractual representation by a bank representative was sufficient to found a claim in misrepresentation when that subjective understanding was at odds with the objective interpretation. These decisions seem to be largely consistent with the general approach taken by the courts to the interpretation of the express terms of banks' customer contracts and a reluctance by the courts to find new duties of care to impose on banks in their customer relationships beyond those already imposed by statute or regulation.

Meanwhile a number of recent decisions in insolvency proceedings have tended to highlight the Hong Kong courts' approach to cross-border insolvency, the extent to which they will support insolvency proceedings initiated in foreign jurisdictions and the expectations on banks in terms of complying with orders made in foreign insolvency proceedings.

II RECENT LEGISLATIVE DEVELOPMENTS

The Banking Ordinance (Cap 155), which provides the legal framework for banking regulation, has been updated by the Banking (Amendment) Ordinance 2018 (BAO). On 13 July 2018, certain provisions of the BAO were brought into operation and the Banking (Exposure Limits) Rules (Cap 155R) were amended so as to remove the obsolete regulatory barrier discouraging the development of banks' equity derivative businesses in Hong Kong. On 1 July 2019, the remaining provisions of the BAO were brought into operation to implement the latest international standards on banking regulation promulgated by the Basel Committee on Banking Supervision.

The Insurance Companies (Amendment) Ordinance 2015 (Commencement) Notice 2019 was gazetted in May 2019. The full provisions of the Insurance Companies (Amendment) Ordinance came into operation on 23 September 2019. From then, the Insurance Authority took over the regulatory function from three Self-Regulatory Organisations to license and

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supervise all insurance intermediaries in Hong Kong, including granting licences, conducting inspections and investigations, and imposing disciplinary sanctions where applicable. So far, the Insurance Authority has formulated two sets of rules: the Insurance (Maximum Number of Authorised Insurers) Rules and the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules, which both took effect on 23 September 2019. Further rules, codes and guidelines are expected to be published in the next few months that will be of relevance to both insurance agents and brokers.

III CHANGES TO COURT PROCEDURE

Civil procedure in Hong Kong has not been substantially reformed since the enactment of the Civil Justice Reform (CJR), which came into effect on 2 April 2009. The CJR focuses on reducing the cost of delay and proper case management. The underlying objectives are to increase the cost-effectiveness of court practice and procedure; to deal with each case as expeditiously as is reasonably practicable; to promote procedural economy; to ensure fairness between the parties; to facilitate settlement; and to ensure fair distribution of court resources. These principles are clearly set out in the Rules of the High Court (Cap 4A).

It is worth noting the expansion of the jurisdiction of the District Court (DC) since 3 December 2018, when the general financial limit of the civil jurisdiction of the DC increased from HK\$1 million to HK\$3 million; the equity jurisdiction of the DC, where the proceedings do not involve or relate to land, increased from HK\$1 million to HK\$3 million, and where the proceedings wholly involve or relate to land, increased from HK\$3 million to HK\$7 million. The judiciary envisaged that these changes would enhance access to the judicial system for the public and reduce the pressure particularly on the Court of First Instance (CFI).

The Financial Dispute Resolution Centre (FDRC) opened in June 2012 as a forum for individual customers alleging mis-selling by banks and other financial intermediaries to make low-value claims, originally not exceeding HK\$500,000, under a framework of ‘mediation first, arbitration next’. Prior to the establishment of the FDRC, an aggrieved customer’s only way of recovering financial losses was to bring court proceedings. This was often too costly and time-consuming for relatively low-value claims. In January 2018, the jurisdiction of the FDRC was expanded including to allow certain commercial customers as well as individuals to bring claims and increase the maximum claimable amount to HK\$1 million. Although this means that there remains some overlap in the respective jurisdictions of the FDRC and DC for claims up to HK\$1 million, the extensions of the jurisdictions of both fora, including the more recent extension of the civil jurisdiction of the DC for claims up to HK\$3 million, are intended to provide principally retail customers with more flexible options for pursuing claims and achieving resolutions in a more expeditious and affordable way.

Although a class action regime is still absent in Hong Kong, a cross-sector working group was established in 2013 by the Department of Justice to study and consider the recommendations by the Law Reform Commission of Hong Kong (LRC) from the previous year. As at 17 April 2019, the working group has held 25 meetings since its inception, while a sub-committee set up under the working group has met 30 times. According to the Secretary for Justice, the working group’s study mainly focuses on the LRC’s recommendation on an incremental implementation approach, starting with consumer cases. Before putting forward a recommendation to the Hong Kong government, the working group would need to study the proposed definition of ‘consumer cases’, the certification criteria for a class action to be

adopted by the court, and the design of the procedural rules and other ancillary measures. However, the Secretary for Justice has indicated that there is still no specific timetable for consulting the public. The draft consultation document is being reviewed by the working group and is currently proposed to cover specific issues, including a close scrutiny of what will be meant by ‘consumer’ and ‘consumer cases’, the inclusion and exclusion of potential litigants from a class action, procedural features of such a class action regime, and the determination and distribution of class action awards. Further progress in implementing the LRC’s recommendations should be observed closely as a class action regime may have a significant impact on banking litigation.

IV INTERIM MEASURES

Common interim measures include applications for summary and default judgments. Under Order 14 of the Rules of the High Court, a plaintiff may apply for a summary judgment on the ground that the defendant has no defence to a claim or has no defence to a claim except as to the amount of damages claimed. Alternatively, a plaintiff may, after the expiry of the period fixed by or under the rules for service of the defence, enter a final default judgment against the defendant if he or she fails to serve the defence on the plaintiff.²

A plaintiff may apply for a *Mareva* injunction to restrain the defendant from removing assets held in Hong Kong or even outside Hong Kong. Section 21M of the High Court Ordinance (Cap.4 JCHCO) enables the CFI to grant interim relief, such as a *Mareva* injunction, despite the absence of substantive proceedings in Hong Kong, where there are or will be proceedings outside Hong Kong yielding a judgment that may be recognised and enforced in Hong Kong. The interim relief is in aid of the foreign proceedings, and therefore would not be restricted in its application to any time before the actual commencement of enforcement proceedings in Hong Kong. The Court rejected the construction that the assistance that the CFI can provide under Section 21M in aid of foreign proceedings has to cease when judgment is obtained in the foreign proceedings, because any such interpretation would result in assistance being unavailable when it is most needed.³

There have been new developments in applying to the Mainland courts for interim measures in relation to arbitral proceedings. On 2 April 2019, the Hong Kong government signed the Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region (Arrangement). After signing the Arrangement, Hong Kong has become the first and only jurisdiction outside the Mainland where parties to arbitral proceedings, seated in Hong Kong and administered by a list of arbitral institutions established or set up in Hong Kong, can apply to the Mainland courts for interim measures. The list of approved arbitral institutions was confirmed by the Hong Kong government and the Supreme People’s Court on 1 October 2019, the date the arrangement came into effect. In the case of the Mainland, available interim measures include property preservation, evidence preservation and conduct preservation. In the case of Hong Kong, available interim measures include injunctions and other interim measures for the purpose of maintaining or restoring the status quo pending determination of the dispute; taking action that would prevent, or

2 The Rules of the High Court (Cap 4A), O.19.

3 *The Export-Import Bank of China v. Taifeng Textile Group Co Ltd & Anor* [2018] HKCU 2653.

refraining from taking action that is likely to cause, current or imminent harm or prejudice to the arbitral proceedings; preserving assets; and preserving evidence that may be relevant and material to the resolution of the dispute.

V PRIVILEGE AND PROFESSIONAL SECRECY

Legal advice privilege (LAP) and litigation privilege (LP) are the two main types of legal professional privilege (LPP) that apply in Hong Kong.

LP applies to communications between parties or their lawyers and third parties for the purpose of obtaining information or advice in connection with existing or contemplated litigation. In order for a communication to be protected by LP, litigation must be in progress or reasonably in contemplation; the relevant communication must have been made with the dominant purpose of anticipated or actual litigation; and the matter must be adversarial as opposed to investigative or inquisitorial.

LAP protects confidential communications between a client and its lawyer for the dominant purpose of giving or receiving legal advice. Its protection does not cover third-party communications and is unlikely to extend to legal advice that may be given by other professionals such as accountants and surveyors in light of a recent English Supreme Court decision⁴ which would be of persuasive value to the Hong Kong courts. The Court of Appeal in *CITIC Pacific Limited v. Secretary for Justice and Commissioner of Police*⁵ has set out a broad definition of ‘client’ where LAP would protect communications and documents produced by a company’s employees (not limited to employees authorised to seek and receive legal advice) provided that the communications and documents have been produced for the dominant purpose of obtaining legal advice. Hong Kong’s approach in declining to follow the narrow interpretation of ‘client’ adopted in *Three Rivers*⁶ has recently found support in another English Court of Appeal case.⁷ Although the English Court did not decide on matters relating to LAP, it acknowledged concerns with the narrow interpretation of ‘client’ in *Three Rivers* and that English law appears to be out of step with the international common law on the issue. The apparent endorsement of the approach taken in Hong Kong means financial institutions should remain vigilant and be aware of the positions in different jurisdictions in relation to LPP.

VI JURISDICTION AND CONFLICTS OF LAW

i Anti-suit injunctions

In cross-border disputes, anti-suit injunctions will be useful to restrain the pursuit of foreign proceedings brought in breach of jurisdiction clauses, particularly if the agreement is to arbitrate in Hong Kong. The CFI has the power to grant anti-suit injunctions under Section 45 of the Arbitration Ordinance (Cap 609) and Section 21L of the HCO. Recently, the Court reaffirmed that foreign proceedings in breach of an arbitration agreement or an exclusive jurisdiction clause are a breach of contract that ordinarily will be restrained by the grant

4 *R (on the application of Prudential plc and another) v. Special Commissioner of Income Tax and another* [2013] UKSC 1.

5 [2015] 4 HKLRD 20.

6 *Three Rivers DC v. Governor and Company of the Bank of England (No 5)* [2003] QB 1556.

7 *Serious Fraud Office (SFO) v. Eurasian Natural Resources Corporation (ENRC)* [2018] EWCA Civ 2006.

of an injunction restraining the party in breach from conducting such proceedings, unless strong reasons to the contrary are shown.⁸ When interpreting an arbitration clause, the Court followed the modern approach in *Fiona Trust & Holding Corporation and others v. Privalov and others*,⁹ which is to give effect to the commercial purpose of the arbitration clause. Thus, the construction of an arbitration clause should start with the presumption that the parties, as rational business people, are likely to have intended any dispute arising out of the relationship into which they have entered to be decided by the same tribunal, unless the language makes it clear that certain questions were intended to be excluded from the tribunal's jurisdiction. If there is no rational basis upon which business people would be likely to wish to have only some issues arising out of, or in connection with, the agreement containing the arbitration clause determined by arbitration, there needs to be very clear language before deciding that they must have had such an intention.

An anti-suit injunction can also be granted to restrain a claimant from bringing foreign proceedings in breach of an arbitration clause even where the claimant is not a party to the contract containing the arbitration agreement. For instance, if the claimant is entitled to enforce an obligation under the contract containing the arbitration agreement, the Court would be willing to intervene because enforcement by arbitration alone is an incident of the obligation that the claimant seeks to enforce and therefore, the defendant is entitled to have any claim against him or her pursued in arbitration.¹⁰

Recognition and enforcement of foreign judgments (including Mainland judgments) and awards

On 18 January 2019, a new arrangement was signed between the Mainland and Hong Kong for the mutual recognition and enforcement of judgments, the sixth arrangement concerning various aspects of mutual legal assistance in civil and commercial matters and the third of these to provide for mutual recognition and enforcement of judgments in civil and commercial matters. It is not yet known when the arrangement will come into effect, but when it does, it will largely supersede the current arrangement by envisaging that a wider range of civil and commercial judgments will be recognised and enforced by the courts of both jurisdictions. The arrangement provides greater clarity as to what constitutes a 'civil and commercial' case, which excludes non-judicial proceedings and judicial proceedings relating to administrative or regulatory matters. A number of types of matters that may otherwise be considered as 'civil and commercial' (at least in certain circumstances) are also specifically excluded. These include matrimonial or family matters, which are already covered by the Arrangement on Reciprocal Recognition and Enforcement of Civil Judgments in Matrimonial and Family Cases, succession cases, corporate or personal insolvency and debt restructuring cases, certain types of judgments involving intellectual property rights, maritime matters, judgments on the validity of an arbitration agreement and the setting aside of an arbitral award. Nonetheless, while the arrangement may not be a comprehensive mechanism for reciprocal recognition and enforcement of judgments in civil and commercial matters between the courts of the Mainland and Hong Kong, it is a welcome development in terms of its widened scope and greater clarity.

8 *Giorgio Armani SpA v. Elan Clothes Co Ltd* [2019] HKCFI 530.

9 [2007] 4 All ER 951.

10 *Dickson Valora Group (Holdings) Company Limited v. Fan Ji Qian* [2019] HKCFI 482.

In *CL v. SCG*,¹¹ the CFI re-affirmed and clarified principles surrounding limitation periods for enforcing an arbitration award in court. There, the issue was when precisely the cause of action in an action to enforce an award accrued. The Court held that the cause of action arises when the party against whom the award is made fails to make payment within a reasonable time of the publication of the award and demand being made. What constitutes a reasonable time for payment and performance under an award would depend on the terms of the award as well as the facts and circumstances of the case. Where an arbitral award can be enforced in the Mainland and Hong Kong, a party should take into account Article 2 of the Arrangement Concerning Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region, which prohibits enforcement in the Mainland and Hong Kong at the same time. The Court clarified that the time limit continues to run while a successful party to an arbitral award applies for enforcement on the Mainland, and that such party should consider withdrawing and procuring determination of a pending application for enforcement on the Mainland before applying for enforcement in Hong Kong, prior to the expiry of the relevant limitation period.

In *Foshan Nanhai Branch of Industrial and Commercial Bank of China Ltd v. Foshan Ruifeng Petroleum and Chemical Fuel Co Ltd*,¹² the CFI considered whether the PRC branch of a bank could register a Mainland judgment in Hong Kong. A key issue was whether the PRC proceedings were properly constituted, which depended on whether the branch had capacity to sue. In *Bank of Credit and Commerce International (Overseas) Limited (In Liquidation) v. Bank of Credit and Commerce International (Overseas) Limited - Macau Branch (In Liquidation)*,¹³ the Court of Appeal had stated that irrespective of the law governing the constitution or incorporation of the bank or the branch of a bank, the branch is not a legal person under the law of Hong Kong and, as such, can never sue or be sued in Hong Kong. Nevertheless, the Court held that the proceedings were properly constituted because under PRC law, the branch has capacity to sue and that PRC law was the relevant law to consider in deciding whether the branch had capacity to sue in those proceedings.

ii Recognition of foreign insolvency proceedings

Banks may sometimes be asked to comply with requests from foreign insolvency officeholders appointed in the country of incorporation of a company in liquidation, and the question of whether the bank would need to see a Hong Kong court order before complying may arise. The Court has clarified that whether the foreign insolvency officeholder would need to obtain a Hong Kong court order requires drawing a balance between the foreign insolvency officeholders' need for convenience and the need for court supervision that the creditors may expect.¹⁴ In relation to the foreign insolvency officeholders' information needs, provided that the directors of the company could obtain the information, the foreign insolvency officeholders, as agents of the company, should be able to obtain the same information from third parties, such as bank account documents in Hong Kong, without a prior Hong Kong

11 [2019] HKCFI 398.

12 [2019] HKCU 976.

13 [1997] 1 HKLRD 304.

14 Re *The Joint Provisional Liquidators of China Lumena New Materials Corp (in provisional liquidation)* [2018] HKCFI 276.

recognition order. However, if the foreign insolvency officeholders propose to take possession of or deal with assets in Hong Kong, it would be appropriate for them to obtain a Hong Kong recognition order first.

The Court has re-affirmed that the assistance it will give officeholders in foreign insolvency proceedings may include allowing the foreign officeholders to pursue restructuring options in Hong Kong (even where those restructuring options may not be available as a matter of Hong Kong law, but only under the law of the jurisdiction of the foreign proceedings).¹⁵ This has become particularly relevant in respect of companies incorporated in Bermuda and listed in Hong Kong, which are subject to provisional liquidation in Bermuda since under Bermuda law provisional liquidators can be appointed for the purpose of exploring a restructuring even where there is no evidence of jeopardy to assets (such jeopardy being a requirement in Hong Kong following *Re Legend International Resorts Ltd.*)¹⁶

VII SOURCES OF LITIGATION

Litigation between customers and banks often arises from issues relating to alleged mis-selling, construction of contracts, and winding up petitions.

The Court has also reiterated the highly restrictive approach of the law to implied terms. In *Lo Yuk Sui v. Fubon Bank (Hong Kong) Ltd formerly known as International Bank of Asia Ltd.*,¹⁷ the Court of Appeal reaffirmed that the law on implied terms had not been changed by the observations of Lord Hoffmann in *Attorney General of Belize v. Belize Telecom*,¹⁸ which were subsequently clarified by the Supreme Court of the United Kingdom not to be authoritative guidance on the law of implied terms. The Court of Appeal agreed that there has not been any relaxation of the traditional, highly restrictive approach to the implication of terms. The law maintains that the process of implying a term into a contract must not require the rewriting of the contract in a way that the court believes to be reasonable, or that the court prefers to the agreement the parties have actually negotiated. A term is to be implied only if it is necessary to make the contract work. This may be the case if (1) the term to be implied is so obvious that it goes without saying, or (2) it is necessary to give the contract business efficacy, or both. The concept of necessity must not be watered down; necessity is not established by showing that the contract would be improved by the addition. The fairness or equity of a suggested implied term is an essential but not a sufficient pre-condition for inclusion. If there is indeed an express term in the contract that is inconsistent with the proposed implied term, the latter cannot, by definition, meet these tests, since the parties have demonstrated that the proposed implied term is not part of their agreement.

In *DBS Bank (Hong Kong) Ltd v. Sit Pan Jit*,¹⁹ a private bank customer sought to argue he had been induced to purchase structured investment products by a reckless or negligent misrepresentation made by his relationship manager. The Court of Final Appeal reiterated the principle that the customer's subjective understanding of the bank's statements is not relevant to proving an actionable misrepresentation against the bank based on the statements objectively understood.

15 *Re Joint Provisional Liquidators of Hsin Chong Group Holdings Ltd* [2019] HKCFI 805.

16 [2006] 2 HKLRD 192.

17 [2019] HKCU 818.

18 [2009] 1 WLR 1998.

19 [2017] HKCU 397.

Creditors such as banks often serve statutory demands on debtors ahead of filing winding up petitions in actions to recover a liquidated debt. Recent decisions have further explored the question whether a statutory demand or subsequent winding up petition should be set aside without any need by the debtor to show a *bona fide* dispute on substantial grounds as regards the subject debt because the underlying transaction document contained an arbitration agreement. Following a decision of the CFI in 2018, a statutory demand should be set aside or winding up petition should generally be dismissed if: (1) the contract under which the debt is alleged to arise contains an arbitration clause that covers any dispute relating to the debt; (2) the company disputes the debt relied on by the petitioner; and (3) the company takes the steps required under the arbitration clause to commence the contractually mandated dispute resolution process (which might include preliminary stages such as mediation) and files an affirmation in accordance with Rule 32 of the Companies (Winding Up) Rules (Cap 32H) demonstrating this.²⁰ Even more recently, the Court of Appeal has questioned, albeit in *obiter dicta*, the appropriateness of this three-part test as unnecessarily curtailing a creditor's statutory right to petition for a winding up based on insolvency. It is contrary to public policy to preclude or fetter the exercise of this statutory right.²¹

VIII EXCLUSION OF LIABILITY

There have been developments in the extent to which banks are able to limit and exclude liability through their terms of business and statutory control of such terms.

Courts have found in favour of banks in recent mis-selling cases. In *Shine Grace Investment Ltd v. Citibank, NA*,²² the bank was able to rely on a contractual clause, which stated that the customer should make its own judgment in relation to its investment transactions. The bank and its staff disclaimed any duty to give advice or make recommendations and even if suggestions were made by them, they assumed no responsibility for any investment made. Referring to such 'non-reliance clauses', the Court found that the bank had not assumed any duty or responsibility to advise its customers, no matter what recommendations or suggestions the bank might have provided to the customer in the course of their relationship. The Court further held that the proposition that there exists a freestanding common law duty of explanation (to the effect that where a banker chooses to volunteer an explanation in respect of a financial product, the banker is subject to a duty to explain fully and accurately the nature and effect of the product), irrespective of whether a banker has assumed legal responsibility to advise its customers in light of the contractual arrangement between the parties and all other relevant factual circumstances, is inconsistent with the approach adopted by the Court of Appeal in *Chang Pui Yin & Ors v. Bank of Singapore Limited*.²³

The Court has recently examined 'anti-Bartlett' provisions. These are terms often incorporated by banks when acting as trustees to exempt or limit their liability in respect of the duty of care they would otherwise assume to supervise trust-owned companies as much as other trust assets. In *Zhang Hong Li v. DBS Bank (Hong Kong) Ltd*,²⁴ the Court of Appeal examined the legal effect of anti-Bartlett provisions contained in a discretionary trust

20 *Lasmos Limited v. Southwest Pacific Bauxite (HK) Limited* [2018] HKCFI 426.

21 *But Ka Chan v. Interactive Brokers LLC* [2019] HKCA 873

22 [2018] HKEC 2123.

23 [2017] HKCU 1817.

24 [2018] HKCU 2522.

(governed by Jersey law). The Court held that such provisions did not exempt the bank, as trustees of the trust, from liability, and that the provisions did not have the legal effect of making the trustees liability-free rubber-stampers of the investment recommendations by the trust's investment adviser. There existed a residual obligation on the trustees that the provisions had not excluded, and thus the bank, as trustee, had a 'high level supervisory role', the purpose of which was to ensure that the value of the trust fund was subject to appropriate controls, reviews, investment expertise and management. The Court further highlighted that the bottom line for the implementation of this high level supervision was to the bank's mandatory approval of investments (although not preapproving them) and its power to override the investment adviser's decisions and reverse the transaction she advised. This is especially in light of the fact that the trustees must have been aware that the beneficiaries of the discretionary trust included minor children, and the contemporaneous documentary evidence showed that the trustees were well aware that the investment adviser's style of investment was unsuitable for a discretionary trust, the purposes of which included asset protection and family wealth succession. However, this may not be the end of the matter as the bank has been granted leave by the Court of Final Appeal in respect of the anti-Bartlett provisions.²⁵

Litigation concerning the effect of exclusion of liability clauses frequently refers to the requirement in the Control of Exemption Clauses Ordinance (Cap 71) (CECO) that the exclusion is reasonable in context. In *Chang Pui Yin v. Bank of Singapore Ltd*,²⁶ the Court of Appeal found for the customers of the bank, and held that, in addition to reviewing the drafting of such a clause, the substance in the context of the dealings between the bank and its customers must also be examined in order to determine whether that clause is effective to exclude or restrict the relevant obligation or duty of the bank. In that case, the clause in question failed to exclude or restrict liability for negligence because it did not satisfy the requirement of reasonableness in the CECO.

IX REGULATORY IMPACT

Anti-money laundering remains a major regulatory focus in Hong Kong by the Hong Kong Monetary Authority (HKMA), Hong Kong's banking authority. On 30 April 2018, the Hong Kong government published a territory-wide Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report, which set out Hong Kong's ability to combat money laundering, as well as the risks and vulnerabilities concerning money laundering and terrorist financing in sectors such as banking. The banking sector was assessed as 'high risk' and the HKMA will continue to focus on addressing such risks by monitoring new typologies, addressing any information gaps, adopting a risk-based approach, cooperating with cross-border regulatory authorities, and supporting innovative financial crime controls. Anti-money laundering fines have grown increasingly hefty and the HKMA continues to reprimand and fine banks for contraventions of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615). One bank was fined HK\$5 million in August 2018 for deficiencies in relation to transaction monitoring and another was fined HK\$12.5 million in December 2018 for deficiencies across key control areas. One likely result of the continuing focus by regulators on anti-money laundering controls is an increased scrutiny by banks of their contractual terms with customers including their ability to require

25 *Zhang Hong Li & Ors v. DBS Bank (Hong Kong) Ltd & Ors* [2019] HKCU 1578.

26 [2017] HKCU 1817.

information from customers to meet anti-money laundering obligations, to freeze money in customer accounts following a suspicious transaction report and, *in extremis*, to terminate customer accounts where there are money laundering concerns.

In the realm of data protection, the Court of Appeal has recently held that claims can be litigated in courts with higher jurisdiction than that indicated in the Personal Data (Privacy) Ordinance (Cap. 486) (PDPO). The Court of Appeal held that although the District Court is expressly empowered by the PDPO to be the court in which to commence claims under Section 66(1) of the PDPO (the statutory right of action for individuals who suffer damage by reason of misuse by a data user of their personal data), the jurisdiction of the CFI is not ousted. Hence, a case can be transferred to, and litigated in, the CFI.²⁷ As substantial repositories of personal data, banks are under constant scrutiny in respect of how they manage personal data both from regulators and customers.

On 6 July 2019, additional measures came into effect applying to the online and offline sales of ‘complex products’ (which are described by the Securities and Futures Commission (SFC), the principal financial and securities regulator in Hong Kong, as products whose terms, features and risks are not reasonably likely to be understood by retail investors because of their complex structures). These measures include performing a suitability assessment on all complex products, regardless of whether there has been any solicitation or recommendation. After a consultation with the banking industry in 2018, and to avoid a perceived risk of regulatory arbitrage, the HKMA has extended some of these measures to certain non-SFO-regulated structured investment products.

X OUTLOOK AND CONCLUSIONS

Regulators will maintain pressure on banks to comply with their regulatory obligations both as gatekeepers to prevent financial crime and in respect of their obligations to customers. Customers will no doubt continue to test the boundaries of these obligations, particularly if economic conditions deteriorate and the financial sector comes under more stress. At the same time, the closer judicial and reciprocal links between Hong Kong and the Mainland in respect of the enforcement of judgments and interim awards in arbitration should enhance investor and creditor confidence in cross-border transactions thereby enhancing liquidity.

²⁷ *Lee Kwok Tung Albert v. Chiyu Banking Corporation Limited* CACV 180/2017.

INDIA

*Sonali Mahapatra and Tanay Agarwal*¹

I OVERVIEW

The banking sector in India has been facing some headwinds on account of the overhang of stressed assets in the system for the last few years and the liquidity crisis (which can largely be seen as a consequence of the former) within the system. The focus has been on bank recapitalisation and strengthening the resolution framework for stressed assets to allow the sector to limp back to normalcy. The two key legislative/regulatory frameworks are the Insolvency and Bankruptcy Code, 2016 (IBC), which has been updated this year, and the new Prudential Framework on Resolution of Stressed Assets (New Prudential Framework) introduced by the Reserve Bank of India (RBI) earlier this year.

The introduction of the IBC has been the watershed moment in respect of resolution of stressed assets. Numerous cases have gone in for resolution with some of the big ticket cases having reached finality in terms of either an approved resolution plan or liquidation. However, the IBC is still in early stages of its development and its effective implementation has been facing some challenges. While the legislature is constantly trying to address these issues, some of them may continue to linger around and delay the process. The New Prudential Framework has been designed to allow flexibility to lenders to tailor resolution packages outside the legislative framework of the IBC and incentivises early resolution. With the regulatory insistence on swift resolution of NPAs, banks have been permitted to opt for bolder resolution solutions.

These developments have come a long way in resolving the NPA issue. Banks have already reported improved provision coverage ratios, capital adequacies and return on capital and the gross non-performing ratios are also expected to fall over the next year.² We expect this trend to continue in the coming year.

II SIGNIFICANT RECENT CASES

Given that the IBC has come into force recently, the jurisprudence under it is still evolving and each decision explores a new area of interpretation. In the past three years, the IBC has successfully overcome two sets of challenges on its constitutional validity with the most recent one being in the case of *Swiss Ribbons Private Limited v. Union of India*,³ where the Supreme Court of India upheld the *vires* of the IBC. Additionally, the judgment of the Supreme Court lays out some key principles that we have set out as follows:

1 Sonali Mahapatra is a partner and Tanay Agarwal is a senior associate at Talwar Thakore and Associates.

2 Financial Stability Report June 2019, Reserve Bank of India, accessible at: <https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=925>.

3 MANU/SC/0079/2019.

- a The distinction drawn between financial creditors and operational creditors is not arbitrary and is constitutionally valid.
- b The intention of the law is ‘maximisation of value’ of the corporate debtor and liquidation should be seen as a last resort. As such, the resolution process should not be seen as an adversarial proceeding against the corporate debtor.
- c Evidence from information utilities under the code is only *prima facie* in nature.
- d The role of the resolution professional is administrative in nature as opposed to quasi-judicial.
- e Resolution applicants do not have a vested right to have their plans considered by the committee of creditors.
- f Related parties or relatives of persons ineligible to present a resolution plan must be connected with the business of the ineligible person to be ineligible.

A few other key areas that banks should be aware of, based on decisions seen so far, are as follows:

- a the categorisation as financial creditors;
- b the treatment of claims against guarantors and third-party security providers; and
- c the justiciability of approval or rejection of resolution plans by committee of creditors.

i Categorisation as a financial creditor

Under the IBC, a financial creditor is a creditor to whom the corporate debtor owes a financial debt along with interest disbursed to the corporate debtor for consideration of time value of money. This includes financial transactions such as a loan, discounting of receivables, derivative transactions in connection with price protection, debentures and other debt securities, forward purchase agreements (including purchase of a real estate units in a real estate project) and a guarantee or indemnity in connection with financial transactions being included within the category of a ‘financial debt’.

Financial creditors can initiate a corporate insolvency resolution process (CIRP) under the IBC upon occurrence of a default in the debt owed to them. They form the committee of creditors, which takes over critical management-level decisions of the corporate debtor and is responsible for approving resolution plans or liquidation of the corporate debtor. Operational creditors, on the other hand, do not enjoy any decision-making powers during a CIRP (unless in cases where the corporate debtor has no financial creditors). Courts have been developing jurisprudence around classifying various structured transactions in one or the other basket. The underlying principle that has emerged is that a transaction with an element of consideration of time value of money will be categorised as a financial debt. Below, we have set out some key cases that have been decided in the last year.

In the case of *Shailesh Sangani v. Joel Cardoso*⁴ the National Company Law Appellate Tribunal (NCLAT) clarified that the requirement of interest is not a *sine qua non* to classify money disbursed as a financial debt if such money had a commercial effect of borrowing. In that case, monies advanced by way of shareholder loans without any requirement to pay interests were held as financial debts owed by the corporate debtor. This principle has been applied in cases of structured obligations as well. By way of illustration, in the case of *Pushpa Shah v. IL&FS Financial Services Limited* (IFIN),⁵ the National Company Law Tribunal

4 Company Appeal (AT) (Insolvency) No. 616 of 2018.

5 Company Appeal (AT) (Insolvency) No. 521 of 2018.

(NCLT) was considering an application to initiate CIRP by IFIN as a financial creditor of La-Fin Financial Services Private Limited (La-Fin) on account of an undertaking provided by La-Fin in respect of the investment by IFIN in MCX Stock Exchange Limited. In terms of the undertaking, La-Fin agreed to purchase the shares of MCX Stock Exchange Limited from IFIN at the higher of a predetermined internal rate of return or the price at which the last sale of shares of MCX Stock Exchange Limited would have taken place. The court observed that the transaction was not a purchase of shares, simpliciter, but involved an element of time value of money on account of the prescription of a minimum internal rate of return at the time of purchase of shares of La-Fin.

Similarly, in *ICICI v. Era Infrastructure (India) Limited*,⁶ the corporate debtor agreed to purchase a loan provided by ICICI Bank in case of a default by the principal borrower. The court found such undertaking to be akin to a guarantee in respect of the loan and, therefore, a financial debt. While the cases set out in this section recognise structured arrangements as financial debt, they also make it imperative for banks to evaluate and diligence such commitments of the borrowers at the time of credit evaluation, which, unlike a guarantee simpliciter, may or may not be disclosed in the accounts of the borrower.

ii Treatment of claims against guarantors and third-party security providers

The definition of a financial debt expressly recognises a guarantee or an indemnity provided in respect of a financial debt as also being a financial debt. However, the rights of beneficiaries under guarantees given by corporate debtors has been a contentious issue under the IBC. By way of the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, the legislature clarified that the moratorium against the principal debtor would not apply to enforcement of invocation of guarantee. Some other clarifications have been provided by the NCLAT/NCLT and we have summarised them here.

In the case of *Edelweiss ARC v. Orissa Manganese and Minerals Limited*⁷ the NCLAT was adjudicating on the claim of a beneficiary of a guarantee provided by the corporate debtor. The beneficiary did not invoke the guarantee prior to the admission of the CIRP and declaration of the moratorium. The NCLAT allowed the insolvency professional to reject the claim of the beneficiary on the ground that the guarantee claim did not mature in absence of alleged default on the part of the 'principal borrower' and consequentially on account of non-invocation of the guarantee prior to the admission of insolvency.⁸ In light of the judgment, it is important to ensure that in cases where primary or substantial credit comfort is drawn from a third-party guarantee, an adequate mechanism is documented to ensure that the guarantee can be invoked, in time, before any admission of insolvency of the guarantor (while no payment default may have occurred in the underlying facility).

Where a transaction draws support by way of security created by a third party, the ability of the beneficiary of such security to stake claim as a financial creditor of the security provider

6 CPNO IB 1151(PB)/2018.

7 Company Appeal (AT) (Insolvency) No. 437 of 2018 & IA No. 1830 of 2018.

8 It is relevant to note that in a previous decision in the case of *Axis Bank Limited v. Edu Smart Services Private Limited* (CA(AT) Insolvency No. 302 of 2017), the NCLAT held that the maturity of the claim under a guarantee has no nexus with filing of claim pursuant to the public announcement and allowed a beneficiary to file a claim where the guarantee was not invoked prior to the admission of CIRP. In the facts of that case, the underlying obligor was in default however, in the case at hand, there was no default by the principal obligor.

was discussed in *Phoenix ARC v. Ketulbhai Patel*.⁹ The NCLAT held that where the corporate debtor only provided a pledge over certain shares as collateral, it did not by itself amount to a disbursement of any amount against the time value of money and therefore it did not amount to a financial debt vis-à-vis the security provider. We note that this order of the NCLAT is under challenge in the Supreme Court and no further orders have been passed as of yet.

In *Vishnu Agarwal v. Piramal Enterprises*,¹⁰ Piramal Enterprises Limited provided a loan to the All India Society for Advance Education and Research that was guaranteed by two corporate guarantors. The creditor filed for initiation of CIRP against the corporate guarantors without initiating a CIRP against the principal debtor.¹¹ The court allowed a CIRP to be initiated against the guarantors without having to proceed against the principal debtor. However, given that it was the same underlying debt in the case of both the guarantors, the NCLAT ruled that simultaneous proceedings for CIRP could not be initiated against the guarantors. However this does not restrict a beneficiary of a guarantee from filing simultaneous claims with the resolution professionals for both the principal borrower and the guarantor, where they are undergoing a CIRP at the same time. This has been clarified by the NCLT in *ICICI v. Ritu Rastogi*,¹² where the creditor was allowed to file its claims under the same debt with the resolution professional of the principal debtor as well as the guarantor.

iii Justiciability of approval or rejection of resolution plans

The IBC requires a resolution plan to be approved or rejected by the committee of creditors after considering the viability, feasibility and manner of distribution proposed in the plan. If approved, the resolution plan is then submitted to the NCLT for its approval. At this stage, the IBC restricts the inquiry by the NCLT to ensure that the mandatory contents of the resolution plan (such as, payment of insolvency resolution costs, payments to dissenting financial creditors and operational creditors, management of the corporate debtor, implementation and supervision of the plan, etc.) have been provided for in the plan. In *K Sashidhar v. Indian Overseas Bank*,¹³ the Supreme Court was considering a challenge to an NCLAT order that ordered the liquidation of the corporate debtor as no resolution plan was approved by the requisite majority of the committee of creditors within the statutory timelines. Upholding the order of the NCLAT the Supreme Court has observed that the decision of approval or rejection of the resolution plan is a collective decision of the committee of creditors and the legislature has not envisaged a challenge to the commercial or business decision of the committee of creditors. Further, the Supreme Court also observed that it is not open to the NCLT to entertain any revised resolution plans after the expiry of the statutory period prescribed for the completion of the CIRP.

While judicial scrutiny has been restricted in cases of commercial decisions, to the extent the resolution plan is required to meet certain criteria (as set out above) and is required to deal with the claims of the operational creditors, similarly situated financial creditors and

9 Company Appeal (AT) (Insolvency) No. 325 of 2019.

10 Company Appeal (AT) (Insolvency) No. 346 of 2018.

11 In this case, the principal borrower was not a Company and a CIRP could not be initiated against it under the IBC. However, subsequently, in the case of *Ferro Alloys v. REC Limited* (Company Appeal (AT) (Insolvency) No. 92 of 2017), the NCLAT allowed initiation of a CIRP against the guarantor without initiating the same against a principal debtor, against whom a proceeding could be initiated under the IBC.

12 CA 366(PB)/2017 Connected with (IB)-102(PB)/2017.

13 Civil Appeal No. 10673 of 2018.

dissenting financial creditors in a fair and equitable manner,¹⁴ it is open to the adjudicating authority to withhold its approval to the resolution plan on these grounds. The extent to which the adjudicating authority can go in terms of a redistribution of amounts proposed by a resolution applicant or the committee of creditors has been the subject matter of a fair amount of controversy and has also led to some legislative amendments discussed in Section III.

III RECENT LEGISLATIVE DEVELOPMENTS

Stressed assets

The RBI has issued a general circular¹⁵ to banks and non-banking financial companies requiring lenders to recognise incipient stress in loan accounts and resolve the stress upon a default in such account (if not prior to the default). The lenders are required to finalise a resolution strategy within a review period of 30 days following the default or choose to initiate a legal procedure for insolvency or recovery. Where a resolution plan is to be implemented, lenders are required to enter into an inter-creditor agreement setting out the ground rules for implementation of the resolution plan. Among other things, the inter-creditor is required to provide for decision-making by a resolution of 75 per cent of the lenders by value and 60 per cent by number and payment of liquidation value to dissenting creditors.

The resolution plan is required to be implemented within 180 days from the reference date or the date of first default from the reference date.¹⁶ Any delay in implementation of the resolution plan involves enhanced provisioning by the lender. The Revised Framework provides for categorising restructured assets as non-performing until such assets show satisfactory performance (absence of a default) during the prescribed monitoring period.

The IBC

In 2016, the government completely overhauled the existing insolvency regime by enacting the IBC. Since coming into effect, the IBC has been amended thrice – once through the Insolvency and Bankruptcy Code (Amendment) Act 2018, the Insolvency and Bankruptcy Code (Second Amendment) Act 2018 and recently through the Insolvency and Bankruptcy Code (Amendment) Act 2019 (2019 Amendment) – in each case, to address specific interpretational issues that have arisen in the course of its implementation. The latest set of complexities came to light in the ongoing resolution process of Essar Steel Limited where the process has been inordinately delayed on account of cross-litigation and lack of clarity on various issues under the IBC. Further, the decision of the NCLAT and the apex court in relation to the fair treatment of creditors in a resolution plan¹⁷ and the application of these

14 See the judgment of the NCLAT in *Binani Industries Ltd v. Bank of Baroda & Anr* (Company Appeal(AT) (Insolvency) No. 82 of 2018) (*Binani*) and the judgment of the Supreme Court in *Swiss Ribbons, supra* at note 3.

15 RBI Circular No. DBR.No.BPBC.45/21.04.048/2018-19 dated 7 June 2019 on 'Prudential Framework for Resolution of Stressed Assets'.

16 Reference date has been provided with respect to loan accounts on the basis of their size. In cases where borrower's exposure to banks, non-banking financial companies and All India Term financial Institutions is more than 20 billion rupees, reference date is the date of the directions and in cases where such exposure is between 15 billion and 20 billion rupees, the reference date is 1 January 2020.

17 See the judgment of the NCLAT in *Binani* and the judgment of the Supreme Court in *Swiss Ribbons*.

principles while approving the resolution plan for Essar Steel Limited by the NCLAT created the need for specific clarification on the issue. The key features of the 2019 Amendment are as follows:

- a* The 2019 Amendment provides for an outer timeline of 330 days from the insolvency commencement date, which will be inclusive of any extension granted in respect of any legal proceedings in relation to the CIRP.
- b* An authorised representative of financial creditors (a class of creditors or holding debt securities) is required to cast its vote in respect of any matter on behalf of all such financial creditors in accordance with the decision taken by a vote of more than 50 per cent of the vote share of such financial creditors, who have cast their vote. The amendment does not save any previous arrangements among such creditors. This voting mechanism however is not mandatory in the case of a syndicated loan which provides for an authorised representative such as a facility agent – in that case a lender can choose to vote either directly or through the agent, but the agent is required to vote each lender's share in the outstanding debt separately.
- c* Resolution plans are required to provide for the payment of debts as specified by the Insolvency and Bankruptcy Board of India (IBBI) to dissenting financial creditors (at least the amount payable to them in accordance with their priority at the time of liquidation) and operational creditors (at least (1) the amount payable to them in accordance with their priority at the time of liquidation; or (2) the amount that would be paid to them, if the amount proposed to be distributed under the resolution plan would be distributed to them in accordance with their priority at the time of liquidation).
- d* The 2019 Amendment empowers the committee of creditors to approve or reject a plan after considering the proposed manner of distribution, which may be based on the order of priority set out under the IBC and the value of the security of a secured creditor.
- e* A resolution plan can include a proposal for corporate restructuring by way of merger, demerger or amalgamation. This will allow resolution plans to provide for more dynamic solutions and maximise the value of the corporate debtor.
- f* It has been clarified that a resolution plan, once approved, will be binding on the central government, the state government and any local authority to whom a debt in respect of payment of dues arising under any law and any statutory dues are owed. This puts to rest the question on the binding effect of a resolution plan to the extent the same deals with payment of any statutory dues owed by the corporate debtor.
- g* The committee of creditors may decide to liquidate the corporate debtor at any time after its constitution but before the approval of a resolution plan.

IV CHANGES TO COURT PROCEDURE

Commercial courts

In 2015, the government passed the Commercial Courts Act 2015 (the Commercial Courts Act). The Commercial Courts Act provides for setting up commercial courts at a district level and setting up commercial divisions and commercial appellate divisions in the High Courts. These courts will deal with commercial disputes, which will include 'disputes arising out of ordinary transactions of merchants, bankers, financiers and traders such as those relating to mercantile documents, including enforcement and interpretation of such documents'. The idea behind the Commercial Courts Act is to speed up resolution of commercial disputes in

India and, to that effect, the Commercial Courts Act has various provisions (on process and timelines) that, if enforced, would have the effect of streamlining processes and reducing timelines for resolution of disputes. However, given that banks already have recourse to debt recovery tribunals and to NCLTs (under the IBC) to address their disputes, the impact of the Commercial Courts Act on banks may be limited.

The Commercial Courts Act has been recently amended to reduce the minimum value of disputes (to determine pecuniary jurisdiction) to 300,000 rupees, thereby bringing more matters into the purview of the commercial courts. The amendment also introduced a mandatory pre-institution mediation for suits not requiring urgent interim relief.

V INTERIM MEASURES

The Specific Relief (Amendment) Act 2018 has been notified by the government. The key takeaway from the amendment is that it makes specific performance of contracts the rule rather than the exception. Under the new amendments, the promisee (the aggrieved party), has a right to have the (breached) contract performed through a third party or by his or her own agency. The promisee can then recover the expenses and other costs incurred for such 'substituted performance' from the promisor (the defaulter). Although the amendment specifically clarifies that exercising such substituted performance does not limit the other rights of the aggrieved party, such as claiming compensation, it conveys a clear message that specific performance should be adhered to as a rule.

Separately, the amendment includes a new provision in the Specific Relief Act, 1963 under which the courts are not permitted to grant injunctions in a dispute involving contracts relating to infrastructure projects (separately defined in the amendment) if granting of such injunctions would impede or delay the progress or completion of such projects. Additionally, the amendment proposes to designate certain civil courts as special courts to try suits under the Special Relief Act in respect of contracts relating to infrastructure projects.

VI PRIVILEGE AND PROFESSIONAL SECRECY

The Indian Evidence Act 1872 (the Evidence Act) attaches privilege to communication made during the course of professional employment to legal practitioners, against disclosure of any advice given to the client or against disclosure of communication made during the course of his or her employment. That privilege continues even after the employment has ceased. The protection is given to what might constitute legal advice and not to any other communications from the adviser. In addition, such protection is not granted to the disclosure of any communication made in furtherance of any illegal purpose or the disclosure of any fact observed by the legal practitioners in the course of employment, in case a crime or fraud has been committed since the commencement of his or her employment (as opposed to before the employment commenced).

The law further provides that a person cannot be compelled to disclose to a court any confidential communication that has passed between that person and his or her legal professional adviser. However, where such person voluntarily offers himself or herself as a witness, he or she may be compelled to disclose such communications to the court that appear necessary in order to explain any evidence that he or she has given.

The privilege under the Evidence Act also extends to the contents or condition of documents with which the legal adviser becomes acquainted in the course and for the purpose

of his or her professional employment. Communications containing facts of a matter for the benefit of the legal adviser that are shared for the purpose of seeking legal advice may enjoy privilege.

The principle of litigation privilege – that privilege is attached to any document prepared for the purposes of, or in anticipation of, litigation – recognised under English law, is not reflected in the Evidence Act. This common law principle has, however, been recognised by the Bombay High Court.¹⁸ In that case, the management of the company had directed for studies to be conducted by its advertising and public relations departments. It was held that the company was entitled to claim legal privilege on the internal communications with the legal and other departments because the documents were brought into existence with the sole purpose of obtaining legal advice. This decision seems to suggest that if any work has been commissioned for the purpose of seeking legal advice, such work product in the form of a document will enjoy privilege.

VII JURISDICTION AND CONFLICTS OF LAW

In contracts where one of the parties is foreign, Indian law generally allows the parties to decide the forum¹⁹ and the governing law of the contract.²⁰ Parties have the option of submitting to the exclusive jurisdiction or non-exclusive jurisdiction of courts within whose jurisdiction they reside or a neutral forum (i.e., a forum not having a nexus with either of the parties to the contract). The only exception to the rule is if the forum chosen violates domestic law or is against public policy.

Other than judgments of superior courts in reciprocating territories,²¹ foreign judgments cannot be automatically executed in India. To enforce foreign judgments from non-reciprocating territories, the judgment creditor will have to file a fresh suit in a domestic Indian court of competent jurisdiction, on that foreign decree or on the original, underlying cause of action, or both.²² However, foreign judgments are considered conclusive as to the matters adjudicated upon as part of the judgment.

Both the execution of judgments from superior courts in reciprocating territories and the conclusiveness of judgments from non-reciprocating territories can be challenged on certain grounds, including: (1) the judgment not being given by a competent court; (2) the judgment not being on the merits of the case; (3) the judgment being founded on an incorrect view of international law or refusal to recognise Indian law, in cases where such laws are applicable; (4) when the proceedings in which the judgment was obtained are opposed to natural justice; (5) the judgment being obtained by fraud; and (6) where the judgment sustains a claim founded on a breach of any law in force in India.

18 *Larsen and Turbo v. Prime Displays Ltd and others*, 2002 (5) Bom CR 158.

19 *Modi Entertainment Network and Anr v. WSG Cricket Pte Limited*, AIR 2003 SC 1177; *Piramal Healthcare Limited v. DiaSorin SpA* 172 (2010) DLT 131; *M/s Gupta Coal India Private Limited v. M/s Swiss Marine Services SA* 2014(4)ABR353; *Sunrise Industries India Limited v. PT OKI Pulp and Paper Mills and Ors* 2017 GLH (2) (226).

20 *National Thermal Power Corporation v. Singer Company*, AIR 1993 SC 998, the only limitation to this rule is that the intention of the parties must be expressed *bona fide* and should not be opposed to public policy.

21 Some of the reciprocating territories are: Bangladesh, Hong Kong, Papua New Guinea, Singapore, Trinidad and Tobago and the United Kingdom.

22 *Marine Geotechnics LLC v. Coastal Marine Construction & Engineering Ltd* 2014 (2) Bom CR 769.

VIII SOURCES OF LITIGATION

In terms of litigation against banks, common causes have included: (1) failure or delay in repaying deposits; (2) wrongful dishonour of cheques; (3) refusal to grant loans; (4) failure or delay in paying bank guarantees; (5) charging interest at rates higher than those stipulated in the loan agreement; and (6) deficiency in service on various other matters.

In addition to the above, for the next couple of years, banking litigation in India is likely to, in large part, revolve around IBC proceedings and matters ancillary thereto (such as resolution of assets, creditor rights inter se, etc.). We have already seen jurisprudence around the IBC evolve substantially since it was enacted and as banks and other creditors continue to make the IBC their first port of call to resolve NPAs and stressed assets, we expect to see the jurisprudence around the IBC evolve even more.

IX OUTLOOK AND CONCLUSIONS

Given the current volume of NPAs in the system, the issue of stressed assets will continue to dominate the landscape in the coming year. Despite facing teething challenges, the IBC has proven to be a game changer in the last few years. The New Prudential Framework introduced by the RBI is also likely to alleviate the situation. Alongside, the government has also floated discussion papers in respect of notifying the insolvency framework in respect of individuals under the IBC and introduction of a legal framework for resolving cross-border insolvency. These developments will go a long way in modernising the insolvency resolution framework in the country.

JAPAN

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I OVERVIEW

No official statistical data on the number and trend of civil litigation cases involving banks and other financial institutions exists in Japan. It is widely believed, however, that the number of lawsuits between investors and financial institutions, one of the main categories from which banking litigation is generated, has decreased compared to the number of the same immediately following the post-global financial crisis era, after the bankruptcy of Lehman Brothers in 2008. This decrease is largely owing to Japan's recent improved economic situation, which benefits many investors, likely obviating their need to seek judicial redress in many instances. Be that as it may, in recent years, some lawsuits involving the banking sector have been heard, on which Japanese courts have handed down seminal decisions. In this chapter we introduce those court decisions and recent legislative developments, specifically reforms of Japan's Civil Code, which are likely to substantially affect future commercial litigation, including banking disputes. We also explain the major causes of and procedural issues related to banking litigation in Japan.

II RECENT LEGISLATIVE DEVELOPMENTS

The Amendment to the Civil Code of Japan was enacted by the National Diet in May 2017 and promulgated in June 2017. Most of the amendments will come into effect on 1 April 2020. Since this reform covers a wide variety of civil law issues, it is not feasible to explain it in its entirety in this chapter. Several reforms may substantially affect commercial litigation, including one involving banks. The examples of those reforms are in Section II.

i Reform on prescription

Under the current Civil Code, a claim is extinguished if not brought within 10 years of the date on which it became possible to exercise its right, owing to extinctive prescription,² with some exceptions (e.g., where the period of extinctive prescription is shorter than the general rule, such as five years, for a claim arising from a commercial act).³ The amendment, which abolishes the exceptions, introduces a new general rule: a claim will be extinguished the earlier of five years after the claimant becomes aware that the right of the claim can be exercised or

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2 Article 167, Paragraph 1 Civil Code.

3 Article 522 Commercial Code.

10 years after the right of the claim can be exercised. In addition, the amendment introduces a new suspension on prescription, where the completion of the prescription period for a right and claim is suspended for a certain period, generally one year, if parties agree in writing to negotiate such right and claim.

ii New restrictions on personal guarantees

The Amendment will impose some restrictions on guarantee agreements entered into by individuals. One of the important restrictions is that a guarantee agreement is not effective if (1) the principal debt of such guarantee agreement is a monetary loan owed by the principal debtor for the debtor's business; or (2) such guarantee agreement is a revolving guarantee in which the scope of the principal debts includes the monetary loan owed by the principal debtor for the debtor's business, unless the individual guarantor expresses his or her intent in a notarised document to perform the guarantee obligations within one month preceding the execution date of the guarantee agreement.⁴ Further, if a guarantee agreement falls within the scope of (1) or (2) above, the principal debtor is required to provide certain information, such as the properties and income and expenditures of the principal debtor, to the individual guarantor when the principal debtor asks the individual guarantor to assume the guarantee obligations. A failure to undertake such obligations may cause the guarantee agreement to be subject to cancellation by the guarantor.

iii Change of statutory interest rates

The current Civil Code and the Commercial Code provide a fixed statutory interest rate of 5 per cent⁵ and 6 per cent per annum,⁶ respectively. The Amendment abolishes those fixed statutory interest rates, and introduces a uniform floating interest rate, which will be 3 per cent when the amendment becomes effective but may be revised every three years in light of the average market interest rate. Most loan agreements involving banks and other financial institutions have a provision under which interest rates are prescribed; therefore, the change of statutory interest rates will generally not affect the practice in banking sector-related litigation as far as such loan agreements are concerned. However, this statutory interest applies to a tort claim, which is one of the main causes for customers to sue their banks and financial institutions, such as a claim of failure to explain, as described in Section IX. Therefore, this change may affect litigation involving financial institutions to that extent.

III REGULATORY IMPACT

The regulatory scheme regarding financial institutions, including banks, is generally administered by the Financial Service Agency of Japan (FSA). The Banking Act and the Financial Instruments and Exchange Act (FIEA) are the main regulatory sources of law governing the activity of banks and other financial institutions. Further, the Act on Sales, etc. of Financial Instruments (ASFI) restricts sales activities by financial institutions. In addition to these statutes, various cabinet orders and ministerial orders, as well as the FSA's policy

4 This restriction is not applicable if the guarantee agreement is entered into by an individual who is involved in the principal debtor's business (e.g., in the case where the individual is a director of the principal debtor if such debtor is a corporation).

5 Article 404 Civil Code.

6 Article 514 Commercial Code.

guidelines, are in effect in the financial sector. As these are administrative regulations, their violation does not necessarily impose civil liability on the violating financial institutions. However, Japanese courts frequently refer to such violation in determining civil liability. Furthermore, some provisions directly invoke civil liability on a violation of those regulations, such as liability for damages of financial institutions that fail to explain prescribed information to their customers.⁷

IV SIGNIFICANT RECENT CASES

i Financial institution's liability regarding damages incurred due to embezzlement using bank account

In its decision dated 2 February 2017,⁸ the Tokyo High Court did not find a defendant bank (a *Shinkin* bank) liable for damages incurred by the plaintiff company that had alleged that the defendant failed to properly verify the identity of a bank account holder, thereby facilitating embezzlement by the plaintiff company's employee via a fictitious bank account with the defendant. Pursuant to regulations under the laws and government notice of Japan, banks and financial institutions owe a duty to follow identity verification procedures in relation to bank account holders when opening or withdrawing money from bank accounts. In this case, the plaintiff, which incurred damages due to the embezzlement committed by its employee, alleged (1) that the employee repeatedly transferred the plaintiff's funds without any authorisation to a fictitious bank account opened in the defendant and then withdrew the transferred money from the fictitious bank account for her own purposes; (2) that the defendant failed to conduct the necessary identity verification steps, which enabled the employee in question to open the fictitious bank account and withdraw money from the account; and (3) that the defendant's failure constitutes a tortious act for which the defendant is liable to the plaintiff for the damages it incurred due to the embezzlement. The Tokyo High Court upheld the Tokyo District Court's decision, which also did not find the bank liable in this case, holding that, even if the defendant had failed to follow the necessary identity verification procedures and such failure enabled the employee who committed the embezzlement to open and withdraw funds from that account, the defendant could not have specifically been aware that the fictitious bank account was being used for the embezzlement; therefore, the defendant's failure to follow the identify verification procedures does not constitute a tortious act, and the defendant is not liable for damages incurred by the plaintiff due to the embezzlement. This decision illustrates a clear distinction between a bank's duty under the relevant regulations regarding identity verification of account holders and the bank's civil liability towards those who incur damages due to transfers to and withdrawals from a fictitious bank account.

ii Excessive selling financial products to a customer

In its decision dated 3 March 2017, the Tokyo High Court addressed the issue of a financial institution's excessive selling of financial products to a customer that ultimately resulted in the customer incurring losses.⁹ In this case, a plaintiff alleged, among others, (1) that the

7 Article 5 ASFI.

8 Tokyo High Court, 2 February 2017, Hei 28 (ne) No. 4305, 1529 KINHAN 27.

9 Tokyo High Court, 25 October 2017, Hei 29 (ne) No. 2554, 1531 KINHAN 54.

defendant, a securities company, repeatedly advised and made proposals to the plaintiff to buy financial products notwithstanding that the plaintiff had consistently incurred losses from investing in similar financial products, and (2) that the plaintiff purchased these financial products in reliance on the defendant's advice and proposals, which constituted excessive selling of financial products by the defendant to the plaintiff, significantly deviating from socially acceptable standards. In its decision at first instance, the Tokyo District Court found the defendant liable for the plaintiff's loss, accepting the plaintiff's allegation that the defendant excessively proposed and sold financial products to the plaintiff. The Tokyo High Court upheld the decision of the Tokyo District Court regarding the defendant's liability on excessive selling of financial products to the plaintiff; however, the Tokyo High Court deducted 70 per cent of the damages incurred by the plaintiff, factoring in the plaintiff's negligence through reasoning such as that the plaintiff eventually purchased those financial products of his own accord. This decision gives some insight into Japanese courts' view as to how liability should be apportioned between financial institutions, which sell financial products to their customers improperly, and the customers, who purchase the financial products in reliance on the financial institutions' advice, but nevertheless still decide to enter into such transactions of their own accord.

V COURT PROCEDURE

Japanese civil procedure falls within the category of a civil law system, which is different from court procedures in common law countries, such as the United States and the United Kingdom. Further, one feature of Japanese civil procedure, which is relevant to litigation between customers and banks, is that no equivalent to widely available class action lawsuits in the United States and other countries exists in Japan. Having said that, however, the Act on Special Measures concerning Civil Court Proceedings for the Collective Redress for Property Damage Incurred by Consumers (ASMCCP), which came into effect in 2016, changes the class action landscape in Japan: for the first time, in limited circumstances, class action-styled lawsuits may be brought. However, such procedure is to be initiated by a specified consumer organisation qualified by the government, and an individual consumer cannot initiate such procedure.¹⁰ Further, the application of the ASMCCP is limited to certain claims stipulated thereunder,¹¹ and certain types of damages, such as loss of profits, are excluded from the scope of recoverable loss.¹²

In contrast to the class action-style procedure, the alternative dispute resolution (ADR) procedure for disputes regarding financial products has become one of the main avenues for the resolution of financial disputes since its introduction in 2010 under relevant legislation, such as the FIEA and the Banking Act. Customers who have a complaint regarding financial products or financial institutions may bring such complaint either to normal court or to a designated dispute resolution organisation for ADR procedure, which has been established in each category of the financial business sector, such as banking and life insurance, although there are no such designated dispute resolution organisations in some financial business categories. This ADR procedure conducted by a designated dispute resolution organisation has some special features compared to standard ADR. One of the main features of this ADR

10 Article 3, Paragraph 1 ASMCCP.

11 *id.*

12 Article 3, Paragraph 2 ASMCCP.

is that a financial institution cannot refuse this procedure without just cause for doing so, if the customer wishes to seek the resolution through the ADR, rather than through court procedure.¹³ Further, in ADR proceedings, a designated dispute resolution organisation may request a financial institution to make a report or to submit books and documents or any other articles, which the financial institution cannot reject without just cause.¹⁴ In addition, unlike normal ADRs where the parties may reject a conciliation proposal by an ADR institution, the financial institution is required to accept such proposal except in certain stipulated situations, such as where it chooses to file a lawsuit on the dispute.¹⁵

VI INTERIM MEASURES

Under the laws of Japan, three types of interim measures concerning civil procedure exist: provisional seizure of assets, provisional disposition of a disputed subject matter, and provisional disposition that determines a provisional status.¹⁶ Regarding litigation involving banks, provisional seizure of assets is often used, whereby a debtor's or guarantor's assets are temporarily seized to enforce a judgment granting a monetary claim over the assets after the court delivers its formal judgment.

VII PRIVILEGE AND PROFESSIONAL SECRECY

i Privilege and professional secrecy

While no concept exactly equivalent to attorney–client privilege exists, a similar type of protection over attorney–client communications is available under Japanese civil procedure.

Lawyers bear confidentiality obligations for information obtained from clients under professional ethics, and a breach of such obligations could subject the breaching lawyer to criminal sanctions.¹⁷ In connection with such confidentiality obligations, the facts that become known to a lawyer during the course of his or her professional engagement and that should be kept secret, are protected. Specifically, the rights of refusal (1) to give testimony on confidential information of clients¹⁸ and (2) to produce documents containing confidential information of clients¹⁹ are provided under the Code of Civil Procedure. Further, documents prepared exclusively for the internal use of document holders are protected from document production orders issued by courts.²⁰

ii Disclosure

In connection to privilege and professional secrecy, no 'discovery' or other document or information-exchange process in the course of litigation exists in Japan. Instead, the Code of Civil Procedure provides for courts to make orders regarding document production; however, such orders are only available where a party succeeds in presenting the existence and identity

13 For example, Article 156-44, Paragraph 2, Item 2 FIEA.

14 For example, Article 156-44, Paragraph 2, Item 3 FIEA.

15 For example, Article 156-44, Paragraph 6 FIEA.

16 Article 20, Paragraph 1; Article 23, Paragraphs 1 and 2 Civil Provisional Remedies Act.

17 Article 134, Paragraph 1 Criminal Code.

18 Article 197, Paragraph 1, Item 2 Code of Civil Procedure.

19 Article 220, Item 4(c) Code of Civil Procedure.

20 Article 220, Item 4(d) Code of Civil Procedure.

of a document²¹ and where the necessity to produce the same as evidence exists.²² Further, several statutory exceptions exist under which the other party does not bear the obligation of document production.²³ Given the general tendency that courts are prudent in granting orders on motions for document production, no substantial disclosure of documents between parties in civil litigation usually occurs.

VIII JURISDICTION AND CONFLICTS OF LAW

Jurisdiction and conflicts of law issues are not usually disputed in banking litigation in Japanese courts. It should be noted, however, that consumers residing in Japan are generally allowed to file a complaint with Japanese courts against banks and other financial institutions concerning disputes arising from agreements between them, even if such agreements provide for the exclusive jurisdiction of a foreign court.²⁴

IX SOURCES OF LITIGATION

There are various types of civil litigation involving banks and other financial institutions. Most such litigation is brought by customers of banks and other financial institutions, such as investors purchasing financial products from banks and the like, and customers who deposit money in their bank accounts. Another major source of banking litigation is for banks and other financial institutions to seek repayment of money against debtors or guarantors under a loan agreement or guarantee agreement, as well as those who seek enforcement of a mortgage right over assets of debtors, etc.

i Lawsuits between investors and financial institutions

One of the major types of litigation between financial institutions, including banks, and customers is those where investors sue the institutions for selling financial products that ultimately result in the investors incurring losses. In those lawsuits, in their complaints, investors seek refunds to the extent of their losses, and their typical arguments include the following:

- a* failure to explain the contents and risks of financial products;
- b* failure to evaluate the suitability of financial products to investors; and
- c* the purchase of financial products by fraudulent means by financial institutions or by mistake by investors.

These arguments often overlap, and are concurrently presented to the court. Each argument's effect differs from the other, as explained in the following subsections.

21 Article 221, Paragraph 1 Code of Civil Procedure.

22 Article 181, Paragraph 1 Code of Civil Procedure.

23 Article 220, Item 4 Code of Civil Procedure.

24 Article 3-4, Paragraph 1; Article 3-7, Paragraph 5 Code of Civil Procedure.

Failure to explain the contents and risks of financial products

The ASFI requires financial institutions to explain to its customers certain important information about the financial products stipulated thereunder at or before the time of sale of the financial products to the customer.²⁵ If financial institutions fail to perform such duty of explanation, they will be held liable for the damages suffered by the said customer as a result thereof.²⁶

In addition to the ASFI, the Supreme Court has held that, if a contractual party fails to disclose to the other party information that could affect the decision of whether to enter into the agreement, the other party may claim against that party damages incurred from entering into the agreement as a general tort claim.²⁷ Based on this court precedent, investors often assert that financial institutions fail to disclose necessary information to them when selling financial products, which constitutes a tortious act, and that the financial institutions are responsible for the damages that they incurred.

The fulfilment of this duty to provide an explanation is generally considered from two different aspects: the scope of explanation and the manner and extent of explanation. Under the scope of explanation, the court essentially requires the financial institutions to explain the basic structure of the financial products in issue and the risk thereof,²⁸ which are essential for investors to make well-informed decisions on the investment of the financial products at their own risk. Concerning the manner and extent of the explanation, the courts consider those factors by referring to, among others, the nature of the financial products and knowledge and experience that the specific investors involved had when the transaction was concluded.²⁹

Failure to evaluate suitability of financial products to investors

A financial institution is required to evaluate a customer's suitability to a financial product in issue, in light of customer knowledge, customer experience and the state of customer assets or the purpose of the transaction in issue, pursuant to the FIEA.³⁰ This requirement is called the 'principle of suitability', and the Supreme Court addressed the relationship between this principle of suitability and the liability of the financial institution violating this principle, holding that a material violation of the principle of the suitability, such as where a sales person of a financial institution offered to sell financial products that included excessive risks to such customers, may constitute a tortious act and cause the financial institutions to owe civil liability to the investor.³¹ This court decision is particularly important in that it affirmed the imposition of civil liability on the financial institutions, even though the principle of suitability is originally considered as a regulatory rule and not a direct cause of civil liability being imputed to financial institutions.

25 Article 3, Paragraph 1 ASFI.

26 Article 5 ASFI.

27 Supreme Court, 22 April 2011, Hei 20 (jyu) No. 1940, 65-3 MINSHŪ 1405.

28 See, e.g., Supreme Court, 7 March 2013, Hei 23 (jyu) No. 1493, 243 SAISHŪ MINJI 51; Supreme Court, 15 March 2016, Hei 26 (jyu) No. 2454, 1648 SAIJI 1.

29 See, e.g., Tokyo High Court, 19 October 2011, Hei 23 (ne) No. 3584, 1942 KINHŌ 114.

30 Article 40, Item 1 FIEA.

31 Supreme Court, 14 July 2005, Hei 15 (jyu) No. 1284, 59-6 MINSHŪ 1323.

Fraud or mistake by investors

An investor sometimes argues that the contract of purchasing the financial products is void or can be cancelled owing to fraud by a financial institution or an investor's mistake regarding the structure and risks of the financial products. However, courts tend to accept such arguments in only limited circumstances, where, for example, a customer did not understand an essential part of the structure and risk of the financial product in issue owing to failure of the financial institution to perform its duty of explanation.³²

ii Lawsuits between a non-investor customer and bank

In addition to lawsuits between investors and banks, lawsuits between non-investor customers and banks occasionally arise. In a typical case, customers with bank deposit accounts sue banks for non-performance of their duty under deposit agreements. For example, customers assert that banks reject their requests to withdraw money from their bank accounts without just cause. A typical reason for a bank to do so is that there is a dispute as to who has the legal right to withdraw money from the account. Another example of this kind of dispute is where customers allege that banks have negligently allowed a payment of money to be made from their bank account to unauthorised persons, and therefore, the banks remain responsible for paying such money to the customers.

In a recent, interesting court case regarding a dispute between a non-investor customer and a bank, a customer filed a lawsuit against a bank for the transfer of money to an incorrect bank account, asserting that such incorrect transfer of the money caused the customer to incur a loss.³³ The Tokyo High Court held that such incorrect transfer constituted a failure of performance under a money transfer agreement between the bank and the customer and that the bank was responsible for the loss incurred by the customer. A unique feature of this court case is that the court determined the amount of damages awarded by referring to Article 248 of the Code of Civil Procedure, which provides that, if damage is found to have occurred, but, owing to the nature of the damage, it is extremely difficult to prove the amount thereof, the court may reach a finding on an amount of damages that is reasonable, based on the entire import of oral arguments and the results of the examination of evidence.

iii Lawsuits between a debtor or guarantor and bank

Another typical litigation source involving financial institutions, especially banks, is litigation related to banks' collection of repayments against a debtor and guarantor under a loan agreement or guarantee agreement. Those lawsuits are usually simple because, in many cases, banks clearly have the right to demand repayment against a debtor and guarantor under the relevant agreement. However, under some circumstances, guarantors assert that they misunderstood or were unaware of material facts related to the debtor and loan agreement in issue and that the guarantee agreement is void owing to such mistake. Under limited circumstances, the courts accept such assertion by the grantor and deny the bank's claim.

Further, this type of lawsuit often concurrently occurs with bankruptcy proceedings concerning the debtor. In those cases, the debtor had typically taken out a mortgage to

32 Osaka High Court, 12 October 2010, Hei 22 (ne) No. 1476, 1914 KINHŌ 68.

33 Tokyo High Court, 14 September 2016, Hei 28 (ne) No. 938, 2323 HANJI 101.

borrow money from the bank or has a deposit account in the bank with which it has entered into a loan agreement. Therefore, disputes frequently occur as to whether the banks' right on the mortgage and bank account has priority over the bankruptcy proceedings.

X EXCLUSION OF LIABILITY

The Consumer Contract Act provides, among others, that clauses are void if they completely exempt a business operator from either liability to compensate a consumer for damages arising from default by the business operator or liability for damages to a consumer that arises from a tort committed during the business operator's performance of a consumer contract.³⁴ Therefore, concerning an agreement between a financial institution and an individual, such clauses are void as long as the individual can be classed a consumer and the agreement constitutes a consumer contract stipulated under the Consumer Contract Act.

Regarding lawsuits between an investor and a bank, if the investor's assertion regarding the damage claimed is established, the investor may seek compensation of damages incurred as long as a proximate causation exists between the bank's conduct and the loss incurred by the investor. Concerning a bank's failure to sufficiently explain information to the investor, one of the main causes of this kind of lawsuit, courts frequently deduct the damages awarded, factoring in the investor's negligence. In some cases, the courts, in fact, deducted more than half the amount of the loss from the awarded damages.

XI OUTLOOK AND CONCLUSIONS

As explored in this chapter, the range of civil litigation involving banks and other financial institutions is extensive, and it is a monumental task to thoroughly explain these disputes uniformly. Nevertheless, one highlight of litigation trends involving financial institutions is disputes between customers, including investors, and financial institutions, where customers claim damages for losses incurred owing to certain activity or products provided by the financial institutions. As approximately 10 years have elapsed since the global financial crisis in 2008, many court decisions addressing alleged losses claimed by investors have been delivered during that period. As a result, with Japan enjoying economic stability in recent years, at present, the incidence of court cases involving financial institutions has stabilised. However, as economic conditions are rarely static and could rapidly change, careful attention should be given to judicial trends on banking litigation to better prepare for the next new or emerging trend in this field in the coming years.

34 Article 8, Paragraph 1, Items 1 and 3 Consumer Contract Act.

LIECHTENSTEIN

*Hannes Arnold and Sophie Herdina*¹

I OVERVIEW

Despite being ranked the sixth smallest nation in the world, Liechtenstein's financial centre is of great international importance and has gained a respectable reputation over the past few decades. Because of Liechtenstein's membership in the European Economic Area (EEA) since 1995, and its close economic ties with Switzerland, financial intermediaries located in Liechtenstein benefit from privileged access to both the European Union, by way of freedom to provide services, and to the Swiss economic area, owing to the customs and currency treaty that is in place between the two neighbouring states.

The highly regulated banking sector plays an important role in the Liechtenstein financial centre and adheres to the harmonised *acquis* of financial regulation and consumer protection. Owing to the political continuity and economic stability that Liechtenstein provides as a country of domicile in conjunction with the recent positive market developments, the consolidated assets managed by Liechtenstein banks, including their foreign group companies, reached more than 300 billion francs in 2018. Fifty two per cent, or 159.1 billion francs, of the total consolidated assets are under the management of banks in Liechtenstein. The amount of assets managed is especially remarkable taking into account that merely 14 banks were licensed in Liechtenstein at the end of 2018.²

By virtue of the importance of banks to the financial centre and to the economy of Liechtenstein, and the amount of assets managed by Liechtenstein banks, it does not come as a surprise that disputes that need to be resolved through litigation arise from time to time. However, we believe the number of cases brought to court is fairly low, especially in relation to the assets managed and in the majority of cases litigation is not initiated by banks.

The majority of legal issues in the field of banking litigation arising in the Liechtenstein courts concern the liability of banks and their bodies for the losses of clients, banking secrecy and issues in connection with asset freezing orders. Moreover, the enforcement of pledges that a bank may hold in assets deposited by clients has led to various disputes.³

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2 The consolidated assets under management have increased from 294.3 billion francs at the end of 2017 to 305.2 billion francs in 2018; for more information see FMA Liechtenstein Financial Market Report 2019, 12; regarding the number of licensed banks please also see FMA Annual Report 2018, 27.

3 OGH 7 May 2010, 03 CG.2009.3, GE 2010, 190.

II SIGNIFICANT RECENT CASES

Although Liechtenstein is not a common law jurisdiction and banking law is thus based on statutory law, Supreme Court decisions and relevant rulings of the lower courts do have substantial influence on Liechtenstein law, without creating binding precedence. Owing to the fact that Liechtenstein is a small jurisdiction and the cases brought to and decided by the courts are few, the developments in significant recent cases are limited.

However, as the Liechtenstein legal system is partly based on Austrian, as well as Swiss, law, the respective Austrian and Swiss Supreme Court decisions need to be taken into account⁴ when assessing the legal situation in Liechtenstein. Thus, the text below focuses on developments in Austrian jurisprudence, which will most likely also be of importance with regard to Liechtenstein.

i Recognition of foreign security interests without publicity

Similar to the Austrian legal situation, Liechtenstein law requires publicity⁵ in order to validly establish a security interest or conduct a transfer of assets for security purposes, assignment of claims for security purposes respectively. In other words, the establishment of a security interest must irrefutably be visible for the outside world.⁶ Thus, the respective assets have to be transferred to the pledgee and may not remain in possession of the pledger, which is why it is not possible to create a pledge by the way of *Besitzkonstitut*.⁷

Based on the above and the provisions of the Austrian International Private Law the Austrian Supreme Court has repeatedly held that a security interest validly created under non Austrian law without fulfilling the requirements of publicity becomes invalid, once the respective assets are transferred to Austria.⁸ This based on the principle that the effects of acquired rights *in rem* have to be assessed based on the law of the respective location (*lex rei sitae*).⁹ Thus, the existence of a security interest depends on the law of the current location rather than the law of the location at which the security interest was acquired.¹⁰

In a recent decision the Austrian Supreme Court has revised its longstanding jurisprudence in this regard. It has now held that it is, inter alia, not in line with the principle of acquired rights to uphold the above-mentioned jurisprudence that a security interest validly established under foreign law becomes void by the transfer of assets to Austria, if the principle of publicity has not been complied with.

It is not foreseeable whether the Liechtenstein Supreme Court will also adopt this jurisprudence at this point. However, as the Austrian and Liechtenstein provisions in this regard are similar and Austrian jurisprudence is thus to be taken into account, the authors believe this to be likely.

4 OGH 5 July 2013, 10 CG.2010.152, LES 2013, 156; OGH 9 February 2006, 06 CG.2004.23, LES 2006, 468.

5 Opilio, Law on Property, Article 365 SR, 008.

6 OGH 25 May 1992, 03 C 144/87-58, LES 192, 144.

7 *Constitutum Possessorum*, the possession remains with the prior possessor which possesses for the current possessor.

8 öOGH 14 December 1983, 3 Ob126/83.

9 öOGH 14 December 1983, 3 Ob126/83.

10 RIS-Justiz, RS0076753; öOGH 14 December 1983, 7 Ob 723/88; 15 October 1997, 3 Ob 2403/96w.

ii Liability in case of violation of duties to inform about internal commissions

In a recent case the Austrian Supreme Court has further specified its jurisprudence with regard to liability in connection with the violation of duties to inform. In a prior decision¹¹ the Austrian Supreme Court provided banks that had, in breach of their obligation to inform, not informed their customers of internal commissions earned for the brokerage of ship and real estate funds with the possibility to avoid liability for damages, by holding that, if the bank succeeded in proving that it would have recommended the respective product regardless of the commissions, there would not be any grounds for liability.

In its more recent decision the Austrian Supreme Court has clarified that the fact that the acting adviser had no knowledge of the respective commissions is irrelevant, if special sales-promoting measures within the bank influence the advisory activities of the respective employees as well as the investment decisions of the clients.¹² With this decision and by focusing also on sales-promoting measures, the Austrian Supreme Court seems to leave open the possibility for banks to avoid liability, in particular if the bank can prove that the adviser has no knowledge of the respective commissions and no sales-promoting measures were undertaken and there is thus no direct or indirect influence of the advisers recommendation of a specific product.¹³

As the provisions on which this decision is based are similar in Austria and Liechtenstein, it is most likely that the Liechtenstein Supreme Court would follow this jurisprudence when concerned with a similar case.

III RECENT LEGISLATIVE DEVELOPMENTS

By virtue of its EEA membership, Liechtenstein implements EU legislation with EEA relevance. In particular in the financial services sector, Liechtenstein is obliged to transpose EU directives and regulations. Thus, financial institutions in Liechtenstein are subject to the same regulatory framework as financial institutions located in EU Member States and EU law has great impact on legislation and subsequently Liechtenstein's financial centre.

Recent relevant legislative developments in the banking sector have been the strengthening of the deposit guarantee by the enactment of the Deposit Guarantee and Investor Compensation Act, the Regulation (EU) 2017/1109 on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading on a Regulated Market (Prospectus Regulation) entering into force and the amendment of the Financial Market Act in the course of establishing an institutional framework for macroprudential policy and supervision.

In Liechtenstein, the relevant supervisory authority is the Liechtenstein Financial Market Authority (FMA), which is part of the European system of financial supervision. Even though Liechtenstein is not a member of the European Union, it is a full member of the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority; however, the FMA has no voting rights in the committees of these financial supervisory authorities.

11 öOGH, 27 April 2017, 2 Ob 99/16x.

12 öOGH 26. February, 8 Ob 166/18x.

13 Kellner, ÖBA 2019, 517 (518).

i Deposit Guarantee and Investor Compensation Act

Whereas EU Member States were obliged to transpose Directive 2014/49 EU on Deposit Guarantee Schemes (DGS III) by 3 July 2015, the respective regulation has not yet been adopted into the EEA acquis. At this point it is not foreseeable when the DGS III will be incorporated into the EEA Agreement, which is why Liechtenstein decided to transpose DGS III early to ensure equality to the EU acquis.¹⁴

Thus, the Deposit Guarantee and Investor Compensation Act as the national transposition law was recently enacted and entered into force on 1 June 2019.¹⁵

The main goal of the respective act is the protection of the depositories in the case of the insolvency of a Liechtenstein bank. As in the EU uniformly an amount of €100,000 is guaranteed, Liechtenstein law guarantees 100,000 francs per depositor and per bank. Whereas the well-established Liechtenstein deposit guarantee will be retained and the organisational structure of the deposit guarantee scheme at the level of the Liechtenstein Banking Association will be recognized *ex lege* as a deposit guarantee scheme, the reimbursement period after the occurrence of a triggering event will be gradually reduced from a maximum of 30 (20+10) working days to a maximum of seven working days.¹⁶

ii Prospectus regulation

Similar to the Deposit Guarantee and Investor Compensation Act, the Prospectus Regulation also has investor protection as its core task. The Prospectus Regulation, as a regulation with EEA relevance, has, meanwhile, been incorporated into the EEA Agreement and is in force. Whereas the Prospectus Regulation is directly applicable in Liechtenstein, it has a limited scope of application as Liechtenstein currently does not have a regulated market and no corresponding regulation on stock exchanges.¹⁷

With the applicability of the Prospectus Regulation the administrative and cost burden in connection with the preparation of a prospectus shall be reduced, especially with regard to small and medium-sized enterprises, issuers of secondary issues as well as constant issuers. The threshold value for the obligation of publishing a prospectus has been harmonised at €1 million euros and simplifications with regard to the preparation and design of prospectuses have been introduced and prospectus summaries have been streamlined. With investor protection in mind, the practice of sometimes excessive catalogues of risk factors has been abolished and such information must now be minimised.

Where the Prospectus Regulation leaves some flexibility with regard to the implementation, the legislator has taken into account the particularities of Liechtenstein in the course of the transposition. As issues with a total value of less than one million euros over a period of 12 months are rare and in practice issues are far above that threshold, Liechtenstein did not make use of the option to provide for other disclosure obligations for such issues.¹⁸ Furthermore, Liechtenstein has decided to exempt issues of securities with a

14 BuA 2018/98, 7 et seq.

15 Article 64 Deposit Guarantee and Investor Compensation Act.

16 BuA 2018/98, 11 et seq.

17 BuA 2019/12, 5 et seq.

18 BuA 2019/12, 27.

total issue amount that does not exceed eight million euros and that are only offered publicly in Liechtenstein from the obligation to prepare a prospectus. In practice, issues limited to the Liechtenstein market are rare.¹⁹

iii Macroprudential policy and supervision

In transposition of Recommendation ESRB/2011/3 of the European Systemic Risk Board, Liechtenstein has amended the Financial Market Act and established a Financial Market Stability Committee in order to contribute to the prevention and mitigation of systemic risks to financial market stability. The newly established committee will consist of two representatives each of the FMA and the Ministry for General Government Affairs and Finance. The tasks of the Financial Market Stability Committee include dealing with warnings and recommendations of the European Systemic Risk Board, discussing issues relevant to the stability of the financial market, issuing recommendations and warnings as well as submitting recommendations to the FMA or government.²⁰

The respective amendments to the Financial Market Act entered into force on 1 May 2019.²¹

IV CHANGES TO COURT PROCEDURE

As court procedures in civil law matters are governed by the Liechtenstein Civil Procedure Code (LCPC) from a procedural perspective and civil law matters naturally form the majority of cases relevant for banks, the extensive revision of the LCPC is of utmost interest with regard to banking litigation.

The LCPC, which is based on the Austrian Civil Procedure Code, dates back to 1912 and has undergone only a few substantial changes since then. It is thus no surprise that the LCPC no longer fully satisfied the requirements for providing a procedure that is as simple, quick and inexpensive as possible. As it is not only of central importance for the confidence in the judicial system that judicial protection is granted within reasonable time, but the duration of proceedings is also a crucial factor from an economical point of view, the legislature decided to finally reform the LCPC in large parts following the amendments the Austrian legislature has made to the Austrian Civil Procedure Code over the past years.²²

Against this background the LCPC has been revised comprehensively and the respective provisions entered into force on 1 January 2019. A detailed discussion of the changes made would, however, be of a more procedural nature and would of course go beyond the scope of this chapter.

V INTERIM MEASURES

The Liechtenstein Enforcement Act (EO) has been reformed to some extent in the past year. As the authors do not consider the respective changes to be of interest this regard, the revision is not discussed hereinafter.²³

19 BuA 2019/12, 29 et seq.

20 BuA 2018/76, 4.

21 II of the Law on the Amendment of the Financial Market Act, LGBl. 2019.100.

22 BuA 2018/19, 8 et seq.

23 Law on the Amendment of the Enforcement Act, LGBl. 2018.472.

Civil law interim measures

Developments

The EO provides for the possibility to request a preliminary injunction to secure either a monetary claim or any other claim before or pending a civil case or execution proceedings.²⁴ The relevant provisions concerning interim injunctions are contained in Article 270 et seq EO and have been implemented on the basis of Austrian law. Consequently, the courts and legal representatives must consider Austrian legal doctrine and jurisprudence when dealing with interim injunctions based on the EO.

The Liechtenstein Supreme Court has recently held that the issuing of interim injunctions by means of a third-party prohibition²⁵ is generally considered as a civil law dispute within the meaning of Article 6 of the European Convention on Human Rights. Thus, such a procedure is a bilateral one and the opponent must be heard before issuing the respective injunction. Only in cases where the purpose of the interim injunction can be thwarted by a prior hearing, must such hearing not be held. The omission of the court to hear the opponent prior to granting an interim injunction must be reasoned briefly and conclusively, otherwise the respective court decision will show a failure to state reason and may be appealed.²⁶ As banks are more commonly third-party debtors than claimants, or even less commonly, debtors, the third-party prohibition as a security measure is of special interest, which is why this development is relevant for banking litigation as well.

Procedure

Regarding the filing of an application of an interim injunction, which may be done separately or in conjunction with a claim, application for a payment order or any other application, certain details must be provided, *inter alia*, the type of order the applicant wishes to apply for and its proposed duration. Further, the creditor's claim must be specified precisely and the facts on which the request is based must be stated truthfully and in detail. With regard to the required determinedness of the respective application for interim injunction, the Liechtenstein Supreme Court has recently held that the assets affected by the interim injunction as well as the prohibited actions must be sufficiently defined.²⁷ In this regard the Supreme Court has stated that the application for interim injunctions, which is intended to prohibit the counterparty from disposing of his or her assets up to a certain amount, is not sufficiently determined, if no detailed description of the assets concerned and the term 'disposal' is made therein and is thus to be rejected.²⁸

As according to Article 51 EO the LCPC is applicable with regard to procedural matters not governed by the EO, the revision of the LCPC is also of importance with regard to interim measures.

24 Article 270, Paragraph 1 EO.

25 Such a third-party prohibition is enforced by prohibiting the debtor from disposing of the claim and ordering the third party not to pay the debt owed to the debtor and not to undertake anything in relation to the debtor that could impede or prevent the recovery of the respective claim. In contrast to the legal situation in Austria, in Liechtenstein, the creditor will acquire a lien on the secured claims. Thus, the bank will be prohibited from disposing of the claim for repayment that the debtor has acquired against it and the creditor will have a lien in said claim.

26 OGH 7 September 2018, 01 CG 2018 91, LES 2018, 265.

27 OGH 5 April 2019, 01 CG 2016 461, LES 2019, 107.

28 OGH 5 April 2019, 01 CG 2016 461, LES 2019, 107.

VI PRIVILEGE AND PROFESSIONAL SECRECY

We are not aware of any changes with regard to privilege and professional secrecy, which took place in the last year. The Liechtenstein Lawyers Act (RAG) still provides for a strong lawyer–client privilege, which provides that lawyers are obliged to maintain secrecy about all matters entrusted to them and facts that become known to them in their professional capacity, the secrecy of which is in the interest of the lawyer’s party.

VII JURISDICTION AND CONFLICTS OF LAW

As outlined above, the Austrian Supreme Court has recently held that security interests created in accordance with foreign law, and without fulfilling the requirements of publicity, will be recognised by Austrian courts.²⁹ As this was not the case before,^s and as the establishment of security interests is inherent to the banking business, this development is very much of interest in this regard.

Furthermore, and for the sake of completeness, we note that Liechtenstein has still not joined any international agreements on the recognition and enforcement of foreign court decisions in addition to those with Austria and Switzerland³⁰ and thus judgments rendered by foreign courts will not automatically be recognised and enforced in Liechtenstein.

VIII SOURCES OF LITIGATION

As outlined above, banks in Liechtenstein rarely initiate proceedings themselves but are most commonly the addressees of litigation. In the past few years, lawsuits dealing with the liability of banks and its bodies for losses in client assets deposited with the bank, asset freezing orders and their prolongation, as well as the extent of banking secrecy, have prevailed in banking litigation in Liechtenstein. In addition, the enforcement of pledges in client assets is commonly dealt with by Liechtenstein courts.

However, as mentioned above, not only the jurisprudence of the Liechtenstein courts is of importance concerning banking litigation, but Austrian and Swiss case law also influences jurisprudence in Liechtenstein and, therefore, must be taken into account.

IX REGULATORY IMPACT

Regulation not only has an impact with regard to the regulated institutions but also affects civil law aspects such as liability. With regard to unlawful conduct Liechtenstein law stipulates that the violation of protective provisions establishes unlawful conduct³¹ and may thus lead to liability. Protective provisions are to be understood as any legal provision that pursues a protection purpose in terms of content.³² The qualification of unlawful conduct is significant

29 öOGH 23 January 2019, 3 Ob 249/18s.

30 Agreement of 25 April 1968 between the Principality of Liechtenstein and the Swiss Confederation on the recognition and enforcement of judgments and arbitration awards in civil matters; Agreement of 5 July 1973 between the Principality of Liechtenstein and the Republic of Austria on the recognition and enforcement of judgments, arbitral awards, settlements and public documents.

31 Section 1311 ABGB – the Austrian and Liechtenstein provisions are identical.

32 öOGH 28 January 2002, 2 Ob 310/01 d; RIS Justiz, RS0027415; OGH 2. October 2015, 01 CG.2012.379, LES 2015, 225.

with regard to liability, as liability based on a violation of a protective law grants claims for damages for pure financial losses even if neither contractual obligations nor absolutely protected legal interests were violated.³³ When assessing the unlawful conduct the material scope of the protective provisions must be taken into account and the damages occurred must have been such, which the protective provision aimed to prevent on the basis of its ratio. Based on the purpose of the Liechtenstein Banking Act (BA) expressly determined in Article 2 Paragraph 2, in particular the protection of creditors and investors of banks and investment firms as well as the safeguarding of confidence in the Liechtenstein monetary, securities and credit system and the stability of the financial system, the Supreme Court has held that the violation of licensing requirements qualifies as a violation of a protective provision within the meaning of Section 1311 ABGB.³⁴

X OUTLOOK AND CONCLUSIONS

From our experience the regulatory environment especially on an EU level is becoming more vast each year, the level of detail is increasingly high and the density of Level II and Level III legal acts is increasing steadily. We do not see any indications for a trend of reduction of regulation in the financial market sector at this point and it is thus to be expected that further regulation will be enacted in the future.

As Liechtenstein is an EEA member, EU legislation with EEA relevance is also adopted in Liechtenstein. It is thus to be expected that the regulatory framework in place in Liechtenstein will develop similar to the EU framework. Liechtenstein is in general eager to transpose relevant EU legislation promptly to guarantee a level playing field and subsequently often decides to transpose the respective legislation into national law even before the respective legislation has been incorporated in the EEA *acquis*.

One of the current regulatory projects in Liechtenstein is the transposition of Directive (EU) 2015/2366 of 25 November 2015 on Payment Services in the Internal Market, better known as PSD II. The national implementation of PSD II creating a framework for payment service providers, will again take place before PSD II has become part of the EEA *acquis*.³⁵ The PSD II and thus the national transposition law, the Liechtenstein Law on Payment Services aims to ensure adequate consumer protection, transparency and security of payments and fair competition in relation to payment services as well as to promote the market continuity and to create a clear legal framework.³⁶ The Liechtenstein Law on Payment Services has entered into force 1 October 2019.³⁷

Further, it is expected that Liechtenstein will implement Directive 2014/17/EU on Credit Agreements for Consumers Relating to Residential Immovable Property, which aims to create a uniform legal framework with regard to the provision of mortgage credit agreements *vis-à-vis* consumers. Thus, it is likely that new lending rules with regard to residential real estate will enter into force in foreseeable future and therewith the requirements with regard to pre-contractual information will be determined and uniform standards concerning the assessment of creditworthiness, employment training and remuneration will be introduced.

33 Schacherreiter in Kletečka/Schauer, ABGB ON (2010), Section 1311 ABGB, Rz 5.

34 OGH 2 October 2015, 01 CG.2012.379, LES 2015, 225.

35 BuA 2019/11, 9.

36 Article 1 paragraph 2 lit a and b Zahlungsdienstegesetz.

37 Article 118 Zahlungsdienstegesetz.

MEXICO

Rodrigo Zamora E, Andrés Caro de la F and Santiago Oñate Y¹

I OVERVIEW

Commerce legislation is a subject matter considered exclusive of the Federal Congress. However, commercial litigation is considered a concurrent subject matter jurisdiction, meaning that, unless a specific rule or statute applies (such as maritime, bankruptcy, aviation laws, etc.), parties may litigate before state or federal courts. The Code of Commerce applies to all merchants and their transactions both from a substantive and procedural standpoint.

No specific rules or statutes exist for banking litigation, except for bankruptcy of banks. That means that banks are subject to the same proceedings as any other merchant. Generally speaking, banks may initiate, or be subject to, the following proceedings: ordinary proceedings, executive proceedings (these two may be both oral or written), enforcement of non-possessory pledges and guarantee trusts, enforcement of traditional pledges (i.e., where the creditor has possession of pledged assets), bankruptcy, tailor-made proceedings and enforcement of foreign judgments.

Ordinary and executive proceedings are, by far, the most common commercial proceedings. There are three main differences between ordinary and executive proceedings: that executive proceedings are faster, the plaintiff may initiate attachment of the debt upon process being served and the defendant may only raise limited defences. To gain access to an executive proceeding, the debt must be documented in an executive title, typically: negotiable instruments, public deeds containing a due and payable amount, final judgments and settlements signed before a court, and some administrative authorities. Additionally, banks can also file executive proceedings relying on the credit (or other financial agreements, such as a master lease or factoring) agreement accompanied by a statement certified by the bank's authorised accountant.

Enforcement of non-possessory pledges and guarantee trusts may be extrajudicial or judicial and the latter does not require prior initiation of the former. As with executive proceedings, these enforcements are fast and focus on granting possession of the collateral to the creditor upon serving of process. Defences for the defendant are limited. If the pledgor refuses to grant possession of the collateral in an extrajudicial proceeding, the creditor will have to resort to judicial enforcement, where the court will issue an order demanding repossession of collateral. These proceedings, when not contested, tend to focus on the appraisal and sale (or acquisition by the creditor) of the collateral.

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Judicial enforcement of traditional pledges consists of requesting the judge's authorisation to sell the collateral upon default, with an opportunity for the pledgor to oppose the sale if he or she alleges the debt is not yet due and payable. A broker will conduct the sale and the creditor will retain the proceeds up to the amount of the debt.

Tailor-made proceedings are judicial proceedings that the parties specifically design in terms of evidence that can be offered, the appeals that are available, what issues can be subject to such a proceeding and what court should rule on them. For parties to have access to a tailor-made proceeding, they must have agreed to it in a public deed or in writing before a court but, in any event, they cannot agree to proceedings which would affect constitutional due process. Due process includes having a way to serve process that sufficiently assures the defendant gets knowledge of the complaint, a reasonable term for answering the complaint and offer evidence, an opportunity to present evidence and argue and an opportunity to appeal.

The Insolvency Law regulates business reorganisation and bankruptcy of merchants as two successive stages of the same proceeding called *concurso mercantil*: conciliation and liquidation. Banks cannot be subject to a *concurso mercantil* as debtors (see next paragraph) but they can (and usually do) participate as creditors. The purpose of the conciliation stage is to preserve companies through a restructuring plan with its debtors. The purpose of liquidation is the sale of the business, as a going concern, in productive units or by piecemeal. The conciliation stage (where a restructuring plan is negotiated) can last up to one year; if no agreement is reached, the court will open the liquidation stage. Generally speaking, the law recognises secured claims as being paid after some super priority employment and administrative claims, but before other labour and employment claims, tax, unsecured and subordinated claims.

As for judicial bank liquidation, the current proceeding can only be petitioned by the Institute for Banking Savings Protection, only upon revocation of the authorisation granted by the National Banking and Securities Commission (and when the bank is in negative equity. The main characteristic of this proceeding is its speediness, where the judge has to declare liquidation if the financial standards are met, no later than 24 hours of the petition being made. During liquidation, the Institution or the Commission mentioned may request corrective measures such as intervention, suspension of some activities and capital injection. There is no reorganisation stage and the liquidator, which shall be the above-mentioned Institute, shall liquidate all pending transactions and pay creditors in an order generally similar to that of the regular insolvency.

Finally, regarding enforcement of final commercial foreign judgments (that do not decide *in rem* actions or corporate governance issues), Mexico will allow such enforcement without revisiting the merits if, among other things, the judgment was rendered in compliance with legal formalities of the foreign jurisdiction and of treaties relating to international communications, if the ruling court was competent, if process was served personally or on an appropriate process agent and if it does not contravene Mexican public policy or if the issues decided have already been decided or are being tried by a Mexican court.

II SIGNIFICANT RECENT CASES

In the past few years, banking litigation in Mexico has witnessed several judicial precedents that point towards a re-imagining of the way in which usurious interests are conceived, the way in which trust funds are treated in bankruptcy cases and to unprecedented consequences in civil liability cases.

i Usurious interests

In 2011, Mexico witnessed a Constitutional Reform of great substantive and practical breadth. It essentially rearranged the way in which human rights adjudication was perceived and it repurposed the role of ordinary and constitutional judges to upkeep said reform.² It was not long before the results of this reform started to appear and one of the matters in which it had a transformative result was in the way interest rates were analysed by courts in promissory notes, contracts and credits. In a series of rulings, the Supreme Court, using the legal framework of the American Convention on Human Rights, considered that usury and any other forms of exploitation of man by man was prohibited.³ In this regard, the Court established that all judges, both state and federal, had the obligation to advert usurious interests, even if the parties did not raise the issue in their motions, and establish a fairer interest rate. Furthermore, the Court stated that this standard applies both to delinquent interests as well as ordinary ones.⁴ However, the Court has also upheld that banks and other financial institutions enjoy the *prima facie* presumption that their interest rates are not usurious.⁵

Another characteristic of these precedents is that the determination of usury has not been dogmatic, but rather context-dependent. For example, in a case of auto financing, a Federal Appellate Court held that in determining if the interest rate was usurious, it had to refer to the industry practice and the interest rates in other similar loans.⁶

ii Trust funds in bankruptcy cases and in rem guarantees

In 2018, a Federal Appellate Court issued a judgment that would prove to have significant effects in the protection of funds transferred by a debtor to a trust. First, the Appellate Court ruled in favour of a detachment standard that would imply the isolation of the trust funds from any liabilities that arise out of insolvency of the debtor (the settlor) who transferred

2 This constitutional reform that essentially introduced the following: (1) that all individuals shall have the human rights recognised in the Constitution and in international treaties and therefore that all interpretation must be made in conformity with both bodies of norms; (2) all human right norms shall be interpreted in the most beneficial manner for the people, and (3) the obligation for all governmental authorities to protect and guarantee human rights in accordance with its core principals.

3 Supreme Court of Justice, First Chamber, *Amparo Directo en Revisión 2534/2014; Tesis aislada 1a. CXCIII/2015 (10a.)*: '*Explotación del hombre por el hombre. Concepto.*' Found in the *Semanario Judicial de la Federación y su Gaceta, Libro 19, junio de 2015, tomo I*, pg. 586.

4 Supreme Court of Justice, First Chamber, *Tesis de jurisprudencia 1a./J. 54/2016 (10a.)*: '*Usura. Su prohibición aplica tanto para los intereses ordinarios como para los moratorios pactados en un pagaré.*' Found in the *Semanario Judicial de la Federación y su Gaceta, Libro 50, noviembre de 2016, tomo II*, pg. 883.

5 *Amparo directo en revisión 777/2016*, Supreme Court of Justice, First Chamber; *Tesis aislada 1a. CCLII/2016 (10a.)*: '*Usura. Las tasas de interés de las instituciones bancarias que conforman el sistema financiero mexicano, gozan de la presunción de no ser usurarias.*' Found in the *Semanario Judicial de la Federación y su Gaceta, Libro 36, noviembre de 2016, tomo II*, pg. 916.

6 *Amparo Directo 736/2017* Eighth Federal Appellate Court of the First Circuit; *Tesis aislada I.8o.C.47 C (10a.)*: '*Usura. Para determinar si el interés moratorio pactado en un pagaré suscrito como garantía en un financiamiento automotriz es excesivo, es válido acudir a la tasa publicada por empresas dedicadas a ese ramo en específico.*' Found in the *Semanario Judicial de la Federación y su Gaceta, Libro 50, enero de 2018, tomo IV*, pg. 2348.

assets to a trust. In other words, the placement of assets in a trust fund removes them from the debtor's liabilities subject to the rules of insolvency proceedings, because the assets are not part of the debtor's estate.⁷

Second, the Federal Appellate Court considered that even when the trust was created as a 'guarantee trust', said trust should not be considered as an *in rem* collateral (such as a pledge or a mortgage). The underlining logic was that an *in rem* collateral is still part of the debtor's estate, with the creditor having a higher priority interest in the assets than other unsecured creditors, whereas the guarantee trust assets belong to the trustee, instead of the debtor and no other creditor has interest in the assets.

Although this precedent is not binding, it reaffirms the principle of bankruptcy remoteness of trust funds that had been called into question by another non-binding precedent issued in 2016, where a court stated that the rules governing trusts should defer to insolvency rules and, thus, the trust assets should be considered as part of the settlor's estate.

iii Civil liabilities and punitive damages

Extra compensatory damages had not been part of judicial adjudication in Mexico, until 2013 when the Supreme Court ruled on the civil liabilities of a hospital that did not practise due care in preventing an accident.⁸ While the facts of the case exceed the scope of this chapter, the introduction of this common law concept to a civil law tradition system has brought with it new litigious scenarios. While the Court acknowledged that punitive damages had two facets, as a retributory mechanism and as deterrent, there is yet to be an academic or judicial consensus on the scope and adjudication guidelines for punitive damages. However, the driving force behind the deterrent criteria is usually to prevent egregiously illicit acts. This driving force, in turn, can have potential effects on all types of companies, including banks, if a court considers the banks' activities cause egregious civil liabilities, for instance, if a court considers that interest rates are so egregious that not only should the court reduce them (see subsection i), but it should also impose punitive damages to deter this practice. Although a scenario of punitive damages against banks seems unlikely, it is important to raise awareness to prevent such a scenario.

III RECENT LEGISLATIVE DEVELOPMENTS

Before 2012, all types of commercial proceedings were written, with the exception of the evidence hearing, which was orally conducted but, in any event, was transcribed and analysed in its written form. Because what mattered for issuing the ruling was the written form of the hearing, it was commonplace for judges not to be present at the hearings, but for clerks of the court to conduct them. Logically, oral arguments were almost non-existent and interrogations and depositions were very mechanical, without the natural flow of an open-court interrogatory.

In 2012, Congress reformed the Code of Commerce to include oral ordinary proceedings for otherwise written ordinary proceedings where the disputed amount is lower than the equivalent of approximately US\$35,000.

7 Eight Federal Appellate Court of the First Circuit, *Amparo en Revisión 70/2018; tesis aislada I.8o.C.57 C (10a)*: 'Fideicomiso de garantía. Sus efectos en caso de quiebra del deudor.' Found in the *Semanario Judicial de la Federación y su Gaceta, Libro 50, agosto de 2018, tomo IV*, pg. 2847.

8 Supreme Court of Justice, First Chamber, *Amparo Directo 30/2013*.

In 2014, Congress passed the Financial Reform, which produced major changes for banking transactions, bringing Mexican financial rules closer to the best practices worldwide. This improved the already existing forms for securing transactions, better and more flexible rules for blanket liens and floating liens, money pledges, more flexible guarantee trusts, etc. The Financial Reform also improved the rules of the electronic public registry for personal property granted as collateral, which makes the creation, enforcement and collection of collateral easier, while it also creates new temporary restraining orders to bind defendants to trial and prevent them from concealing assets. The Financial Reform also encompassed several other regulatory changes, many of them discussed in Section X.

In sum, the Financial Reform intended to make credit transactions more accessible to small and medium-sized companies and enforcement upon defaulting easier for banks, thus reducing the cost of credit.

In 2017, Congress passed a new reform to the Code of Commerce, creating a new oral executive proceeding available for claims that are above the threshold indicated before but below the equivalent of approximately US\$200,000 and making oral ordinary trials the norm for any ordinary procedure, removing any quantitative threshold for these proceedings. This reform is still being gradually introduced in courts.

IV CHANGES TO COURT PROCEDURE

As discussed in Section III, court proceedings are now mainly oral. This speeds up the proceeding, because all or almost all evidence and arguments are offered in a single hearing. The judge, who is present at the hearing, can now issue a faster judgment, based on what he or she sees and hears from the parties. Open-court interrogation helps the judge to better perceive the facts and makes judgments more accurate. Legislative changes now also restrict access to appeals to more limited issues, preventing parties from using them for delaying purposes.

V INTERIM MEASURES

Legislation and court precedents have been developing and expanding the application of interim measures in recent years. For instance, the defendant's intent to conceal fungible assets, such as money, is now presumed, thus relieving the petitioner from demonstrating so before obtaining a freezing order.⁹ This makes asset-freezing orders significantly easier to obtain.

Additionally, in the past, the petitioner had to identify, for instance, the exact bank and bank account to freeze, while a recent binding precedent states that providing this data is not required for obtaining the freeze.¹⁰ Therefore, provided the other requirements are met (including the existence of a due and payable debt, the absence of other goods to collect from and posting a bond), the judge may grant the asset-freezing order addressed to any

9 See Article 1168, fraction II of the Code of Commerce.

10 First Circuit Civil Court *en banc*, *Tesis de Jurisprudencia* PC I C J/85 C (10a.): '*Medida de aseguramiento en materia mercantil. La identificación del número de cuenta y de la institución bancaria no constituye un requisito para la procedencia del embargo de cuentas bancarias como providencia precautoria, y puede solicitarse de forma genérica al juez mercantil para que la otorgue.*' Found in the *Gaceta del Semanario Judicial de la Federación*, Libro 62, enero de 2019, tomo II, pg.s 1220.

bank. Moreover, courts have stated that the very limited previous regime, that subjected the petitioner to showing the necessity of the interim measure with appropriate documents or at least three witnesses (which is still generally applicable to proceedings initiated before 2014) violates the fundamental right of full access to justice.¹¹

Nevertheless, courts have also issued precedents preventing creditors from using the interim measures abusively. For instance, a non-binding precedent states that an interim measure shall be denied if the debt is already secured, even when the creditor argues that the collateral is insufficient.¹²

VI PRIVILEGE AND PROFESSIONAL SECRECY

The Law of Credit Institutions provides that, generally, information and documents related to banking transactions and documents the banks handle are confidential.¹³ In this regard, banks are forbidden from giving information to third parties about the deposits, transactions and services it provides to its clients. This rule, however, has several exceptions. Credit institutions must give information when a judge orders it because the account holder, trustee, settlor, principal or agent, etc., is a party to a judicial proceeding.¹⁴ The judicial warrant can be made directly to the credit institution or it can be made through the National Banking and Securities Commission. Furthermore, banks are also required to provide information upon request from the state or federal Attorney Generals, the Secretary of the Treasury and other designated authorities.

However, these exceptions have been subject to judicial interpretation by the Supreme Court. In 2017, the Supreme Court ruled that that the exception to the general rule regarding the obligation to provide information about clients when required by a state or federal Attorney General was unconstitutional because it violates the privacy of the clients. It specifically states that the only way by which banks could provide information about their clients in an ongoing criminal investigation was through a judicial warrant.¹⁵

New Federal Congress majorities (as well as a new administration) have entailed a series of proposals and readjustments that may have repercussions for the financial regime as well as more particular issues like bank secrecy. This year, a political party belonging to the

11 Supreme Court of Justice, First Chamber, *Amparo en revisión* 710/2017; *Tesis Aislada* 1a. CCXLI/2018 (10a.): '*Medidas precautorias. El artículo 1173 del código de comercio, en su texto vigente en 2012, vulnera el derecho a la tutela jurisdiccional efectiva en su vertiente de derecho a la ejecución de las sentencias.*' Found in the *Gaceta del Semanario Judicial de la Federación, Libro 61, diciembre de 2018, tomo I*, pg. 350.

12 15th Federal Appellate Court of Civil Matters of the First Circuit, *Amparo en revisión* 70/2019; *Tesis Aislada* I.15o.C.19 C (10a.): '*Medidas cautelares o providencias precautorias en materia mercantil. la solicitud de que se dicten para asegurar el reclamo de una cantidad determinada es improcedente, cuando el juzgador advierta la existencia de una garantía real que pudiera respaldar lo demandado.*' Found in the *Gaceta del Semanario Judicial de la Federación, Libro 67, junio de 2019, tomo VI*, pg. 5206.

13 *Ley de Instituciones de Crédito*, Article 142.

14 *idem*.

15 Supreme Court of Justice, First Chamber, *Amparo Directo en Revisión* 502/2017; *tesis aislada* 1a. LXXI/2018 (10a.): '*Secreto bancario. El artículo 117, fracción ii, de la ley de instituciones de crédito, en su texto anterior a la reforma publicada en el diario oficial de la federación el 10 de enero de 2014, viola el derecho a la vida privada.*' Found in the *Semanario Judicial de la Federación y su Gaceta, Libro 55, junio de 2018, tomo II*, pg. 977.

majority submitted a proposal to the Senate, which purported the objective of weakening bank secrecy, with the idea of helping combat corruption, money laundering and organised crime.¹⁶

VII JURISDICTION AND CONFLICTS OF LAW

Conflict of laws is an area of the law that has been left mostly unexplored by Mexican courts. Thus, precedents are hard to find. The applicable laws explain that Mexican laws apply to (1) persons that are in Mexico, (2) transactions executed in Mexico and (3) transactions in which the parties agree to abide by them, excepting when Mexican conflictual laws state that foreign laws shall govern. A court will recognise transactions executed in accordance with foreign laws. Transactions regarding real and personal property will be governed by the laws where the property is located. Formalities of foreign transactions shall be governed by foreign laws, although parties may choose to comply with formalities of Mexican laws if the transaction is to produce effects or be enforced in Mexico. Other than that, a court will apply the foreign laws the parties choose, excepting when the foreign law is inconsistent with Mexican public policy.

In regards to forum choice, parties may freely choose among the courts located (1) where one of the parties reside, (2) where the contract shall be performed, (3) or where the goods related to the transaction are located.

A recent nonbinding precedent stated that when subrogation occurs, the jurisdiction agreements will not apply to the incoming party.¹⁷ Subrogation, generally, occurs when a third party becomes the new creditor of a debtor in an already existing obligation by virtue of paying in place of the original debtor; the third party subrogates the original creditor. The precedent states that the jurisdiction clause should not apply to the payer because he or she did not agree to it. However, applicable laws to negotiable instruments consider that assignment or transfer of said instruments produces subrogation. Although the precedent was issued in connection with subrogation by payment, it is not clear whether it will also apply to subrogation by transfer of negotiable instruments. This may impact the assignment of credits that are guaranteed by promissory notes or other negotiable instruments.

A recent binding precedent states that forum choice shall be set aside if it is part of an adhesion contract and the choice impairs the party's full access to justice.¹⁸ The holding of the case is that the forum is supposed to be freely chosen, which does not occur in adhesion

16 See, *Senado de la República, Presentan iniciativas para eliminar 'secreto bancario y fiscal'*, 12 February 2019. <http://comunicacion.senado.gob.mx/index.php/informacion/boletines/43645-presentan-iniciativas-para-eliminar-secreto-bancario-y-fiscal.html>.

17 12th Federal Appellate Court of Civil Matters of the First Circuit, *Amparo en revisión* 389/2018; *Tesis Aislada* I.12o.C.149 C (10a.): '*Sumisión expresa. El pacto previsto en el artículo 1093 del código de comercio no se transfiere por medio de la subrogación, por tanto, para el caso de controversia, no obliga a quien se subroga en los derechos y acciones de uno de los contratantes originales, atento al derecho fundamental de acceso a la justicia.*' Found in the *Gaceta del Semanario Judicial de la Federación*, Libro 68, julio de 2019, tomo III, pg. 2159.

18 Supreme Court of Justice, First Chamber, *Tesis de jurisprudencia* 1a./J. 1/2019 (10a.): '*Competencia por sumisión expresa. La regla establecida en el artículo 1093 del código de comercio, no resulta aplicable a las cláusulas estipuladas en contratos bancarios de adhesión cuando se advierta vulneración a la garantía de acceso a la impartición de justicia.*' Found in the *Gaceta del Semanario Judicial de la Federación*, Libro 65, abril de 2019, tomo I, pg. 689.

contracts. What constitutes sufficient burden as to impair full access to justice remains unclear, but the precedent explicitly refers to standard form contracts executed by financial institutions. Thus, choosing a forum where the debtor resides (or close by) is, at least, advisable.

VIII SOURCES OF LITIGATION

Commercial litigation in Mexico is usually characterised by summary proceedings involving the collection of debt under a negotiable instrument.¹⁹ Furthermore, as explained in Section I, there are essentially two types of commercial proceedings: ordinary and executive. While the first includes summary proceedings, the latter are generally concluded within 25 months²⁰ and the action consists of claims of negotiable instruments to creditors like promissory notes and bills of exchange. In these cases, the debtor's ability to contest the execution is quite limited since the negotiable instrument is thought to be pre-constituted evidence of the plaintiff's right to collect.

Moreover, litigation in Mexico consists of multi-instance procedures, including appeals and in some cases, the writ of *amparo*.²¹ This can distort the measurement of how long it will take a plaintiff to enforce a judgment.

In cases where the banks' clients are the plaintiffs, probably the most recurrent procedures refer to unauthorised credit card charges. For said cases, Mexican legislation has enabled financial service users to opt between submitting claims to the National Commission for the Protection and Defence of Financial Services Users, to the courts or both.²² Other cases involve the annulment of abusive clauses in contracts and, in recent years, there has been an increase in cases concerning fiduciary responsibility of brokerage firms. On the other hand, when banks are the plaintiffs, the most common sources of litigation are debt collections.

IX EXCLUSION OF LIABILITY

The Code of Commerce states that, in commercial transactions, parties will be liable in the terms they agreed to in the transaction (absent any breach of commercial laws). This has usually been interpreted as limiting the court to ruling in the exact terms parties agreed to, excluding civil law exclusion of liability principles, such as extreme ignorance or excessive benefit for one of the parties.

19 Stephen Zamora, José Ramón Cossio, Leonel Pereznieta, Jose Roldan Xopa and David Lopez. *Mexican Law*, Oxford University Press, 2004. pg. 559-560.

20 M and A López Ugalde, *Administración de Justicia en México, Indicadores en materia Mercantil e Hipotecaria*, cited by *ibid* pg. 561.

21 The writ of *amparo* has its own procedural nature and a complicated set of rules and procedures. However, its study exceeds the limits of this article and it is sufficient to state that it is a procedural mechanism by means of which citizens can protect their rights against acts of government (judicial and administrative) and in judicial procedures it is independent and autonomous from the original trial and appeal process.

22 See, Supreme Court of Justice, First Chamber, *tesis de jurisprudencia* 1a./J. 69/2012 (10a.): '*Nulidad de pagaré (voucher) emitido por el uso de tarjeta de crédito. La procedencia de la acción no está sujeta a que, previamente a su ejercicio, el tarjetahabiente objete los cargos ante el banco emisor del plástico o ante la condusef, si tal pretensión se sustenta en la falsedad de la firma estampada.*' Found in the *Semanario Judicial de la Federación y su Gaceta, Libro XI, agosto de 2012, tomo I*, pg. 444.

However, as explained in Section II, courts have been reducing *ex officio* the interest rates when they consider them to be abusive. Thus, there appears to be a trend in not letting parties (especially, lenders) exclude any liability and agreeing to terms in any way they want.

X REGULATORY IMPACT

In modern history, the first historical stage of banking regulation can be identified from 1941 to 1982 and it consisted of protectionist and substitution industrialisation policies. Between 1982 and 1990 all private banks in Mexico were nationalised and a bureaucratic financial system was established. From 1990 to 1994, banking was privatised and an increase in commercial banks ensued. Mexico endured an economic crisis between 1994 and 2004, referred to as the ‘tequila effect’, which had lasting effects on local and regional finance. Between 2001 and 2006 there was a period of stabilisation and orderly regulation of banks in which foreign banks started to gain access to the Mexican financial market. Finally, from 2007 to the present day, the Mexican financial system has undergone a trend of transnational banking, economic synchronisation and global regulation.²³

Regarding global regulation, Mexico has been an active country in implementing the new approach to macro prudential regulation. In 2012, the National Banking and Securities Commission announced that Mexico was the first country to integrally adopt Basel III. This entailed a modification in the integration of capital, early warning systems and criteria for the inclusion of subordinated obligations in capital. The entry into force of Basel III in Mexico and the adoption of all its characteristics was structured through a seven-year plan.²⁴ Specialists have considered that these new regulations are only effective insofar as suitable risk management and supervision mechanisms are put in place to prevent dangerous and excessive risk taking by banks.²⁵

Mexico has not been the exception and regulation has pointed towards policies of reinforced prudence and contention. While this has been considered as a disincentive for some transnational banks that are accustomed to regulation in other jurisdictions, this will provide local banks with an opportunity to grow.²⁶ Furthermore, the Financial Reform in Mexico strengthened the National Commission for the Protection and Defence of Financial Services Users.

However difficult the empirical identification of the effects of specific regulations and policies is, we can point to certain statistics that exemplify it. For example, in 2018 the total balance of loan portfolios was 4,713 billion pesos with an annual growth of 2.7 per cent in comparison with 2017; while the total customer funds was 5,184 billion pesos, 1.7 per cent higher than the previous year. In the same year, banks concentrated 89 per cent of the total assets of financial groups; brokerage firms held 4.5 per cent and insurance companies 3.1 per cent.²⁷

23 See, L. Carlos Felipe Dávalos, *Banca y Derecho*, Oxford University Press, 2006. Chapter 8.

24 *ibid.* pg. 504.

25 *idem.*

26 See footnote 23. pp. 505-506.

27 *Comisión Nacional Bancaria de Valores, 27/2019 Información Estadística y Financiera a diciembre de 2018, correspondiente a 21 grupos financieros en operación.* <https://www.gob.mx/cnbv/prensa/27-2019-informacion-estadistica-y-financiera-a-diciembre-de-2018-correspondiente-a-21-grupos-financieros-en-operacion?idiom=es>.

XI OUTLOOK AND CONCLUSIONS

The regulation of financial institutions and the litigation surrounding their activity are interdependent components of a very complex global phenomenon. Therefore, the outlook of a country's financial system is rarely only subject to local circumstances. As explained above, in recent years Mexico has taken several steps towards making access to credit easier, that includes making banking litigation more efficient. However, the still 'sluggish global growth' and 'mixed policy cues and shifts in risk appetite'²⁸ paint a bleak picture for some sectors and could inevitably have repercussions in Mexico's financial institutions. Moreover, the recent presidential elections, the shift in the way political majorities are arranged in both the House and the Senate, as well as the promise of more stringent public policies that combat corruption and inequality will change the landscape for financial institutions. How big or small those changes prove to be remains to be seen.

28 International Monetary Fund World, Economic Outlook, July 2019, World Economic Outlook Reports. <https://www.imf.org/en/Publications/WEO/Issues/2019/07/18/WEOupdateJuly2019>.

PORTUGAL

*Nuno Salazar Casanova and Pedro Ferreira Malaquias*¹

I OVERVIEW

Litigation in Portugal involving banks has increased dramatically in the past decade. This is not surprising in light of the 2008 financial crisis and the subsequent generalised defaults on loan agreements. However, in Portugal there were other major contributing factors for this increase. In 2011, Portugal required financial assistance. In 2014, one of the biggest Portuguese banks – Banco Espírito Santo – became unexpectedly insolvent among suspicions of serious fraud and was subject to the first banking resolution measure in Europe, from which a supposedly good bank emerged (Novo Banco). Nevertheless, this caused losses to thousands of shareholders and bondholders who were left with assets held in the bad bank. In 2015 the biggest telecom group – Portugal Telecom – was acquired by the Brazilian telecom group Oi, which then became insolvent the next year and was later sold to the French group Altice, but with the exclusion of the bonds that had been issued, also causing losses to bondholders. In late 2015, Banif, a bank with a market share of around 30 per cent on the islands of Madeira and the Azores, become insolvent, was also subject to a resolution measure, and the majority of its assets – but not subordinated bonds – were sold to Banco Santander Totta, also causing significant losses to investors. Consequently, thousands of civil lawsuits were filed against banks and their directors, seeking compensation for damages. These claims are generally based on mis-selling and the breach of duties of information.

Since 2011 the government has injected more than €4 billion into the state-owned bank Caixa Geral de Depósitos. This led to two parliamentary inquiries, during which the existence of several loans of hundreds of millions of euros granted under dubious conditions became public knowledge.

Taking all this in consideration, it is fair to say that at present banks in Portugal are not enjoying the best reputation. Yet another blow was recently dealt by the Portuguese Competition Authority, which imposed a record-breaking fine of more than €200 million on 14 banks for having carried out an anticompetitive concerted practice. The Portuguese Association for Consumer Protection (DECO) has already announced that it is studying the possibility of claiming damages.

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II SIGNIFICANT RECENT CASES

There is an ongoing debate as to whether, in enforcement proceedings, debtors may try to compensate the debt with a counterclaim. This was often attempted by debtors against banks and when the discussion on the counterclaim was accepted this usually significantly delayed the satisfaction of the banks' claim. The Supreme Court adopted a restrictive interpretation in its jurisprudence, only accepting a counterclaim when the debtor has a judicial decision against the bank, or an enforceable title. But recently, a significant faction of Court of Appeal judges has challenged this jurisprudence and accepted the discussion of counterclaims when there was no previous decision or enforceable title, which understandably raised eyebrows, particularly within banks. This past year, however, the Supreme Court upheld its jurisprudence and restated it – see, for example, the decision of 4 July 2019.²

Another topic of discussion is the resolution measure applied to Banco Espírito Santo and Banif. Although the validity of the measure itself may only be challenged before the administrative courts, the civil courts have been indirectly asked to review these measures, especially as to whether it was a constitutional decision not to transfer subordinated bonds to Novo Banco. In the decision of 19 June 2019,³ the Supreme Court held that the resolution measures of BES did not breach the constitutional principles of trust and legal certainty, nor the principle of the separation of powers.

In mis-selling of financial instrument claims, the decision on who bears the burden of proof regarding the fulfilment of duties of information is quite relevant. Although the majority of the jurisprudence considers that burden of proof rests with the claimant, in 2017 the Supreme Court, in an interest-rate swap agreement case, ruled that due to the regime on general contractual clauses the burden of proof that the bank complied with its duties of information rested with the bank. This 2017 decision could have been one of a kind, especially because the *rapporteur* retired immediately after it was handed down. However, in a decision of 26 March 2019 the Supreme Court ruled once again that in swap agreements it is the bank that has to prove it complied with its duties of information.⁴

Also in regard to mis-selling claims, jurisprudence has held that the claimant must prove the cause-effect relationship between the breach of duties and the damages suffered. This usually amounts to having to prove that the claimant would not have bought the financial products if the bank had complied with its duties. This cause-effect relationship is difficult to prove and is, therefore, one of the main reasons claims against banks are rejected. However, in the past few years some decisions from the Courts of Appeal argued that this cause-effect relationship is presumed, and hence the banks had the burden of proving such relationship did not exist. This presumption would certainly become a game changer in most of the mis-selling claims. However, recently the Supreme Court upheld and restated its previous jurisprudence, stating there was no such presumption (see, for example, the decision of 6 November 2018).⁵

A recent trend in banking litigation is to hold banks that sold financial products liable for not disclosing information subsequent to the investment. This has sparked a debate on whether banks are required to provide information on changes in the risks of the investment when they are only acting as custodians and not as portfolio managers. These changes include,

2 Proceedings no. 132/11.0TCFUN-A.L1.S2.

3 Proceeding no. 4140/14.0YYLSB.L1.S1.

4 Proceedings no. 1942/12.6TVLSB.L1.S2.

5 Proceedings no. 6295/16.0T8LSB.L1.S1.

for example, the substitution of the issuer of guarantor of bonds after the investment was made. This issue is of particular relevance to bondholders of Portugal Telecom, because when the group was sold to Altice the bondholders general meeting voted in favour of changing the issuer to a company that was left with the almost insolvent Oi group.

This year, the Lisbon Court of Appeal rendered a decision that had the following summary:

in the course of the execution of a contract for the deposit and registration of financial instruments, the financial intermediary and custodian cannot alienate itself from the changes related with the entity that issued the bonds as well as those related with the maturity date of the products, factors which are capable of having negative reflections on the outcome and solidity of the products, and should inform the investor in a way so as to allow him to adopt, in due time, the conduct that minimises or prevents risks which are known and are not negligible, and which threaten the normal conservation and fructification of the financial instruments⁶

This decision was often referred to by those who argued that the banks should have informed the bondholders that a change in the issuer was approved. However, a closer look at the decision reveals that, in fact, the court only accepted this duty as a plausible legal outcome in order to justify the decision to ask the lower court to further investigate some facts, but directly stating that it did not wish to anticipate a ruling on that issue.

In 2014, the Supreme Court rendered a decision to harmonise the jurisprudence (a decision that carries special weight and is taken by all the judges of the civil sections and not only by three judges) on a very important matter for banks: the ranking of claims in cases involving the mortgage of a property with a promissory buyer, when a bank subsequently claims for damages due to the breach of the promissory agreement, in the event that the possession of the property had been given to the promissory buyer. In that 2014 decision, the Supreme Court decided that the claim from the promissory buyer was ranked above that of the bank only when the buyer should be considered a consumer. However, the Supreme Court did not define what should be considered a consumer for that purpose. There was hence a subsequent debate on whether a natural person who promised to buy the property to resell it or to carry out a commercial activity in it should be considered a consumer. In a decision of 12 February 2019, the Supreme Court rendered another decision to harmonise the jurisprudence, stating that, for the purposes of the 2014 decision, a consumer was only defined as a party who intends to use the property for private purposes and not to resell it or the use it for a lucrative or professional activity.

Two other court decisions from these past 12 months are also worth mentioning.

A decision from 31 January 2019⁷ ruled that a client who had lost his wallet, containing a debit card, but who only reported it to the bank three days after the loss was liable for the improper use of the card by third parties.

A decision from 22 November 2018⁸ ruled that a bank may not annul a transfer order for securities on the grounds of mistake, but rather that it must request the annulment before a court of law.

6 Decision of 8 January 2019, Proceedings no. 2115/17.7T8VFX.L1.7.

7 Proceedings no. 2344/16.0T8PNE.P1.S1.

8 Proceedings no. 236/14.7T8PRT.P2.S2.

Finally, one of the most important decisions of 2019 was a decision by the Portuguese Competition Authority that imposed fines of a total sum of €225 million on 14 banks acting in Portugal, on the grounds that these banks had exchanged information between 2002 and 2013, on sensitive future business behaviour regarding spreads, and on recent sensitive data regarding production values. The decision is subject to appeal in a court of law and, if upheld, may spark significant damages claims, although the Competition Authority considered it to constitute an infringement by object (and not by effect) and hence it did not present evidence of effects on competition, which makes it difficult for consumers to prove damages.

III RECENT LEGISLATIVE DEVELOPMENTS

i Securitisation

One of the most significant legislative developments in Portugal has been the entry into force of Regulation (EU) 2017/2402, of the European Parliament and of the Council, of 12 December 2017, which lays down a general framework for securitisation and creates a specific framework for simple, transparent and standardised securitisation (Securitisation STS). These frameworks aim at separating complex and opaque securitisations, which entail a high level of risk, from the simpler and more transparent securitisations, which are now encompassed within the category of Securitisation STS.

Additionally, this Regulation sets out the distinction between traditional securitisation and synthetic securitisation. While the first requires the transfer of the economic interest in the exposures being securitised through the transfer of ownership of those exposures, the latter occurs when the transfer of risk is carried out by means of credit derivatives or guarantees and the ownership of the exposures being securitised does not change, as it remains with the originator.

ii Mass assignment of credits

The Portuguese government approved Decree-Law No. 42/2019, of 28 March, which sets forth a simplified framework for the mass assignment of credits, and seeks to simplify the assignment of non-performing loans. This framework was approved in the context of the Capitalise Programme (Programa Capitalizar), which was set up by the Portuguese government in 2016, with the aim of eliminating or mitigating some of the financial constraints experienced by Portuguese companies.

This simplified framework is applicable to the assignment of credits, provided that (1) the assignee is a credit institution, a financial company or a securitisation company; (2) the assignment price is, at least, €50,000; and (3) the portfolio includes at least 50 different credits. The assignment of credits shall be in the form of a private document and is subject to registration, which must be carried out on an urgent basis.

iii Payment services

Another significant legislative development in Portugal has been the implementation of Directive (EU) 2015/2366, of the European Parliament and of the Council, of 25 November 2015, which sets out the new legal framework applicable to payment services. The implementation of this directive in Portugal has been carried out through Decree-Law No. 91/2018, of 12 November, which establishes the requirements to access the activity of payment institutions and electronic money institutions. This legislation has introduced several changes, namely: (1) new means and services of payment; (2) the acquisition or

decrease of qualified stakes in payment institutions becomes subject to the non-opposition of the Bank of Portugal; (3) the providers of services shall establish remuneration policies that cover the employees who directly contact clients, or who are engaged in management or supervisory functions; and (4) the implementation of security measures that are sufficient to protect the confidentiality of the users' security credentials.

iv Markets in financial instruments

The Markets in Financial Instruments Directive II (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR) have become effective as from January 2018. This legislative package aims to create a level playing field for financial firms to compete in the European Union's financial markets, and to ensure a consistent level of consumer protection across the European Union.

In Portugal, the implementation of MiFID II and MiFIR was carried out by Law No. 35/2018, of 20 July, which brought several changes to the relevant legal frameworks in the financial sector, in particular the General Framework for Credit Institutions and Financial Companies. For instance, it has introduced the provision of investment services by tied agents of credit institutions; and the provision of investment advice services on structured deposits by investment advice companies.

v Data protection

Regulation (EU) 2016/679, of the European Parliament and of the Council, of 27 April 2016, also known as the General Data Protection Regulation, became effective in Portugal as from May 2018. This regulation aims to unify the framework on the processing and movement of personal data through the European Union, and imposes a set of new obligations on companies, as well as strengthening the rules on consent. Taking into account that banks handle large quantities of personal data, this regulation has also brought significant challenges in terms of compliance.

vi Urban leases

In October 2018, the tenants' rights of preference set forth in the Civil Code were amended by Law No. 64/2018. This law granted tenants who had leased just part of an individual real estate property the option to exercise a right of preference on the sale (including judicial sales on foreclosures) for just a percentage of the property corresponding to the leased part, and having the right of use of such part. The law was intended to allow tenants of apartments in buildings that were not organised on a horizontal property basis to exercise preference only on the apartment rather than on the whole building. This, however, may have unexpected effects on foreclosures, because if the right of preference is exercised on only part of the estate, the buyer of the remainder not only may not sell individual apartments (because they lack separate legal status) but also may not sell nor take decisions alone regarding the whole building, because the buyer is not the sole owner. This may affect the price investors are willing to pay for buildings that are not under a horizontal property regime, if there are leases on parts of the property.

In February, Parliament enacted Law No. 13/2009, with the purpose of correcting unbalanced situations between landlords and tenants, to reinforce the security and stability of urban leases and to protect tenants in particularly fragile situations. This law introduced significant changes to the urban lease regime. Notably – and although according to the law

the lease agreement should be made in writing – the tenant may now prove the lease by other means if the lack of a written agreement is not considered to be his or her fault. This obviously increases the risk of litigation and surprise leases upon foreclosure.

IV CHANGES TO COURT PROCEDURE

Decree-Law No. 97/2019, of 26 July 2019, introduced two changes that may be relevant to banks.

One, which may significantly change the way appeals on the facts are decided, allows the depositions of witnesses to be videotaped for the first time, rather than just recorded. It may, however, take some years until the courts have the means to videotape depositions. However, if the depositions are videotaped, courts of appeal may decide an appeal on the facts by viewing the tapes. In this case, a court of appeal will no longer have a strong argument in saying that they should in principle refrain from changing the decision on the facts, due to the lack of immediacy.

Another change, regarding enforcement proceedings, sets forth that the debtors' claims against public entities may be seized electronically to satisfy the claim that is being enforced. It is common for debtors to be entitled to IRS refunds and this change in law will expedite the seizure of these tax claims.

V PRIVILEGE AND PROFESSIONAL SECRECY

Pursuant to the Portuguese Bar Association Conduct Rules, lawyers shall keep confidential all the facts and documents whose knowledge derives from the exercise of their functions as lawyers and the provision of legal services.

This duty of secrecy is binding upon all lawyers registered with the Portuguese Bar Association in the performance of their professional activity in Portugal or abroad, and is also extended to all people who collaborate with the lawyers in their professional activity.

It should also be noted that the duty of secrecy is non-waivable by the client, which means that the lawyer will be bound to it, even in the event that the client releases him or her from the duty of secrecy. However, a lawyer is allowed to disclose privileged information for the purposes of preserving the reputation of the lawyers or clients' reputation, legal rights and legitimate interests, provided that prior authorisation is obtained from the competent body of the Portuguese Bar Association.

In general, the lawyer–client privilege is respected in Portugal. Whenever a lawyer is requested by a judge to testify in criminal proceedings, the Portuguese Bar Association shall be consulted on privilege issues. On the other hand, any criminal investigation carried out in the office of a lawyer or law firm shall be done in the presence of a representative of the Portuguese Bar Association.

In the event that the duty of secrecy is breached, the information disclosed by the lawyer cannot be used to provide evidence, nor taken into account by the court. Finally, a breach of lawyer–client privilege is deemed a serious offence, and may lead to criminal charges and to disbarment from the Portuguese Bar Association.

VI EXCLUSION OF LIABILITY

Under Portuguese law, exclusion or reduction of liability clauses are generally not admissible. On the one hand, Article 809 of the Portuguese Civil Code sets forth that any clause pursuant to which a creditor waives any indemnity rights, in advance, is deemed void. Such clauses are restrictively interpreted by legal scholars and the courts, which have only accepted exclusion or reduction of liability clauses in cases of negligent breach (i.e., excluding liability in cases of wilful misconduct or gross negligence is not possible under Portuguese law). On the other hand, Article 18(c) of the Portuguese Legal Framework of Unfair Terms lays down that any general contractual clauses that exclude or limit, directly or indirectly, liability in the event of wilful misconduct or gross negligence, are unlawful.

Notwithstanding the above, the parties can use a penalty clause as a mechanism to regulate their liability. Thus, the penalty clause allows the parties to predetermine the indemnity amount due in the event of contractual breach, provided that it does not exceed the damage resulting from the breach of the main contractual obligation. The penalty clause may, however, be reduced by a court, in the event the indemnity amount pre-established by the parties is deemed disproportionate when compared with the actual damages.

Depending on the type of financial service, there might be specificities in this regard.

VII REGULATORY IMPACT

The regulatory framework has a significant impact upon banking litigation. In recent years, banks have been subject to an increase in the number of regulatory obligations.

In particular, MiFID II has brought several and demanding pre-trade and post-trade transparency obligations, which are applicable to banks in the provision of financial services. The General Data Protection Regulation and the second Payment Services Directive (PSD2) have also brought a number of significant challenges to banks, not only compliance-wise, but also in terms of business models.

The proliferation of regulatory provisions and obligations in the financial sector is a clear source of increased risk of litigation based on lack of compliance. Moreover, the reshaping pressure brought about by the General Data Protection Regulation and the PSD2 may also lead the banks to walk previously unknown paths or to be willing to take more risk, or both, which might naturally result in an increase of litigation with clients, or even with the regulatory authorities.

VIII OUTLOOK AND CONCLUSIONS

The regulatory burden over the entities operating in the financial markets and providing financial services is expected to increase at a demanding pace in the next few years.

In terms of planned legislative changes specific to the Portuguese jurisdiction, it is worth noting that, in March 2019, the government approved Draft Law No. 190/XIII, the main purposes of which are: (1) the reinforcement of the coordination and cooperation between the three existing financial supervisors; (2) the prevention of potential conflicts of interest in the context of the financial supervision; and (3) the reinforcement of the transparency and accountability of the financial supervisors.

In light of the above, Draft Law No. 190/XIII proposes the creation of a National System of Financial Supervision, composed of the following entities:

- a* the existing supervisory bodies (Bank of Portugal, Portuguese Securities Market Commission and Portuguese Insurance Supervisory Authority), which would maintain their competences, but have their cooperation duties reinforced; and
- b* the Supervisory and Financial Stability Council and the High Council of Financial Policy – two new entities that would lead to the termination of the existing National Council of Financial Supervisors, the National Committee for Financial Stability and the National Council of the Securities Market.

The Supervisory and Financial Stability Council would become the macroprudential national authority and the entity responsible for the resolution of financial institutions, whereas the financial supervision, economic and monetary policy decisions would be carried out by the High Council of Financial Policy.

The Minister of Finance recently stated that the government has been working on this new legal framework, in coordination with the European Central Bank.

RUSSIA

*Alexey Borodak and Sergey Avakyan*¹

I OVERVIEW

Disputes involving banks (or more broadly – credit organisations in the context of Russian legislative terminology) are subject to the general civil procedural framework prescribed by Russian procedural legislation. Specific procedural regulation may, for instance, apply within bankruptcy proceedings of banks as well as in some aspects of interaction between the Central Bank of Russia (CBR) and other banks.

Civil procedure allowing the involvement of banks as a party to litigation proceedings leads to the case being considered by one of two court branches: courts of general jurisdiction (implying that one of the parties is not a commercial entity) and *arbitrazh* courts (dealing with all types of disputes involving exclusively commercial parties, also, for example, corporate disputes and other related categories closely referring to entrepreneurship activity). Depending on the competent court, the procedure is governed either by civil procedural legislation or by *arbitrazh* procedural legislation, however for the purposes of this chapter it will be generically referred to as civil procedure.

Civil procedure in Russia follows an adversarial model, where the parties to the proceedings have to prove the facts they are stating before the court. The court's role is to provide general governance of the proceedings supplemented with support to the parties in obtaining evidence subject to the parties' requirements. Court procedure generally require oral proceedings in person (*inter partes*) subject to certain exceptions when proceedings are held without the parties' presence in court (*ex parte* proceedings).

The activities of the bank towards its counterparties are largely considered on the basis of the Civil Code setting up the general legislative framework for regulation of civil-law obligations and activities. In addition to general regulation, the banks' activities falls mainly within the scope of the specific laws listed below, non-exhaustively:

- a* The Federal Law On the Central Bank of the Russian Federation, 10 July 2002 No. 86-FZ (CBR Law) provides, among others, general regulation of the CBR's legal status, functions and powers as well as specific procedures applicable to interaction of the credit organisations with CBR.
- b* The Federal Law On Banks and Banking Activity, 2 December 1990 No. 395-1 (Banking Law), together with CBR Law, establishes the general framework for the structure of Russian banking sector, including its working mechanisms. The legal limitations for the activities of the banks as legal entities (special legal capacity) are also established by this law.

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- c* The Federal Law On prevention of legalisation (laundering) of income obtained by illegal means and financing of terrorism, 7 August 2001 No. 115-FZ (AML Law) regulates the applicable procedures for the banks with individuals and legal entities while performing operations with monetary funds and other property for the purposes of due AML and counter-terrorism as well as mechanisms of supervision of these activities by the state authorities (including sanctions proceedings in the case of a breach).
- d* The Federal Law On Protection of Competition of, 26 July 2006 No. 135-FZ (Competition Law) along with the general regulation of antimonopoly sector, the Competition Law provides specific rules on limits and exercising control over credit organisations by various parties (individuals, entities, groups of entities, etc.) and procedures of authorisation of such control by the CBR.
- e* The Federal Law of 27 June 2011 No. 161-FZ On The National Payment System regulates the status of the national payment system, including processing of payment services and sets up the requirements for procedure for supervising and monitoring of the above payment system by state authorities.
- f* The Federal Law On Insurance of Private Deposits in the Banks of the Russian Federation, 23 December 2003 No. 177-FZ regulates the legal status and functions of the Deposit Insurance System, which, inter alia, provides additional protection for individuals' deposits placed within the credit organisations.

II SIGNIFICANT RECENT CASES

The legal positions interpreting the legislation that deals with the activities of Russian banks are often produced by the Supreme Court. Mainly, such disputes relate to two basic spheres: debt collection by the banks or special collector organisations and consumer's claims related to particular banking services. A large part of bank litigation activity is derived from bank-customer relations and, namely, is based on the claims related to performance of contractual obligations by either of the parties. The remaining portion relates to the various forms of administrative liability incurred by regulators against the banks.

Meanwhile, assessing the potential effects and risks for the banking sector, one of the most significant cases of 2018 was the renewed *LLC Dalnaya Step* bankruptcy case, resulting in the claims of its newly appointed bankruptcy administrator against a Russian branch of HSBC bank. Thus, a Russian bank was held liable for the amount of nearly US\$20 million for performing transactions of its client. Thus, this was the first case in Russian litigation history when the mechanism of subsidiary liability (namely, the personal liability of the controlling parties within the bankruptcy proceedings) has been applied to the bank in regard to the bankruptcy of its client. Although the argument of the courts in the above-mentioned case (including the Supreme Court) is highly disputed among the legal community, this case creates a significant precedent for the Russian courts.

In 2019 the Russian Supreme Court also specifically reviewed and interpreted the application of guarantees (including bank guarantees) in its review.² Its content may be briefly summarised as follows:

- a* the amount of the guarantee may be definable (i.e., the parties may set the mechanism for defining it);

² Review of the court practice on resolution of disputes related to application of legislation on independent guarantees (approved by Presidium of the Supreme Court on 5 June 2019).

- b* the bankruptcy of the guarantor does not imply termination of the guarantee; and
- c* the guarantor is obliged to formally check only the documents triggering the payment.

III RECENT LEGISLATIVE DEVELOPMENTS

From June 2018 legislative initiatives have allowed the performance of remote identification of the banks' clients by means of biometric protocols. This new procedure is aimed at simplifying the identification for access of individuals to the financial services. Thus, the primary identification shall be performed subject to the client's wishes by the authorised banks that are entitled to register individuals within the unified identification and authentication system (ESIA) and the unified biometric system (UBS). After a personal presence has been identified in a bank branch, the bank enters the citizen's data into the ESIA, as well as obtaining biometric parameters and sending them to the UBS.

From beginning of 2020 Russia will sufficiently ease currency control restrictions with respect to payments made by non-residents to accounts allocated in Russia and belonging to Russian residents, on the condition that the jurisdiction of a paying party participates in the automated exchange of account information with Russia (members of FATF and OECD). In particular, this would allow Russian residents with foreign accounts to easily arrange transactions to their own Russian accounts or the accounts of other Russian residents. Additionally, the reporting obligations with respect to the foreign accounts of Russian residents shall be also eliminated, if the yearly balance does not exceed 600,000 roubles (this amendment is also limited to the jurisdictions covered above).³

IV CHANGES TO COURT PROCEDURE

A group of amendments made to the Civil Procedural Code (in court practice of disputes that involve banks mainly regulates proceedings in cases between consumer-individuals and the banks) aimed at establishing the class action concept for the cases involving individuals.⁴ From 1 October 2019 groups of individuals are entitled to file class action claims against the banks, which may result in additional litigative pressure on them.

Under the introduced amendments the following criteria would have to be satisfied for the claimants to apply the class action procedure:

- a* all of the class action group members should have claims against the same respondent;
- b* the substance of the claims should be same or alike;
- c* the circumstances of the claims should be the same or alike; and
- d* all the class action group members should have chosen the same legal method of defence.

Such claims would primarily ease the financing of litigation proceedings on the claimants' side and thus ease the individuals' access to justice. This may, in particular, result in an increase in claims brought against banks with respect to certain banking services, for example, debit or credit cards processing, terms of loan agreements, etc.

3 Federal Law amending Federal Law No. 173-FZ On Currency Regulation and Currency Control dated 10 December 2003 No. 265-FZ.

4 Federal Law On Amendments to Particular Legislative Acts of the Russian Federation dated 18 July 2019 No. 191-FZ.

V INTERIM MEASURES

Interim measures in Russia may be divided into three: (1) preliminary interim measures; (2) measures to secure the claim; and (3) enforcement measures. Depending on the nature of the claim all of these measures can be applied within the proceedings. In addition, Russian procedural legislation allows interim measures to be requested in support of the arbitration proceedings (interim measures granted by the arbitral tribunals per se are not subject to recognition and automatic execution in Russia).

Preliminary interim measures may be requested prior to submitting the statement of claim to the court. The aim of such measure is to provide the future claimant with an immediate mechanism for secure of safe execution of further court decision. The claim on the merits would have to be submitted by the applicant within up to 15 days after such measures were granted.

Measures to secure the claim may be requested and granted at any stage of the proceedings once it is commenced.

At the same time enforcement measures would mainly be performed by the bailiff service at its own discretion in order to secure the execution of the court decision.

The test applying to the content of application for interim measures (hereinafter relates to types 1 and 2) would consist in satisfying the below criteria:

- a* the non-granting of such measures may seriously complicate the enforcement of a court decision or make such enforcement impossible; or
- b* the applicant may suffer material damage if an interim measure is not granted.

At the same time, measures sought should comply with the balance of interests of the involved parties and be directly linked with the claim (or future claim) to be considered by the court.

In practice the chance of granting interim measures may be increased by the applicant in case of providing the countersecurity (comprises the temporary security for losses that may be suffered by the party against which the interim measures are sought). This is commonly done by a payment of the specific amount made to the court's deposit or, for instance, by providing the court with the bank guarantee for the respective amount. However providing the mentioned counter security would not require the court to grant the measures sought.

The list of types of interim measures prescribed by the procedural legislation, as follows, is non-exhaustive:

- a* freezing bank accounts, seizure of monetary funds, and seizing property in the respondent's own possession or in the possession of a third party;
- b* obliging the respondent to perform certain acts in order to prevent spoilage and impairment of the property in dispute;
- c* placing a restriction order on the respondent and third parties that prohibits certain conduct or acts related to the subject matter of the claim;
- d* ordering the placing of property in dispute into the possession of the applicant or a third party; and
- e* suspending the enforcement of a writ of execution or any other enforcement document.

The interim measures sought may be one or a combination of the aforementioned measures or represent the non-listed measures that would lead to a balance of interest of the parties within the proceedings.

It is worth mentioning that since 2018 escrow accounts have passed legislative regulation and are actively progressing in Russia. For instance, escrow account mechanisms have become

fully regulated and are available to banks and notaries public (later mechanism would also require opening a special bank account by the notary public). Thus, interim measures, such as freezing an account or related restrictive measures, cannot be performed with respect to escrow accounts. At the same time, granting interim measures towards a right of the party to claim money from the escrow account may theoretically take place.⁵

VI PRIVILEGE AND PROFESSIONAL SECRECY

Since bank privilege may not be considered legal privilege in its purest meaning under Russian law, this type shall not be discussed in this chapter: thus, banks are obliged to provide the information that may contain bank privilege to the courts and other public authorities upon their requests due to rules set out in Article 26 of the Banking Law.

The only conception of legal privilege in Russia that would play a similar role to the attorney–client privilege widely recognised by Western and other jurisdictions is the advocate privilege. The concept of advocate privilege is set down and regulated by the Law on Attorney Activity and Advocacy together with the Criminal Procedural Code.⁶ Advocate privilege provides protection to information exchanged between advocates and their clients. This is justified by the fact that legal privilege is assigned a fundamental role in a democratic society aimed at defending litigants.

Despite the importance of this rationale, Russian practice shows substantial problems in relation to the treatment of legally privileged information, in that such information is commonly used by courts and investigative authorities in a manner contrary to the statutory rules and regulations. The only criterion that a communication must satisfy to be protected by advocate privilege is that it is made in the course of an advocate rendering advocacy services (rendering services under instruction of a client) to a client. Nonetheless, the investigation authorities often extract and seize items marked ‘Privileged’ or similar type disclaimers, and such items may become a part of evidence, disregarding the objections of advocates.

It should be noted that there is no professional privilege that explicitly covers the activity of an in-house lawyer (including in-house lawyers on banks or other credit organisation. Moreover, an in-house lawyer cannot become an advocate (an advocate cannot be in an employment relationship with any types of entities (including banks, auditors, etc.) other than advocate entities) and thus the privilege regime does not apply to communications between an in-house lawyer and his or her employer.

At the same time, Russia recognises a general constitutional right to the secrecy of correspondence, telephone calls, etc. While this right of secrecy can be used to protect some communications with in-house lawyers, this right applies only to private correspondence and not to official or business correspondence. Moreover, this right can be limited, for instance, if the information is officially requested by authorised state bodies.

In any case, the banks and other involved parties are recommended to use secured communication forms regarding those types of information that may be sensitive or crucial for the litigation proceedings. The parties should also be advised that applicability of privilege rules within civil proceedings (as opposed to criminal proceedings) may suffer difficulties, since, in general, the evidence in the civil proceedings in Russia would be considered in regard

5 See Article 926.7 of the Civil Code.

6 Article 8 of the Federal law on Advocate Activity and Advocacy dated 31 May 2001 No. 63-FZ, Articles 56 and 450.1 of the Criminal Procedural Code.

to its admissibility (i.e., legally prescribed possibility of proving specific circumstances with certain evidence) and relativity (the relation of evidence to the dispute), while the sources of obtaining the evidence are formally not limited by civil procedural legislation – although, in practice, this question may be raised at the court’s discretion.

VII JURISDICTION AND CONFLICTS OF LAW

Both *arbitrazh* and civil procedural legislation provide general rules on the jurisdiction of Russian courts. Since most parts of these rules are equal to all types of litigants (including the banks), we wish to direct the attention of banking sector practitioners to some specific topics – the jurisdiction of Russian courts in cases involving foreign parties, and disputes subject to the exclusive jurisdiction of Russian courts.

The procedural legislation sets out a list of circumstances under which Russian courts have jurisdiction in disputes involving foreign entities or nationals, including the following:

- a* the respondent is located in Russia;
- b* the respondent’s assets are located in Russia;
- c* the respondent has a representative office or branch located in Russia;
- d* the dispute arose from agreement that was performed or should have been performed within Russia; or
- e* a close connection between the legal relationship and Russia is at hand.

Below are mentioned examples of disputes that shall fall under the concept of exclusive jurisdiction of Russian courts:

- a* disputes over property owned by the Russian state;
- b* disputes over real property in Russia or related property rights;
- c* disputes over the issuance or registration of patents, trademark certificates, industrial designs, utility models or other IP rights that require the issuance or registration of patents or certificates in Russia;
- d* disputes concerning requests to nullify entries in state registers; and
- e* certain types of corporate disputes (i.e., disputes related to establishing of, exercising management, or participation in legal entities).

Regarding conflict of laws regulation in Russia, the law applicable to the parties’ relations is determined by the parties themselves (in applicable cases) or is according to the statutory rules (once the parties fail to choose the applicable law or are legally deprived of such possibility).

In late 2013 the Civil Code was supplemented with new rules on conflict of laws among other in order to harmonise with the provisions of the EC Regulations ‘Rome I’ and ‘Rome II’.

VIII SOURCES OF LITIGATION

Among the most frequent sources of litigation by and against banks, litigation arising out of the consumer bank services should be noted. With year-to-year growth of the consumer loans market⁷ the number of defaulted loans is also subject to increase. Thus, the percentage

⁷ Consumer lending in Russia: prospects and risks based on household finance survey, CBR, September 2017 (https://www.cbr.ru/Content/Document/File/27556/analytic_note_170928_e.pdf).

of defaulted consumer loans remains about 20 per cent,⁸ while its temporary decrease may mainly be caused by the increase of new loans, which is considered to cause strategic negative macroeconomic effects.

Consumer claims against banks are mainly concentrated on challenging the calculations by the bank within the provided loans or commissions (and other types of payments) under the existing consumer products.

The CBR continuing policy on clearance of banking sector of banks with insufficient funds or those performing systematic non-compliance with the applicable regulation results in withdrawal of such banks' licences, which often gives rise to claims of its clients for the deposited amounts within the liquidation proceedings.

IX EXCLUSION OF LIABILITY

While the Civil Code prescribes the possibility for contractual limitation of liability by the parties, Russian court practice evidences that bank's liability cannot be limited in certain cases. For example, limitation of liability may not apply to the banks' breaches in performance of obligations under the bank account agreements and similar instruments, therefore the concept of full compensation would be generally applied.⁹ As a separate matter, bank's liability in relations with consumer-individuals may not be limited in cases when such liability is statutorily established.

X REGULATORY IMPACT

The CBR has continued its policy on ceasing the activity of Russian banks performing badly and lack of due corporate governance level, or both, as well as non-compliance with other applicable regulation.

At the beginning of 2019 there were 440 banks operating in Russia, around 450 fewer than in 2013. The overall capitalisation rate of the Russian banks remains above the regulatory minimum, while non-performing loans were relatively high at around 10 per cent by the end of 2018. New regulatory policy initiatives in 2017 allowed the CBR to acquire troubled Russian banks and perform their recapitalisation by means of the Bank Consolidation Fund. Accordingly, by the end of 2017 the CBR acquired control over a number of large private banks. In 2018 the CBR used substantive funds to support such banks. The CBR is declaring it will continue with plans for the elimination of negative assets of the acquired banks for future resale of such banks' shares back to the private sector.

Due to the abovementioned policy of the CBR an overall share of state-controlled banks in Russia (including the banks under the CBR's rehabilitation) reached over 70 per cent compared to the level of 50 per cent in 2013.

8 <https://tass.ru/ekonomika/6451876>.

9 See for example, Section 9 of the Resolution of Plenum of the Higher Arbitrazh Court, 19 April 1999 No. 5.

SPAIN

Javier Izquierdo and Marta Robles¹

I OVERVIEW

Banking litigation in Spain has been governed in recent years by several judicial resolutions that, by interpreting the existing consumer protection laws in favour of the consumer, have increased the number of claims brought against financial entities. A significant number of Spanish courts have positioned themselves as pro-consumer, and judicial proceedings against financial entities have overwhelmed Spanish courts in the past decade, in particular over the past five years. This even led to the constitution of specialised courts for certain banking litigation proceedings, their aim being to reduce the workload of other courts that were accumulating significant delays.

Spanish courts have therefore shaped the current landscape of banking litigation, determining how to apply the corresponding regulation that, in truth, has not changed significantly in recent years. European Directive 93/13/EEC of 5 April 1993, on Unfair Terms in Consumer Contracts, constituted the basis on which Member States have adapted, since then, their own national regulations. Its implementation in Spain has been carried out through the introduction of fundamental laws such as Law 7/1998 of 13 April, on General Conditions of Contracts, Royal Decree-Law 1/2007 of 16 November, approving the consolidated text of the General Defence of Users and Consumers Act and other complementary laws.

These laws constitute the basic fundamental framework of banking litigation in Spain. In fact, most legal proceedings against banks are initiated in our local jurisdiction on the basis of their provisions and, principally, on the provisions regulating unfair clauses.

In fact, in order to reduce the number of proceedings affecting financial entities, several laws have been enacted recently in Spain. Their ultimate aim is to keep consumers duly protected against any abuse to be committed by banks and, at the same time, ensure that financial entities remain protected from allegations regarding the unfairness or invalidity of their contracts. In particular, and among others, we refer to the recent Law 5/2019 of 15 March, on Real Estate Credit Agreements (Real Estate Credit Agreements Act), and the different regulations that the Markets in Financial Instruments European Directive (the MiFID Directive) implemented in Spain in the most recent version enacted in 2014.²

The main changes introduced by those rules will be analysed in this chapter, after reviewing the most relevant judicial cases that have decisively influenced the current banking litigation situation in Spain.

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2 European Directive 2014/65/EU of the European Parliament and of the Council, of 15 May 2014, on Markets in Financial Instruments, and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II).

II RECENT BANKING JUDICIAL PROCEEDINGS OF RELEVANCE

Most judicial proceedings initiated against financial entities in recent years have as their subject matter the declaration of invalidity, due to their alleged unfair nature, of clauses included in mortgage loan agreements. This has led to several judgments declaring, depending on the case, the validity or invalidity of clauses challenged by consumers.

In this chapter, we will focus on the most common type of judicial proceedings of recent years, with reference to certain judicial decisions of considerable relevance rendered during the last months of 2018 and throughout 2019.

i Judicial proceedings concerning the invalidity of ‘*cláusulas suelo*’

The ‘*cláusula suelo*’ is the clause that establishes a minimum interest rate below which the floating interest rate may not fall, known as the ‘floor clause’. This clause, which is no longer used in banking practice following judgments on the matter, sets a minimum interest rate to be paid by the mortgage borrower, despite the parties having agreed on a floating interest rate normally based on Euribor. Thus, as consumers say, this clause establishes, in practice, a fixed interest rate despite the fact that, in the mortgage loan contract, the interest rate is set forth as floating. On this basis, consumers request that it is declared null due to its unfair nature.

It should be noted that invalidity due to the unfair nature of this clause entails the repayment, to the consumer, of significant amounts. The fall of Euribor in 2009 led to the minimum interest rate (floor clause) being applied. Therefore, those consumers who had agreed to a floating interest rate on their mortgage loans could not benefit from the widespread fall in interest rates. Thus, the declaration of this clause as null and void implies the repayment to the consumer of those amounts paid in excess due to the application of the minimum interest rate.

On the basis of the above, the Supreme Court, in its judgment of 9 May 2013, after carrying out an abstract and general analysis of these clauses, considered them unfair and, hence, null and void. This judgment became essential, establishing itself as the judicial decision of reference on this matter.

However, notwithstanding the importance of the above-mentioned judgment of the Supreme Court, there are still pending judicial proceedings dealing with the validity of these clauses. We refer to proceedings initiated in 2010 by a well-known banking consumer organisation against the majority of financial entities operating in Spain. Commercial Court No. 11 of Madrid, in its judgment of 7 April 2016 (and based on the prior judgment of the Supreme Court of 2013) confirmed that, in general terms, this kind of clause is null and void as it is unfair. On 12 November 2018, the Court of Appeal of Madrid confirmed such judgment, although making a number of relevant considerations on this matter.

In particular, the Court of Appeal set forth that the abstract and general analysis of ‘floor clauses’ does not prevent consumers from initiating individual proceedings challenging their validity. In those individual proceedings, the specific clause must be analysed on the basis of the information provided to the consumer, also taking into account how it was included in the mortgage loan contract by the bank. It is, therefore, possible for the court to conclude that the latter acted with the necessary diligence and, thus, to agree that the clause, in that particular case, is valid, as the consumer was well aware of its content and consequences.

Currently, the judgment rendered by the Court of Appeal of Madrid is being appealed before the Supreme Court by many of the financial entities against which charges were originally brought (however, most decided not to appeal, given the time elapsed since the

claim was filed and the fact that most of them have reached agreements with their clients in respect of this clause). The Supreme Court is expected to render a judgment that shall determine, as the case may be, the validity of these clauses in general, several years from now.

ii Judicial proceedings concerning the invalidity of clauses that foresee that the mortgage borrower must pay all fees and expenses arising from the granting of the mortgage loan

Currently, some of the most common judicial proceedings in banking litigation are those initiated to request that clauses that compel the mortgage borrower to pay all the expenses related to the granting of the mortgage loan (essentially, Property Register and Notary Public fees, taxes, expenses of the agency in charge of processing the granting of the loan, and expenses resulting from the appraisal of the mortgaged property) are declared null.

One judgment that triggered claims challenging these clauses was the Supreme Court judgment of 23 December 2015, which analysed several typical clauses included in mortgage loan contracts, including the clause in question. This resolution declared it unfair, and therefore, null and void. However, subsequent Supreme Court rulings have qualified this judgment, particularly in relation to the consequences of the invalidity of this clause. We refer to Supreme Court Judgments no. 44, 46, 47, 48 and 49, rendered on 23 January 2019.

The Supreme Court understands that it is unfair to compel the consumer to pay all the expenses arising from the granting of the mortgage loan, when many of them result from the benefit that it implies for the financial entity to establish a guarantee over the property. However, it is the consequences of this invalidity that are relevant, that is, whether the bank should return to the consumer expenses paid by the latter.

In relation to this, the Supreme Court agrees that the invalidity of this clause does not imply that the bank should repay the fees and expenses that have already been paid by the borrower. It shall depend on which party benefited from the services that accrued the fee or expense, as well as on what is regulated in the specific rules for each expense. For example, it is understood that, as the mortgage loan is registered with the Property Register in favour of the financial entity, it is the latter that should pay the corresponding fee. However, it is understood that the bank and the borrower should each pay half of the Notary Public fees, as this service benefits them both when the loan is granted.

The issue has been particularly controversial with respect to stamp duty, since this is the highest amount that borrowers usually pay when securing a mortgage loan, and the rules that govern who must pay it are not very clear. In this regard, the Supreme Court, when interpreting said controversial rules³ in the judgments mentioned in this section, has clarified that the mortgage borrower should pay the stamp duty.⁴

3 Article 29 of Royal Decree-Law 1/1993, of 24 September, approving the Revised Text of the Property Transfer Tax and Stamp Duty Act, and Royal Decree 828/1995, of 29 May, approving the Regulation of Property Transfer Tax and Stamp Duty.

4 These judgments differentiate between the variable and fixed tax rate, indicating that the borrower must pay the fixed rate. The previous judgment of the Civil Chamber of the Supreme Court of 15 March 2018 already agreed in this sense; however, the Public Administration Chamber of the Supreme Court, *ex post*, contradicted said resolution. The Supreme Court, in plenary session and by means of said judgments, settled such contradiction by confirming that the borrower must pay this tax.

In any case, and as we will see later, the recent Real Estate Credit Agreements Act has definitively regulated which expenses arising from the granting of a mortgage loan must be paid by the bank and which must be paid by the borrower, in order to avoid further judicial proceedings on this matter.

iii Judicial proceedings concerning the invalidity of clauses that compel mortgage borrowers to pay certain banking fees or service fees (emphasis on the arrangement fee)

The payment of banking fees has also given rise to a significant number of judicial proceedings against banks, in which the unfair nature of some of these fees is considered. In general, Spanish courts understand the payment of banking fees by consumers to be justified if the bank has provided an effective service to the latter from which an expense has resulted, being proportionate to the service provided and the fees to be paid. For example, in relation to the debt claim fee, if the bank proves that it has had to incur expenses in order to claim the non-payment from the debtor on several occasions, without the latter having complied with the request, the fee to be paid by the debtor will be valid.

Among others, the validity of the arrangement fee in particular, which is accrued as a result of granting a new mortgage loan, has been questioned. Judgments of the Supreme Court of 23 January 2019, to which we referred in subsection ii, understand this fee to be part of the price of the loan. In particular, the Supreme Court states that interest and the arrangement fee are the main remunerations received by the financial entity for granting the loan. Thus, it is a fee duly received by the bank.

Moreover, and as stated by the Supreme Court, when preparing and granting the loan, the bank carries out a range of activities other than the mere disposition of money (examination of the application form, collection and analysis of solvency information, evaluation of the guarantees provided, preparation of the contract, etc.). All these actions, which are obviously necessary for granting any loan, would justify the lender charging an arrangement fee as part of the loan's price.

Notwithstanding the foregoing, as we will see, the aforementioned Real Estate Credit Agreements Act has also regulated which banking fees are valid and should be paid by borrowers (specifically, banking fees to be paid by the borrowers have been restricted to those corresponding to the appraisal of the property for which the mortgage is granted).

iv Judicial proceedings concerning the invalidity of clauses that apply the Mortgage Loan Reference Index to mortgage loans

The Mortgage Loan Reference Index (IRPH) is one of the indexes used by Spanish financial institutions instead of Euribor (the usual reference rate for mortgage loans) to calculate mortgage interest. This index has been defined, in recent years, as being higher than Euribor (normally between 1.5 and 3 per cent) and more stable (it dropped less severely than the latter). Thus, holders of mortgage loans that incorporate this reference index have gone to the Spanish courts to request that it be declared invalid due to its unfair nature, and that it be substituted by Euribor, demanding that the amounts paid in excess be returned.

To date, Spanish courts have faced, to varying degrees, these requests for invalidity. The Supreme Court, in its judgment of 14 December 2017, agreed that this index is valid and, therefore, so are the clauses that apply it to mortgage loans. This judgment, which could have led Spanish courts to adopt a consistent stance, has not, however, been followed by all.

Within this context, the Court of First Instance No. 38 of Barcelona, by means of its Court Order of 16 February 2018, requested that the European Court of Justice (ECJ) render a preliminary ruling on the validity of the clauses applying this reference rate to mortgage loans. The final decision of the ECJ on the unfair nature of the clauses incorporating this reference index is expected to be rendered by the end of 2019 or the beginning of 2020.

The Advocate General of the ECJ has recently published his conclusions on this matter, which the ECJ may or may not follow. According to said conclusions, it can be understood that clauses incorporating this index will be ultimately subject to the control of the courts and therefore, those courts will have to determine whether such incorporation was unfair.

v Judgment rendered by the ECJ in relation to the consequences of nullifying an early maturity clause in mortgage loans

Although the case law of the ECJ and, consequently, of the Supreme Court have already ruled on the unfairness of clauses allowing the early maturity of a mortgage loan in the event of non-payment of a single monthly instalment, yet to be clarified was:

- a* whether the clause could be partially retained in the contract by eliminating those elements that make it unfair (i.e., the possibility of repaying the loan for non-payment of a single instalment); and
- b* whether, if it is not possible to partially retain the clause in the contract, mortgage enforcement proceedings initiated on the basis of this clause may continue, therefore not applying that foreseen in Article 695 of the Spanish Civil Procedure Act (SCPA).

In particular, Article 695 of the SCPA foresees that the court should waive enforcement proceedings if the early maturity clause that determined the institution of said proceedings is declared unfair and, hence, null and void. However, this measure, which apparently benefits the debtor, could lead the bank to initiate ordinary enforcement proceedings. These would be more harmful to the debtor, since it enables the creditor to claim all of the debtor's property, not only the mortgaged property.

In its judgment of 26 March 2019, the ECJ ruled out a number of preliminary questions raised in this regard by the Spanish courts, concluding that:

- a* it is not possible to partially retain the early maturity clause in the contract; and
- b* taking into account the damages that would be caused to the debtor if the clause were to be eliminated from the contract and enforcement proceedings were to be terminated, it is possible to replace, exceptionally, the clause declared unfair by the alternative rule established in Article 693.2 of the SCPA. This would mean including an early maturity clause that enables early maturity when three or more instalments have not been paid.

The Real Estate Credit Agreements Act has also regulated this issue, setting forth the requirements that an early maturity clause should meet in order to be considered fair and therefore valid.

III RECENT REGULATIONS

i Law 5/2019 of 15 March, on Real Estate Credit Agreements

Law 5/2019 of 15 March, on Real Estate Credit Agreements, is aimed at implementing in Spain Directive 2014/17/EU of the European Parliament and of the Council on credit agreements for consumers relating to residential immovable property.⁵

In general, the purpose of this rule is to strengthen the protection of the consumer and, at the same time, of the bank, by protecting it against possible allegations of unfair clauses and lack of information provided to consumers on the conditions of their mortgage loan. Indeed, the Real Estate Credit Agreements Act regulates the content of many of the clauses referred to above that have traditionally been challenged before the courts. The main changes introduced by this Real Estate Credit Agreements Act are as follows.

Pre-contractual information and transparency

Pre-contractual information must be provided to the consumer at least 10 days before the contract is executed before a notary public. Documents to be provided should consist of (1) the Standard European Consumer Credit Information Sheet (SECCI); (2) the Standard Warning Consumer Credit Information Sheet (FIAE); and (3) the draft contract to be signed by the borrower.⁶ The information to be provided under this new Real Estate Credit Agreements Act must be more detailed and should ensure that the borrower is fully aware of all the implications of their loan.

The notary public figure takes a leading role in ensuring that the consumer is duly aware of all conditions and clauses of their loan. For this purpose, the Real Estate Credit Agreements Act foresees that, before the signing of the loan contract, the notary public must grant a notarial certificate to certify that the advice they have given to the borrower has been sufficient, and that the latter understands and accepts the content of the contract and its risks. In addition, the notary public must submit the borrower, who must receive all the relevant information in writing, to a test before signing.

Early repayment fee

The Real Estate Credit Agreements Act restricts early repayment fees. In particular, with regard to floating interest rate mortgage loans, the early repayment fee may only consist of a maximum of 0.25 per cent over the capital amount redeemed in the first three years, and for the remaining term of the loan, a maximum fee of 0.15 per cent must be applied. For fixed interest rate mortgage loans, the maximum fee to be applied during the first 10 years of the loan's term shall be 2 per cent, and 1.5 per cent for the remaining term of the loan.

The possibility that the bank will enforce early maturity

Before the Real Estate Credit Agreements Act came into force, the early maturity of mortgage loans was considered valid after the third instalment defaulted by the borrower. However, under said Act, it shall depend on the number of instalments due and not satisfied as well as on the phase of the loan's term in which the defaults occur. Specifically, early maturity would

5 Its scope is thus restricted to this type of contract. In particular, loans secured by mortgage or other security rights over real estate for residential use, provided that the borrower or guarantor is a natural person, and the lender is a natural or legal person who carries out that activity in a professional manner.

6 The content of these documents is regulated in the same Real Estate Credit Agreements Act.

be valid during the first phase of the loan's term when the unpaid instalments correspond to 3 per cent of the capital granted or to 12 monthly instalments; during the second phase of the loan's term, the unpaid instalments must correspond to 7 per cent of the capital granted or to 15 monthly instalments.

The default interest rate and incentives to convert the loan to fixed interest rate

The Real Estate Credit Agreements Act sets forth that the default interest rate should be three times the legal interest. Likewise, it foresees that the borrower must be given incentives for switching their loan from a floating interest rate to a fixed rate.

Fees and expenses arising from the granting of the loan

This constitutes one of the most important measures introduced by this rule, given its impact on banking litigation. In particular, we refer to the fact that, by virtue of the Real Estate Credit Agreements Act, it is finally established that lender must pay all notary public, property register and administrative fees and expenses, including the payment of stamp duty,⁷ arising from the granting of the mortgage loan. The borrower, for their part, must only pay expenses resulting from the appraisal of the mortgaged property.

The entry into force of the Real Estate Credit Agreements Act in June 2019 entailed major practical problems, such as what would happen to mortgage loans negotiated under the previous regulation but which had to be signed once the new act came into force, or what would happen if financial institutions had not had time to update their files in time in order to adapt to the new requirements introduced by the act. This situation obliged the General Directorate of Registers and Notaries to intervene, so as to provide a balanced solution for all parties involved pursuant to the law and in the spirit of the Real Estate Credit Agreements Act.

ii Markets in Financial Instruments European Directive (MiFid II)

The initial deadline for the Member States of the European Union to implement Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014, on Markets in Financial Instruments (MiFid II), was 3 January 2017. As the European Commission ultimately delayed this deadline, the Spanish government arranged an implementation process consisting of three phases, by means of the following three laws:

- a* Royal Decree-Law 21/2017, of 29 December, on urgent measures for the adaptation of Spanish law to European Union regulations on securities markets.
- b* Royal Decree-Law 14/2018, of 28 September, amending the Securities Market Act.
- c* Royal Decree 1464/2018, of 21 December, implementing the Securities Market Act and Royal Decree-Law 21/2017, of 29 December referred to above. As this Royal Decree entered into force at the end of December 2018, it was implemented in 2019.

The main changes introduced by these regulations, in terms of investments and investor client protection, are:

⁷ Specifically, it is foreseen in Article 14 that the corresponding Property Transfer Tax and Stamp Duty Act shall be paid in accordance with the applicable regulation.

- a* Suitability and convenience test: investor clients must undergo a test to determine their risk profile, so that investment institutions can offer them suitable products. Depending on the results of the suitability test, customers must be classified as retailers, professionals or an eligible counterparty, ranging between those with less to more experience and knowledge, respectively. In addition, investment institutions are obliged to review the products that their clients have contracted annually, and to confirm that they are the most suitable for them.
- b* Advice and incentives: depending on whether the financial advisers are dependent or independent (they are obliged to report this to the client), they may or may not collect incentives and retrocessions.⁸ In general, independent advisors may not collect incentives corresponding to the sale of funds.⁹ Non-independent advisors may continue to obtain incentives, if they can provide evidence that they have improved the quality of the service provided (for example, if they give the client access to a wide range of third-party products), and it is ensured that no benefit is being generated for the investment services firm without there also being a benefit to the client.
- c* Contracts: the provision of investment services, with the exception of advisory services, must be duly set out in a contract signed by both parties, indicating the rights and obligations of both. For advisory services, it will be necessary to record the recommendation made in writing or by other reliable means.
- d* Training: MiFID II requires a more personalised service to be provided to each investor. Financial institutions that provide advisory services must ensure and certify that their investment employees are sufficiently trained. Thus, new training and knowledge requirements are established for those who provide advisory services. If an employee does not have sufficient certification, he or she may continue to carry out this activity for two years, although always under the supervision of another professional with the required qualification.
- e* Transparency and necessary information: there is an increasing obligation to inform investors of the costs involved in acquiring financial products, as well as to provide pre-contractual information and include more details in periodic reports. In relation to this, and depending on the case, there will be a periodic evaluation of the suitability of the financial instruments that are recommended to clients. In essence, the new information requirements set out in MiFID II focus on three main aspects:
- information on the advisory service to be provided, namely, independent or non-independent, as well as the range of financial instruments analysed and their selection process;
 - information on costs and associated expenses, both for financial instruments and for investment and ancillary services; and
 - information regarding financial instruments and associated investment strategies, including associated risks and how the financial instrument in question may operate in different scenarios (both favourable and unfavourable).

8 We refer to incentives as rewards provided by the owners of the funds, corresponding to the achievement of sales targets; retrocessions are part of the service charge that the marketer of an investment product, usually a fund, retains, including them within the final price.

9 In other words, they can only charge a service charge to their clients, not to the managers of the investment funds that they market.

The obligation to record all telephone conversations and communications related to transactions carried out when negotiations are performed independently, and to the provision of services related to the reception, transmission and execution of client orders, was also introduced. All this compulsory information must be collected on a durable medium (which, for the purposes of this new legislation, is considered to be hard copy or online), for a minimum period of five years.

IV CONCLUSION

Banking litigation in Spain has been governed in the past few years not so much by the applicable regulation, but by the interpretation that courts have made of it, often seeking help from the ECJ to reach their conclusions.

The current trend is to encourage greater protection for the consumer and, in turn, for the bank, by protecting the former in order to avoid the litigation against the latter, as the significant number of judicial proceedings initiated against financial entities had begun to overwhelm some courts, leading to substantial delays.

A good example of this trend are the two laws we have mentioned: MiFid II and the Real Estate Credit Agreements Act; the latter decisively influenced by certain judicial resolutions that have decided upon the unfair nature of certain clauses commonly used in banking practice. In fact, the Real Estate Credit Agreements Act shows the impact that banking litigation and, in particular, judicial resolutions such as those mentioned in this article, have had on banking practice.

Nonetheless, it is expected that banking litigation will continue in the coming years, in terms of consumer protection proceedings and proceedings related to the validity of clauses included in banking contracts, including investment transactions. It should be noted that more information is continuously being provided with the aim of nullifying any allegation of defective consent of the client, and that conditions offered by financial entities are now designed to ensure a balance of benefits that may avoid any allegation of unfairness.

In short, legislators' response to the deluge of banking litigation has been to exercise extreme caution and ensure the protection of the consumer and the investor client, thus reducing the chances of questioning, *ex post*, the transactions they have entered into. This is as a result of significant judgments rendered in relation to the unfair nature of certain clauses traditionally included in banking contracts, and some questionable attitudes of financial institutions.

However, there are still many banking transactions that fall within the scope of the previous legislation, which was less protective of consumers. This situation, together with the fact that, to date and to a large extent, judgments have mainly favoured the position of consumers against financial entities, leads us to believe that, in the immediate future, there will continue to be a significant number of legal proceedings initiated against banking entities, questioning their transparency and behaviour towards their clients.

SWITZERLAND

Daniel Tunik, Lorenzo Frei and Téo Genecand¹

I SOURCES OF LITIGATION

The banking industry is an essential economic sector in Switzerland and frequently results in litigation. In most cases, litigation is directed against the banks but occasionally it is initiated by them.

The categories outlined below are among a variety of situations that generate litigation in banking matters.

The issue of bank liability for losses incurred by clients on their deposited assets is one of the most recurring themes in banking litigation in Switzerland. The applicable legal principles, as well as the client's expectations towards banks, vary significantly depending on the legal nature of the relationship between the bank and its client. Typically, this relationship is characterised as 'execution only', 'advisory' or 'asset management' and Swiss courts have developed an abundance of case law setting out the relevant criteria to determine whether the bank is liable for its client's losses.

Overdrafts on client accounts constitute an important source of banking litigation in Switzerland. The most frequent situations are the ordinary foreclosure procedures against pledged real estate, as well as procedures on the merits against the client where the overdraft is not covered by any pledged assets.

Enforcing pledges on client assets deposited with banks has generated numerous disputes in instances where banks have attempted to protect themselves against avoidance claims arising from transactions effected for the benefit of their clients, as well as against possible penalties imposed on banks in relation to the undeclared tax status of their clients.

The use of emails and other forms of communication between banks and clients is a regular source of fraud that leads to disputes aimed at determining who should bear the responsibility for the consequences. The actions brought before courts have, in particular, addressed the question of the validity of contractual clauses excluding the bank's liability in situations where it was not able to detect fraud.

II SIGNIFICANT RECENT CASES

i The practice of bank retrocessions as a case of criminal mismanagement

The Supreme Court had already recognised in 2006 that an agent's contractual obligation to give an account of its agency activities and return anything received as a result of such activities fully applies to retrocessions that the agent might have received in the performance

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of the mandate.² The matter is particularly relevant for the banking sector with regard to the retrocessions paid or received by banks for business contributions, such as bringing new clients or selling specific banking products.

In the following years, the Supreme Court specified the legal framework applicable in this matter in several rulings. This case law clearly indicates an intent to protect the rights of the principal or client. For example, a client may waive its right to the restitution of the retrocessions. However, the case law provides strict conditions for such waiver to be valid, in particular regarding the information that is due to the client beforehand. If the client has not waived its right or the waiver is not valid, the client is entitled, in civil terms, to claim restitution of the retrocessions received by the agent. This claim is subject to a 10-year limitation period.³

In a new decision of 14 August 2018, the Supreme Court took another significant step to increase the protection of clients.⁴ The court ruled that the breach by an asset manager of its obligation to give account of its agency activities and return anything received as a result of these activities could constitute a case of criminal mismanagement within the meaning of Article 158 of the Swiss Criminal Code. If the Court first observed that the breach of the obligation of restitution is not per se an act of criminal mismanagement, the judges ruled that the breach of the obligation to give account of agency activities to the client falls under the scope of this offence. The court considered that obligation to give account represents a prerequisite for the client to be able to claim restitution of the retrocessions.

This decision is important to the extent that the topic of bank retrocessions has now moved from a purely civil level to a criminal one. A significant consequence of this evolution is the ability for clients to benefit from investigative and coercive measures offered by criminal proceedings. While civil procedure is governed by rather strict principles, in particular concerning the gathering of evidence by the claimant, criminal procedure is organised in such a way that it provides extensive investigative resources. One could expect that clients may turn to criminal proceedings to recoup retrocessions.

ii Banks' liability for the losses suffered by a client

In the context of execution-only relationships, the bank is under an obligation to execute its client's orders but is not bound by a general duty to safeguard the interests of the client. Accordingly, the principle under Swiss law is that the bank in such relationship shall provide information to its client only upon request. However, over the years, court decisions have held that there are specific situations in which relevant facts should be spontaneously drawn to the attention of the client by the bank. An example of such a case would be if it appears that the client is absolutely unaware of the risks incurred, or if a special trust relationship has developed over the years between the parties.

In a decision dated 25 April 2016,⁵ the Supreme Court provided further guidance on the bank's special duty of information in the context of execution-only relationships. The judges had to decide whether the custodian bank could be held responsible for the losses caused by the fraud committed by an external asset manager in a situation where the bank had information that cast doubts about the reliability of the manager in question. The

2 Published under ATF 132 III 460.

3 Published under ATF 143 III 348.

4 Published under ATF 144 IV 294.

5 4A_369/2015.

Supreme Court held that the following circumstances constituted the relevant elements that triggered a special warning and duty of information even in the absence of any contractual mandate (execution-only relationship):

- a* where the bank has doubts about the reliability of the client's external asset manager because of an absolute lack of diversification of the asset management strategy;
- b* where the bank had previously refused to lend money guaranteed by a pledge on part of a fund managed by the client's external asset manager because it considered this to be a guarantee of insufficient quality;
- c* where the bank refused to be the custodian bank for a fund managed by the client's external asset manager because it could not understand its functioning; and
- d* to a lesser extent, where the bank had knowledge of negative press coverage on the directors of the client's external asset manager, even though the press coverage did not concern a matter that was financial in nature.

By contrast, in another decision dated 14 September 2016,⁶ the Supreme Court found that the bank had complied with its duty of care by informing its client that it had suspicions of potential criminal conduct by the external asset manager. The judges held that the bank was not expected to take additional precautionary measures on behalf of the client, it being specified that in this case the client did not react despite the alarming information provided by the bank.

In 'asset management' relationships, the bank undertakes to manage all or part of the client's assets at its discretion but in accordance with the strategy, limits and objectives set with the client. In contrast with execution-only relationships, under asset management relationships, the bank has an extensive duty of information, as well as a duty to take whatever measures are necessary to safeguard its client's interests.

In addition to the execution-only and asset management relationships, banking practice has developed an intermediary relationship, namely the 'advisory' relationship. This covers a wide variety of situations ranging from a mandate that, in many ways, is similar to an asset-management mandate through which the investment decisions are taken directly by the client but on the basis of the bank's regular advice, to relationships with one-off advice given by the bank. The bank's duties to inform and advise the client depend on the type of advisory contract as well as on other prevailing circumstances, such as the client's knowledge and experience in banking and finance matters. As a matter of principle, Swiss law considers that the client bears the risks of the transaction if it follows the bank's advice, unless the advice was patently unreasonable at the time it was given.

On 18 April 2017, the Supreme Court reviewed a case⁷ in which clients had invested in a Lehman Brothers structured product recommended by the bank. The investment was made in January 2007 and resulted in a nearly total loss following the bankruptcy of Lehman Brothers. The clients claimed that the bank's presentation of the product as being guaranteed-capital structured product was misleading and that they were not (sufficiently) made aware of the risk of issuer. The Supreme Court ruled that this was not relevant. At the time of the advice, the issuer risk related to Lehman Brother was minimal according to the financial expert. Additional explanations on the risk of issuer would thus not have discouraged the clients from investing in the contentious product. Furthermore, as the bank had not

6 4A_361/2015.

7 4A_403/2016.

given any recommendation as regards the amount to invest, the bank was not expected to warn the clients about the risks associated with an absence of diversification, even though the clients had invested approximately half of their savings in the contentious product.

The question that courts face regularly relates to the calculation of the damages that the client may claim in the event of a breach by the bank of its duties.

In a recent case, the Supreme Court recalled the quite strict requirements regarding the demonstration of the damages.⁸ The case involved a relationship manager who had performed unauthorised transactions on a client's account. Following the discovery of the fraud, the client sued the bank for \$6 million claiming that this amount corresponded to the difference between the value indicated on the false statements provided by the relationship manager and the effective value of his portfolio. In the course of the proceedings, the client had offered another method to demonstrate his damages based on the difference between his initial investment and the profit of approximately 2.8 per cent gained by a similar portfolio during the same period. The lower court considered that the exact amount of damages could not be determined and, by making an estimate, awarded the client \$5.7 million. Following an appeal of the bank, the Supreme Court overruled the decision of the lower court and dismissed the client's claim. The Supreme Court held that since it was possible to individualise the wrongful investments, the client was in a position to determine precisely his damages. This is done by calculating the difference between the actual value of the investments and the hypothetical value that they would have if they had been performed according to the agreed strategy. Hence, the client should have demonstrated his damages for each wrongful transaction, which he did not do. This led to the dismissal of the client's action.

iii Right to information of the heirs

In a decision dated 18 July 2019, the Supreme Court determined under which conditions a bank is obliged to disclose to the heirs the identity of the account holder having benefited from a transfer ordered by the *de cuius*.⁹

The *de cuius*, who was a Spanish national, had an account with a bank in Geneva. In 2009, she ordered the bank to transfer all her assets to another account. After her demise, the heirs requested to receive several information from the bank, including the identity of the account holder who benefited from the transfer. Because the transfer had occurred within the same bank the banking documentation pertaining to the deceased's account only contained the number of the account having benefitted from the transfer, but not the identity of its holder.

In defining the scope of the right to information, the Supreme Court made a distinction depending on whether this right to information is based (1) on the contractual relationship that existed between the *de cuius* and the bank; or (2) on the provisions governing the inheritance.

The contractual right to information provides the heirs with the right to receive full information about the assets at the time of the demise. However, this does not include transfers ordered by the *de cuius* before their demise. In that context, the heirs are only entitled to the information necessary to determine whether the bank correctly performed its obligations. Endorsing the interpretation of the lower court, the Supreme Court ruled that the rightful heirs are also entitled to receive information about the transfers made by the *de cuius* to the

8 Published under ATF 144 III 155.

9 4A_522/2018.

extent that this information is necessary for the heirs to assert their forced heirship. Due to its nature, the contractual right to information falls within the subject matter scope of the Lugano Convention, which gives jurisdiction to the courts where the bank has its seat.

The right to information based on the provisions governing the inheritance covers all information that are relevant for the distribution of the estate. However, the heirs only have standing to assert this right to information if they can demonstrate that they have a legal interest in recouping the concerned assets. The inheritance-based right to information falls outside of the Lugano Convention. The applicable Swiss conflicts rules grant jurisdiction over such action to the authorities of the last domicile of the deceased.

In the case at hand, the Supreme Court considered that the heirs were asserting their contractual-based right to information and dismissed their action to the extent that they did not allege that the bank had breached its obligations or that their forced heirship had been breached.

III CHANGES TO COURT PROCEDURE

Switzerland is a federation. Pursuant to the Constitution, material civil law and debt enforcement procedures are governed by the federal state and have been unified thereunder for over a century. By contrast, the authority to legislate on the rules regarding civil procedure remained with the cantons, as a result of which civil proceedings in Switzerland were characterised by the existence of 26 different procedural civil laws. This was eventually deemed to be excessively burdensome, costly and an obstacle to the predictability of proceedings. After a lengthy process, a Federal Code of Civil Procedure (CPC) entered into force as of 1 January 2011 and replaced the previously existing cantonal laws.

Although the unification of the rules of civil procedure did not fundamentally modify banking litigation, it has certainly made it easier for lawyers to appear before other cantonal courts. In that respect, the change in question may be considered to make access to courts easier for clients. There is an ongoing review of the CPC. The major change of the current draft is the additional possibilities for collective action (currently not admissible to claim damages). Additional suggested amendments include considering that attorney privilege also covers the work of in-house attorneys in civil proceedings, a new procedural status for reports of private experts or reduction of the amount of the advance on judicial fees.

IV ATTORNEY–CLIENT PRIVILEGE

Attorney–client privilege, in particular its scope, can raise questions in the context of banking litigation. This happens, in particular, when litigation is related to situations where the factual background is complex and requires fact-finding activities. In such situations, banks often decide to carry out internal investigations, which can be conducted by lawyers.

This activity is generally considered to be covered by the attorney–client privilege. This is based on the general rule that provides that attorney–client privilege covers typical activities of a lawyer, such as legal representation, provision of legal advice and drafting of legal documents. Other activities, such as serving as a director, asset manager, testamentary executor or trustee, are regarded as atypical activities for which this particular protection is not justified and are thus not covered by attorney–client privilege. This distinction is, however, not always clear and some activities are considered mixed.

A decision by the Supreme Court made on 20 September 2016¹⁰ caused particular concern in the legal community and illustrates the types of difficulties that may arise where the tasks carried out by lawyers may be viewed as overlapping with activities that a bank would be compelled, by law, to conduct. The case involved a Swiss bank, whose employee – a wealth manager – was the subject of a criminal investigation in relation to a corruption matter involving Greek officials. In this context, the bank mandated two law firms to carry out an internal investigation to determine if anti-money laundering legislation had been violated. The internal investigation also included the review of the bank's internal notes and the interviewing of its employees. The question arose as to whether the work product of the bank's attorney was covered by attorney–client privilege after various documents, including memos and minutes of interviews, were seized in the context of the criminal investigation. Following an appeal by the bank, the Supreme Court considered that the results of the internal investigation were not entirely covered by attorney–client privilege. To understand the reasoning of the Supreme Court, it must be noted that the Anti-Money Laundering Act (AMLA) imposes on Swiss banks (and other entities concerned) a duty to document transactions and clarifications carried in a manner that enables a third party to make a reliable assessment of the transactions and business relationships, and of compliance with the provisions of the AMLA. In the case at hand, the judges held that the fact-finding work done by the bank's attorneys was part of the bank's duty to document the clarification work done and that the bank had, in fact, delegated its duty to its attorneys. The Supreme Court concluded that this work could not be subject to attorney–client privilege, otherwise it would mean that the AMLA provisions could be circumvented by delegating these duties to attorneys. The Supreme Court confirmed this ruling on 21 March 2018,¹¹ in a procedure directed against representatives of a bank for violation of their duty to report a case under the AMLA.

Since then, the scope of these decisions has been the subject of intense debate among scholars and has not settled yet. However, the lesson from these rulings is that attorneys and banks should be aware of this issue and take the appropriate steps before and during the performance of an internal investigation to isolate the information covered by attorney–client privilege from the rest of their (fact-finding) work.

V JURISDICTION AND CONFLICTS OF LAW

Swiss banks usually provide in their general terms and conditions that the contract shall be governed by Swiss law and that Swiss courts shall have sole jurisdiction over any dispute. In the context of clients residing abroad, the question that arises is whether Article 15 Paragraph a, letter c of the Lugano Convention (CL) may result in setting aside such contractual agreement.

In its ruling dated 9 February 2016,¹² the Supreme Court considered that the client of a Swiss bank falls under the broad definition of a consumer within the meaning of Article 15 CL. However, in order to set aside a jurisdiction and choice of law clause, the bank's client had to prove that he was actively solicited by the bank in his country of residence at the outset of the relationship.

10 1B_85/2016.

11 1B_433/2016.

12 Published under ATF 142 III 170.

In the context of foreign proceedings, banks also frequently face document production orders issued by Swiss authorities following an international mutual assistance request; be it in administrative, criminal or civil matters. In civil proceedings, when banks are ordered as third parties to produce documents, they may – or shall, based on their contractual relationship with the client – try to dismiss the order based on the argument that banking secrecy should prevail on the interest to produce the documents in the civil procedure pursuant to Article 166, Paragraph 2 CPC. The Swiss judge shall weigh up both interests and decide whether to maintain the order. In Swiss proceedings, the client to whom the documents are related is not in a position to intervene in this process. The Supreme Court rendered an interesting decision setting different standards in the context of international mutual assistance in civil matters, in a dispute where the Hague Convention of 18 March 1970 (HC70), on the taking of evidence abroad in civil or commercial matters, was applicable. In its decision dated 21 December 2015,¹³ it indeed considered that the client – if he or she is not a party to the foreign procedure – shall be heard in this procedure before any production order may be addressed to a Swiss bank through the channel of international civil mutual assistance. If the client had not been heard in the foreign procedure, the international civil mutual assistance request was to be rejected based on Article 12, paragraph 1, letter b HC70. In a decision dated 29 August 2017,¹⁴ the Supreme Court specified that the client had to inform the foreign judge that he disputes the request for international mutual assistance and requests to be heard if he wishes to assert rights under the above-mentioned case law.

VI EXCLUSION OF LIABILITY

As a matter of legal principle, banks bear the risk of executing orders from unauthorised persons. Indeed, to the extent that a bank executes a payment without having validly received an order to this effect from the client, the bank is not authorised to debit the client's account in order to cover the amount of the transfer. However, banks usually include a clause in their contractual documents and general conditions, which shifts this risk onto the client. Pursuant to Article 100 CO – applicable by analogy to this type of clause – such transfer of risk is not valid in case of serious misconduct or gross negligence on the bank's part. In the event the behaviour is attributable to officers with functions falling within the meaning of corporate bodies, the transfer of risk may be considered as invalid, even in the case of mere negligence.

As regards the bank's duties when it receives a transfer order, it is generally admitted that banks are required to verify the authenticity of orders only within the limits agreed by the parties, unless the circumstances surrounding the order give rise to doubts and warrant to carry out additional checks.

In a decision dated 5 December 2016,¹⁵ the Supreme Court ruled that the following elements are to be considered when assessing whether the circumstances warrant carrying out additional checks before executing an order:

- a* where the style of the communications issued by the client change dramatically, such as by suddenly using poor vocabulary and containing syntax and spelling errors despite being written in the native language of the client;

13 Published under ATF 142 III 116.

14 4A_167/2017.

15 4A_386/2016.

- b* where the timing or beneficiary of the order given is unusual for the client. In the case at hand, the first order emanated from a hacker and was only the second exit of funds ordered in the past 10 years and the first in favour of a third party who was neither located in Switzerland nor in the home country of the account holder. The bank unsuccessfully argued that in view of the rarity of transfers it was not possible to determine what was usual for this account, as the client had on several occasions indicated that he held this account to diversify his funds in Swiss francs as well as for the purposes of safety and stability;
- c* where the amount of the envisaged transfer is unusual for the client. In the case at hand the first order involved nearly a quarter of the assets under management despite the fact that the client had wired the majority of his assets to his Swiss account a few months before and mentioned that they represented his savings and were intended to be kept long-term;
- d* where the cause of the transfer is not specified immediately, despite the fact that the client usually shared spontaneously his intended actions and the underlying reasons for them;
- e* where the order is required in an urgent manner without clear reasons justifying the need to act quickly; and
- f* where an executed order is only signed with the first name of the client and not with the signature known by the bank.

In the context of this decision, the Supreme Court addressed the disputed question of the impact of the client's contributory negligence. In other words, can a bank argue that a client's claim is to be reduced or discarded by virtue of the fact that the client contributed to the damage by reason of its negligence or reckless conduct? The Supreme Court took a formal and strict approach by stating that the client, in this type of situation, is not entitled to seek damages strictly speaking, but rather the mere performance of the contract by prohibiting the bank from debiting the client's account on the basis of an unauthorised order. In such cases, according to the Supreme Court, the indemnity cannot be lowered as a result of contributory negligence within the meaning of Article 44 CO. On the other hand, the judges considered that the bank could assert its own claim against the client by invoking a breach by the client of its contractual obligations resulting in damages caused to the bank (i.e., the fact that it had to pay the third party without being in a position to debit the client's account to cover the payment in question). In practice, this means that the bank may not simply oppose the client's contributory negligence in its defence against the client's claim, but has to prove that the conditions for a contractual or tort liability against the client are met, which is undoubtedly more difficult to prove.

This approach was confirmed in a decision dated 29 May 2018.¹⁶ In this case, the Supreme Court also clarified the test to be performed under those circumstances and the issue of the burden of proof. There, a company active in the diamond trade that used to transfer large sums was claiming the reimbursement of an amount corresponding to two transfers made to South Korea. The company was arguing that these transfers had been instructed by a third party after the email account of one of its representatives had been hacked. However, the company had not lodged a criminal complaint nor provided any other evidence that its email had been hacked. The Supreme Court ruled that, before assessing

16 4A_81/2018.

whether the bank was negligent in executing these orders, the client had to demonstrate that the instructions did not come from an authorised representative and that a third party had hacked the representative's email account and falsely impersonated him. Since the company had not provided evidence of its allegations, the action was dismissed.

The general conditions of banks usually contain a clause pursuant to which the client is deemed to have accepted an order in the absence of reaction within a certain period of time. The Supreme Court had considered, however, that this legal fiction of ratification of the order is to be disregarded in situations where the client never received the information in relation to the transfers, such as for hold mail accounts. The Supreme Court recently limited the application of this rule in situations where the client is claiming reimbursement of unauthorised orders coming from a third party.¹⁷ In the case at hand, an asset manager had meticulously forged the signature of her client to order transfers. The bank had identified that the transfers were unusual, but called the external asset manager – who had the necessary power of attorney to order the relevant transactions – to ensure that the orders reflected the client's intent. After the Supreme Court had considered in 2017 that this was a serious misconduct on the bank's part not to contact the client directly,¹⁸ the question remained whether the bank could set off the client's claim with its own claim against the client for not having picked up her hold mail for four years. The Supreme Court responded in the affirmative and held that a client who does not pick up its hold mail for four years breaches its duty of care and may be liable. Although the agreement with the bank did not provide any obligation of the client to pick up its hold mail, the Supreme Court considered that the principle of good faith imposed such a duty on the client.

VII REGULATORY IMPACT

As a matter of principle, Swiss regulatory rules usually aim at protecting public interests rather than private interests and, thus, do not apply directly in the private law relationships between banks and their clients. For example, the Supreme Court stated in a decision¹⁹ that a person could not base a liability claim against a bank solely on a violation of regulatory rules (such as the one provided in the AMLA); the person has to prove that a law protecting his or her own private interests was violated by the bank – such as money laundering pursuant to Article 305 *bis* of the Swiss Criminal Code in order to have valid grounds for a liability claim.

That said, there has been an increasing number of exceptions to this principle with regulatory provisions that envisage specific liability claims. By way of example, Article 145 of the Federal Act on Collective Investment Schemes provides that all persons involved with the establishment, management and distribution of the fund (e.g., the custodian bank) are subject to direct liability towards individual investors and other creditors of the company.

The Swiss Federal Council's message accompanying the draft Swiss Federal Financial Services Act (FFSA) and the draft Swiss Federal Act on Financial Institutions (see Section VIII) state that the various prudential rules that the actors of the financial sector will be expected to comply with are regulatory rules that are not directly applicable to client–bank

17 4A_118/2018.

18 4A_379/2016.

19 Published under ATF 134 III 529.

relationships. They do, however, point out that civil judges will be able to review these obligations to interpret and clarify the applicable civil obligations. This approach highlights the increasing impact of regulatory rules and its impact on civil banking litigation.

VIII LOOKING AHEAD

Following the 2008 financial crisis, as well as the international developments in financial regulations in general, the Swiss Federal Council has been actively involved in the enactment of two new pieces of legislation that will have an impact on the financial sector as a whole: the FFSA and the Swiss Federal Act on Financial Institutions. These two laws are still in draft form and will be subject to further discussion and amendments at the federal parliament. Without entering into detail, it can be said that several provisions of the FFSA are likely to impact the procedural rules governing disputes arising between banks and their clients. As an example, the current version of FFSA provides for the possibility to opt for a mediation procedure as an alternative to the mandatory conciliation procedure. In addition, there are discussions regarding the enactment of a rule that would exclude the possibility for banks to claim an indemnity for legal fees – as is usually the case in Switzerland for the successful party to a litigation – except where the amount in dispute exceeds a certain level. Although it is still uncertain whether these changes will eventually be enacted, they certainly reflect the prevailing trend that aims at favouring the position of clients in relation to banks in the context of litigation. Banking litigation will undoubtedly continue to evolve in Switzerland.

TAIWAN

Patrick Marros Chu, Salina Chen, Joyce W Chen and Chi Lee¹

I OVERVIEW

In Taiwan, the financial crisis of 2008 has led to several recent legislative developments. The array of disputes regarding target redemption forward foreign-exchange-related derivative financial products (TRFs) in 2014 and 2015 further resulted in a vigorous debate among regulators, financial institutions and consumers regarding consumer protection in financial services.

II SIGNIFICANT RECENT CASES

i Taiwan High Court civil judgment 106-Zon-Shan-Zi-646 (2017)

The plaintiff, a commercial bank, claimed against the defendant, a foreign corporate investor, for the proceeds from certain TRF transactions entered into between the parties. The district court ruled against the plaintiff on the ground that the plaintiff failed to fulfil its obligation to disclose the investment risks to the investor before the transaction, thereby causing the defendant to be unable to properly assess the potential transaction risks beforehand. The district court's decision was among the very few cases in which the court ruled against the financial institutions in similar disputes. However, on appeal, the Taiwan High Court overruled the district court's decision and concluded that the plaintiff was not required to provide such risk alert to a professional investor such as the defendant, and, therefore, the plaintiff's claim had merit.

ii Taichung District Court civil judgment 103-Su-Zi-3271 (2016)

The plaintiff, a corporate investor, alleged that the defendant, a commercial bank, violated relevant selling restrictions when selling certain TRFs to the plaintiff, and argued that the transaction should be void. The plaintiff further asserted that the defendant failed to perform a suitability test on the plaintiff regarding the TRFs and committed fraud; therefore, the plaintiff should have the right to cancel the transaction. The Taichung District Court ruled in favour of the defendant. The court held that the TRFs are not covered by the selling restriction and a bank can legally sell such product in Taiwan through its offshore banking unit (OBU). The court further ruled that the defendant had provided sufficient disclosure documentation to the plaintiff, including presentation decks, the product terms and conditions, and certain risk-alert documents to the plaintiff, and the plaintiff was fully aware

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of the risk to the transaction. The court also held that the defendant had duly performed suitability analysis on the plaintiff's risk endurance level. In sum, the transaction between the plaintiff and the defendant was legally effective, and the defendant was not liable for the investment loss suffered by the plaintiff.

iii Supreme Court civil judgment 102-Tai-Shan-Zi-1189 (2013)

The Taiwan High Court held that a bank failed to fulfil its duty of disclosure to an investor because the disclosure documents were complex and difficult to read. The Taiwan High Court also held that the investor's signature on the disclosure document alone cannot prove that the bank had properly disclosed the investment risk to the investor. The Supreme Court of Taiwan vacated the Taiwan High Court's decision and remanded the case for further investigation of evidence on whether the bank fulfilled its duty of disclosure. The remanded case was subsequently resolved through mediation.

iv New Taipei District Court civil judgment 107-Su-Zi-1954 (2019)

The plaintiff, a futures commission merchant, sued an investor for the amount of the performance bond under a futures option contract, which was forced liquidated pursuant to the terms thereof. The New Taipei District Court ruled in favour of the plaintiff on the basis that the forced liquidation clause allowing a futures commission merchant to liquidate an investor's position without prior warning followed the relevant regulations and was necessary for the operation of the futures market. Hence, the forced liquidation clause was effective and not 'obviously unfair' under the relevant financial consumer protection laws. Due to a sudden fluctuation of futures option market in February 2018, a series of similar disputes regarding forced liquidation of futures options contracts were brought to the courts in 2018.

Since the establishment of the Financial Ombudsman Institution after the promulgation of the Financial Consumer Protection Act in 2011 (the FCP Act), most of the banking disputes involving financial consumers in Taiwan that were traditionally decided by courts through litigation are now resolved by the Financial Ombudsman Institution.² The Taichung District Court Judgment described in subsection ii, is one of the few disputes resolved through civil litigation in recent years. Many other cases were resolved through settlement or mediation, such as the Supreme Court judgment outlined above. The FCP Act does not apply to banking disputes involving offshore branches, OBUs, qualified institutional investors, or persons or entities with a certain level of assets or professional investment intelligence prescribed by the competent authority from time to time.

III RECENT LEGISLATIVE DEVELOPMENTS

i General regulatory scheme of financial institutions

The regulations of financial institutions in Taiwan are generally imposed by the Financial Supervisory Committee. The sale of financial products is generally regulated under the Banking Act with regard to the sales by banks, and the Securities Exchange Act with regard to the sales by securities firms. There are also other relevant regulations authorised by the two aforementioned acts, such as the Regulations Governing Foreign Exchange Business of Banking Enterprises, the Regulations Governing Foreign Exchange Business of Securities

² See Section III.iii.

Enterprises, the Regulations Governing Internal Operating Systems and Procedures for Banks Conducting Financial Derivatives Business, and the various orders and opinion letters issued by the competent authorities from time to time.

In general, a financial institution is required to submit a proposed financial product, such as a fund or a bond, to the regulatory authorities for their review. The purpose of such submission is to ensure that the financial product is properly designed and the relevant information is properly disclosed in the transaction documents. Approvals by the regulatory authorities must be obtained before the financial institution can sell the product to a customer. Nevertheless, a structured product is usually sold through the structure of 'specific monetary trust' in Taiwan and the trust agreement governing the transaction of the structured product is generally deemed a private contractual relationship between the financial institution and the investor. An investor entrusts his or her money to a domestic financial institution, which in turn invests the entrusted money in an offshore structured product based on the trust agreement. As such, unlike funds or bonds, the regulatory authorities are not required to review these products prior to the transaction. Prior to the 2008 financial crisis, a wide variety of structured products were, therefore, sold to many investors without adequate regulatory review or approval.³

Given the commonly used investment structure mentioned above, the financial institutions are also governed by the Trust Law as trustees of the trust properties. Pursuant to the Trust Law, a trustee should manage the trust matter with the due care of a 'prudent administrator'.⁴ When a trustee fails to manage the trust matter with such due care thereby causing the settlor any damages, the trustee is liable to the trust property for such damage.⁵

ii Additional regulatory requirements in response to the financial crisis

In light of the 2008 financial crisis and in response to the call from the public for more stringent regulations, the Regulations Governing Offshore Structured Products were promulgated, which target a specific category of financial products, namely, the offshore structured products. The Regulations set forth the requirements for the sale of offshore structured products, including, among others, the requirements for Chinese disclosure documents,⁶ the obligation of the financial institutions to explain to the investors whether the product is principal guaranteed⁷ and the obligation of the financial institutions to read out the disclosure documents to the investors and to record such conversation.⁸ Although the regulations provide rather detailed guidelines regarding the sales by financial institutions, they do not cover the general regulations of other financial products.

During 2014 and 2015, many small to medium-sized corporations in Taiwan invested in TRFs (as defined in Section I) and suffered serious losses. In response to these cases, the Financial Supervisory Committee further set forth a series of regulations on 'complex, high-risk derivative financial products' (e.g., the Regulations Governing Internal Operating Systems and Procedures for Banks Conducting Financial Derivatives Business). These

3 Li-Chung Lee, 'Analysis on financial product sale disputes and cases', *Taiwan Bar Journal*, 2009.8, at 25–27.

4 Trust Law, Section 22.

5 *id.*, Section 22.

6 Regulations Governing Offshore Structured Products, Section 9.

7 *id.*, Section 23.

8 *id.*, Section 22.

regulations provide a detailed definition on what kind of products constitute ‘complex, high-risk derivative financial products’. In general, the products with higher risk and higher leverage will more likely fall into this category, which also includes offshore structured products.⁹ Violation of the regulatory rules may lead to administrative penalty or disciplinary actions but does not necessarily invalidate the investment contract between the investor and financial institutions.¹⁰

iii Financial Consumer Protection Act Enacted in 2011

In response to the need for a more stringent regulatory scheme on a wide array of financial products, the Financial Consumer Protection Act (FCP Act) was promulgated in 2011. The FCP Act has two major regulatory purposes. It aims to provide general regulations covering more categories of financial products, and replaces the prior rules that were scattered across several different laws and regulations. Additionally, the FCP Act also sets forth a new mechanism for the financial disputes resolution procedures.

The FCP Act applies to disputes between a financial institution and a financial consumer with regard to provision of financial products and services.¹¹ The financial institutions regulated under the FCP Act do not include offshore branches and OBU's.¹² The FCP Act also specifically narrows its application to ‘financial consumer’ and excludes its application to investors, such as qualified institutional investors and persons or entities with a certain level of assets or professional investment intelligence prescribed by the competent authority from time to time.¹³

The major aspects of the FCP Act include, among others, the due care obligation of a financial institution when selling financial products or providing services; the truthfulness obligation of a financial institution when soliciting customers, promoting products and advertising; the obligation of disclosure; the obligation of evaluation of suitability of certain products to a consumer; and the responsibility of the financial institution for failure to fulfil these obligations. The FCP Act specifically provides that a financial institution should bear the duty of due care of a ‘prudent administrator’ to an investor when providing financial products or services.¹⁴

Furthermore, the Financial Ombudsman Institution was established under the FCP Act in 2012. The Financial Ombudsman Institution is the major focus of the new alternative dispute resolution mechanism. Under the new mechanism, when a financial consumer dispute arises, the financial consumer reports first to the financial institution with which the consumer has a dispute. If the solution proposed by the financial institution is not satisfactory to the consumer or if the financial institution fails to review the case, the consumer can then apply to the Financial Ombudsman Institution for an ‘ombudsman case’.¹⁵ The ombudsman case will be reviewed by an ombudsman committee.¹⁶ If the applicant accepts the decision of

9 Regulations Governing Internal Operating Systems and Procedures for Banks Conducting Financial Derivatives Business, Section 2.

10 See New Taipei District Court civil judgment 107-Zon-Su-Zi-477 (2019).

11 FCP Act, Section 5.

12 Financial Supervisory Committee Letter Jin-Guan-Fa-Zi No. 1010070279.

13 FCP Act, Section 4.

14 FCP Act, Section 7.

15 FCP Act, Section 13.

16 FCP Act, Section 17.

the ombudsman committee, the financial institution should also accept the decision if (1) it is under the amount prescribed by the competent authority, or (2) the applicant is willing to reduce the amount of the case to a figure below the prescribed amount.¹⁷ The applicant can then apply to the court for the court to approve the decision of the ombudsman committee.¹⁸ A decision approved by the court has the same legal effect as a court judgment. Since June 2019, the Taipei District Court has launched an initiative in actively referring potential financial consumer disputes to the Financial Ombudsman Institution for its review with an aim of reducing the court's caseload.¹⁹

During 2016, 2017 and 2018, the Financial Ombudsman Institution received 278, 244 and 239 applications, respectively, with regard to banks, and 38, 44 and 101 applications, respectively, with regard to securities firms.²⁰

IV SOURCES OF LITIGATION

The major source of banking litigation in Taiwan is between financial institutions and individual investors in the financial product retailing market. In the litigations regarding investment product retailing, the most common causes of action include:

- a* failure in the formation of contract;
- b* failure of a financial institution in fulfilling its duty of disclosure;
- c* failure of a financial institution in evaluating consumer suitability in investing in a specific product;
- d* failure of a financial institution in fulfilling the post-transaction duty of disclosure;
- e* violation of sales limitations;²¹ and
- f* null and void contractual clauses for being unfair to consumers.

Each of the categories is further elaborated on in this section, while (b) and (d) will be addressed together as the general duty of disclosure of financial institutions.

i Formation of contract

Entering into a contract through an agent

One of the common disputes that arises between a financial institution and an investor is whether the agent of the investor has the authority to enter into a contract on behalf of the investor. Based on banking practice in Taiwan, it is very common for an investor, as a principal, to delegate to an agent by giving the agent the investor's name chop (which has the same legal effect as a signature in Taiwan) and, sometimes, the identification document.

In a case before the Taiwan High Court in 2011, the investor delegated his spouse as an agent, by giving his spouse his name chop, to renew his deposit contract with a bank. The spouse instead purchased a structured product on behalf of the investor. The investor subsequently accepted the interest distribution of the structured product without any

17 FCP Act, Section 29.

18 FCP Act, Section 30.

19 <https://www.foi.org.tw/Article.aspx?Lang=1&Arti=3096&Role=1> (last visited on 8 September 2019).

20 <https://www.foi.org.tw/Article.aspx?Lang=1&Arti=3044&Role=1>. (last visited on 8 September 2019).

21 See Chen, Christopher Chao-hung, 'Legal Risk and Investor Protection for Retail Investment Products: An Empirical Study of Lawsuits Regarding Mutual Funds and Structured Notes in Taiwan', *Chengchi Law Review*, 2014.2, at 153.

objection.²² The issue then was whether the agent had the authority to purchase a structured product for the investor, and whether the investor recognised such authority by accepting the interest distribution. The court ruled that (1) although it is common for spouses to have each other's name chop for daily transactions in Taiwan, the renewal of a deposit and the purchase of a structured product have different investment risks in nature, and (2) the bank failed to verify with the principal regarding the agent's scope of authority, which the bank could have known had it simply contacted the investor for verification; therefore, the fact that the agent possessed a name chop was insufficient to prove that the agent had the requisite authority.²³ The fact that the spouse entered into a structured product contract without authority, therefore, rendered such contract invalid. Furthermore, even though the investor subsequently accepted the distribution payment without any objection, the investor did not explicitly recognise or promise to be bound by the spouse's action.²⁴ However, it is worth noting that the majority of the Taiwanese courts used to hold the opinion that the presentation of a name chop can establish that the agent has effective presence of authority as long as the agent also presents other forms of documentation in addition to a name chop, such as a cheque book or a receipt.²⁵ Given the above, it remains uncertain as to whether a financial institution is under the burden of further verifying the authority of an agent or can simply rely on the presentation of the name chop of the investor.

Delivery of investment documents

The investors asserted in some cases that the financial institutions failed to deliver proper documentation when entering into the investment contracts with the investors. A court held that failure of the financial institution to deliver proper documentation should be deemed non-performance of the contract.²⁶ However, it is of the view that so long as the financial institutions have duly delivered the Chinese offering circulars or disclosure documents, the fact that the original English offering circulars or disclosure documents were not delivered to the investors would not affect the formation of a contract.²⁷

Cancellation of contract

In some situations, a court will allow the investor to exercise its right to cancel the investment contract, such as in cases of fraud. In a case before the Taipei District Court, a financial institution failed to properly specify in the contract or to explain to an investor the exact items, amounts and calculations of the fees and commissions. By withholding important information such as the existence of relevant service fees payable by the investor, the financial institution was deemed to have withheld information and committed a fraud, and the investor would be entitled to the right to cancel the investment contract.²⁸

22 See Taiwan High Court civil judgment 100-Shan-Zi-202 (2011).

23 *id.*

24 *id.*

25 See Supreme Court civil judgment 44-Tai-Shan-Zi-1428 (1955). See also Supreme Court civil judgment 56-Tai-Shan-Zi-2156 (1967). See Wu, Jiin-Yu, 'The exclusion of the principles responsibility for apparent agency', *Taiwan Law Journal*, 2013.12, at 189.

26 See Taipei District Court civil judgment 98-Zon-Su-Zi-195 (2009).

27 See Taiwan High Court civil judgment 98-Shan-Yi-Zi-672 (2009).

28 See Taipei District Court civil judgment 97-Su-Zi-5116 (2009).

ii Duty of disclosure of financial institutions

Disclosure upon sales

A financial institution is generally obligated to disclose certain essential information during the process of transaction as a seller of a financial product. The duty and scope of disclosure of a financial institution upon selling financial products are generally regulated by the Financial Supervisory Commission in its various administrative orders. Nevertheless, before the promulgation of the Regulations Governing Offshore Structured Products in 2009, the specific disclosure obligation of financial institutions on the sale of structured products was less regulated than other financial products.

One of the major issues here is whether the signature of the investor on the disclosure documents is sufficient to prove that the financial institution has properly delivered such disclosure documents to the investor or fulfilled its disclosure obligation. Most courts are of the view that if the investor signed a document with sufficient disclosure of investment information, the signature itself is sufficient to prove that the financial institution has fulfilled its disclosure obligation prior to and upon the transaction, such as in Taiwan High Court civil judgment 98-Zon-Shan-Zi-288.²⁹ On the other hand, in another case, the court ruled that if the investor in fact signed the disclosure document under the instruction of the sales representative, the signature cannot serve as the evidence that the sales representative has fulfilled the financial institution's disclosure obligation.³⁰ In a more extreme case, the Taiwan High Court held that the signature alone is insufficient to prove that the financial institution has fulfilled the obligation of disclosure.³¹ However, very few courts have adopted such view.

Another common argument made by the investors is that the transaction documents are too complicated in form and in written language, and are difficult or impossible for the investors to understand. In a case before the Taiwan High Court Taichung Branch, the Court ruled that so long as the documents clearly specified the investment risks, and alerted the investors to such risks, the fact that some parts of the documents are complicated did not prevent the investor from understanding the investment risks.³² Another case before the Taiwan High Court, however, ruled that if the layouts of the transaction documents were too difficult to read and comprehend, the delivery of such document was not sufficient to prove that the financial institution had fulfilled its disclosure obligation.³³

Another issue that frequently surfaced during litigation is the scope of the duty of disclosure, namely, how much information a financial institution is obligated to disclose. In the same case before the Taiwan High Court, the financial institution that failed to disclose to the investor about the nature of the product as a structured product without principal guarantee, as well as other risks, was held by the court to have violated the financial institution's duty of disclosure to the investor.³⁴ In another case, the court held that the

29 See Taiwan High Court civil judgment 98-Zon-Shan-Zi-288 (2010).

30 See Taiwan High Court Tainan Branch civil judgment 99-Shan-Yi-Zi-157 (2011).

31 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010). The judgment was later vacated and the case was remanded by the Supreme Court on other grounds. See Supreme Court civil judgment 101-Tai-Shan-Zi-26 (2012). The parties subsequently settled the case.

32 See Taiwan High Court Taichung Branch civil judgment 99-Shan-Zi-26 (2010).

33 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010).

34 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010).

financial institution had made sufficient disclosure by providing the disclosure document that specifies the structure of the product, the annual return rate calculation and the risk alert regarding potential loss at the event of early redemption.³⁵

In addition to the general disclosure obligation as the seller, in an investment structure of specific monetary trust as mentioned in Section III.i, the financial institution, as a trustee, is also obligated to act in accordance with the due care of a 'prudent administrator'.³⁶ The courts generally held that a financial institution should bear such obligation at the time of entering into a specific monetary trust agreement. A financial institution that fails to provide sufficient disclosure when selling structured products violates the due care of a prudent administrator and should be liable for the damages suffered by the investor, as the settlor.³⁷

Continuing duty of disclosure

The financial institutions' continuing duty of disclosure, or post-transaction duty of disclosure, is usually raised in trust cases. The background of such issue is that when the 2008 financial crisis gradually unfolded, many financial institutions failed to alert the existing investors regarding the change of risks in their investments. A financial institution, as a trustee in a specific monetary trust, is generally obligated to report necessary information of the trust property to an investor, as the settlor, such as the change in value of the trust property.³⁸

Nevertheless, the courts remain split as to whether the financial institution has the general obligation of continuing disclosure of potential risks after it enters into a transaction. In the Taiwan High Court civil judgment 99-Zon-Shan-Zi-45, the court decided that the financial institution should inform the investor of the subsequent material change of the product risk.³⁹ However, another court is of the view that there are too many factors affecting the change of product risk and, therefore, the burden of notification should not be placed on the financial institution that sold the products.⁴⁰

It is worth noting that the plaintiffs in a substantial portion of cases in structured bond disputes raised the argument based on financial institutions' continuing duty of disclosure.⁴¹ Nevertheless, the FCP Act does not elaborate on or provide clarification regarding financial institutions' continuing duty of disclosure to the consumers.⁴² It is anticipated that the disputes in the future, to be resolved either through litigation or through the Financial Ombudsman Institution, will still focus on the continuing duty of disclosure, considering the lack of clear regulations and judicial guidance.

35 See Taiwan High Court Tainan Branch civil judgment 99-Jin-Shan-Yi-Zi-1 (2011).

36 Trust Law, Section 22.

37 See Taiwan High Court civil judgment 98-Shan-Yi-Zi-299 (2010).

38 Trust Law, Section 31.

39 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010).

40 See Taiwan High Court civil judgment 98-Zon-Shan-Zi-463 (2010).

41 See footnote 19, at 153–4.

42 *id.* at 154.

iii Consumer suitability

Prior to 2009, there were no laws or regulations that clearly set forth a financial institution's duty to evaluate or monitor a consumer's suitability in investment in terms of risk-bearing ability other than the financial institution's internal policies. It is usually argued by the financial institutions that they have fulfilled their duty to evaluate a consumer's suitability in investing in certain products by conducting an internal review.

In a case before the Taipei District Court, the consumer filed a claim arguing that the sales representative of the bank was aware of the fact that the target product was substantially riskier than the products suitable for the plaintiff according to the suitability test, which was evidenced by the investment plan prepared by the sales representative.⁴³ The court ruled that, even if the product at issue is not suitable for the consumer's risk-bearing ability, so long as the sales representative clearly explained the investment risks to the consumer and the consumer made his or her own decision to invest, the bank had sufficiently fulfilled its duty.

Similarly, in a case before the Taiwan High Court, the court also recognised that so long as the investor agreed to make such investment with written consent, the bank should be deemed to have fulfilled its duty to assess the investor's suitability with regard to such product.⁴⁴

In sum, the courts have generally held that the financial institutions have no obligation to actively refrain from selling financial products that are beyond a consumer's risk-bearing ability,⁴⁵ and have generally yielded to the parties' freedom of contract.

With that said, for offshore structured products, the Securities and Futures Commission has promulgated the Regulations Governing Offshore Structured Products in 2009, pursuant to which financial institutions are prohibited from entering into transactions with non-professional investors regarding certain products and products beyond the investor's risk-bearing ability.⁴⁶ It should be noted that such regulations are still different from a general obligation to refrain from a transaction, and apply only to the transactions of offshore structured products.

Additionally, the courts sometimes make *de novo* decisions in evaluating an investor's suitability. However, in such cases, the courts rarely find an investor lacking suitability. For example, in one of the cases, the court ruled that so long as an investor has prior investment experiences in the stock market or the fund market, it is generally sufficient to conclude that such investor is suitable to invest in a structured bond.⁴⁷

iv Selling restrictions

The offering circulars of structured notes generally contain selling restrictions, including a clause stating that 'the Notes may not be sold or offered in the Republic of China (ROC) and may only be offered or sold to ROC resident investors from outside Taiwan in such manner

43 See Taipei District Court civil judgment 99-Jin-Jian-Shan-Zi-5 (2010).

44 See Taiwan High Court civil judgment 98-Shan-Yi-Zi-1021 (2010).

45 Chu, Te-fang, 'Should a selling institution refrain from transaction when a customer decides to purchase the financial product above one's risk level?', *Taiwan Law Journal*, 2011.4, at 196.

46 Regulations Governing Offshore Structured Products, Section 21.

47 See Taichung District Court civil judgment 98-Su-Zi-1060 (2009).

as in compliance with Taiwan securities laws and regulations applicable to such cross-border activities'.⁴⁸ Many investors relied on such language to claim that the financial institutions violated the selling restriction of specific products.

Most of the courts are of the view that the selling restriction should be construed as forbidding the notes from being sold or offered publicly and directly to Taiwanese investors. The common practice of the banks was to sell the structured notes through a specified monetary trust, in which the financial institutions are the direct investors and theoretically the products were not sold to the Taiwanese investors. From a legal point of view, the individual investors were the settlors of these trusts, instead of the direct investors of the structured notes. As such, the financial institutions did not violate such restriction of the offering circular under the investment structure through specified monetary trusts.⁴⁹

The minority view of the courts is that, in fact, such selling structure circumvented the selling restriction and should be deemed a violation of the offering circular.⁵⁰

v Consumer protection

General consumer protection regulations

Prior to the enactment of the FCP Act in 2011, many investors raised claims pursuant to general consumer protection regulations, for example, the Consumer Protection Act and the relevant Civil Code provisions.⁵¹ The vast majority of the courts overruled the consumer protection claims, stating that the purchase of structured products is generally for investment purposes and should not be governed by the general consumer protection laws.⁵² The competent authority for consumer protection in Taiwan is also generally of the view that investment activities are highly risky and are different in nature from consumption activities. The application of general consumer protection laws should exclude structured financial product transactions.⁵³ Since the promulgation of the FCP Act, it is expected that fewer investors will rely on general consumer protection regulations in financial and banking litigations when filing their claims.

Contractual clause being 'obviously unfair'

In an array of futures option contract disputes, a number of investors argued that option contracts allowing financial institutions to force liquidating the investors' option position, without notifying the investors of the insufficiency of performance bond and giving investors the opportunity to make up for the bond, should be deemed 'obviously unfair' and therefore null and void under Article 7.2 of the FCP Act, especially in view of the unexpected significant

48 See Taipei District Court civil judgment 99-Su-Zi-438 (2010).

49 See Taiwan High Court civil judgment 99-Siao-Shan-Zi-5 (2010). See also Chen, Christopher Chao-hung, 'Structured notes fiasco in the courts: A study of relevant judgments between 2009 and 2010', *Academia Sinica Law Journal*, 2012.3, pp. 203–4.

50 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010).

51 See footnote 47, at 207–8.

52 See Taiwan High Court civil judgment 99-Siao-Shan-Zi-5 (2010) (see footnote 47, at 208).

53 Consumer Protection Committee Letter Siao-Bao-Fa-Zi No. 0980010052.

market fluctuation in a very short period. Nevertheless, the courts generally followed the principle of freedom of contract and rejected the aforementioned unfairness argument for invalidating the relevant provisions.⁵⁴

V LIABILITY

In the discussion of liability calculation, the court is generally of the view that in the event that a financial institution is held liable for failing to fulfil the obligation of disclosure, thereby leading to cancellation of the contract, or that the contract was not effectively formed, the financial institution should return the full principal amount of investment.

Some financial institutions have asserted the causation defence, stating that since the damage of the investor was in fact caused by a force majeure event, namely, the global financial crisis, there was no proximate causation between the action of the financial institution and the damage of the investor. These financial institutions have claimed that even if the financial institutions fulfilled their obligation of disclosure, the investors would still make the same investment decisions and would still suffer from the global financial crisis. The courts remain split as to whether such defence of causation stands in such cases.⁵⁵

VI OUTLOOK AND CONCLUSIONS

Since the promulgation of the FCP Act, it can be expected that a majority of the disputes between financial institutions and investors and consumers will be resolved by the Financial Ombudsman Institution in future. Unlike the cases arising from structured product disputes, many of which are resolved through traditional litigation, a certain proportion of the TRF investment disputes since 2014 and a number of futures option contract disputes in 2019 have been resolved through the mechanism of the Financial Ombudsman Institution or arbitration. While the courts have provided abundant literature regarding structured product disputes, the TRF investment and futures option contract disputes that have been resolved through the Financial Ombudsman Institution or arbitration have not been disclosed to the public, which means that, for the foreseeable future, it will be difficult to take a closer look at TRF or other investment disputes between consumers and financial institutions.

54 See New Taipei District Court civil judgment 107-Su-Zi-1954 (2019) and Taipei District Court civil judgment 107-Zon-Su-Zi-1269 (2019).

55 See Taiwan High Court civil judgment 99-Zon-Shan-Zi-45 (2010). Contra Taipei District Court civil judgment 98-Su-Zi-1684 (2010).

UNITED KINGDOM

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I OVERVIEW

Owing to a combination of London's status as a global financial centre and the perceived advantages of its court system (including its specialist Commercial Court), the UK is a key jurisdiction for litigation involving banks and other financial institutions. This is reflected in a consistently high volume of cases being brought in the UK, covering a diverse range of issues. As discussed further below, there is no reason to think that Brexit (whenever it happens) will affect this, at least in the short term.

II SIGNIFICANT RECENT CASES

i Contractual interpretation

The courts continue to provide important guidance to parties as to the correct interpretation of contractual documents.

In *Astor Management v. Atalaya Mining*,² the Court of Appeal considered whether and when a condition precedent may become futile or unnecessary, such that the courts would not insist upon its performance.

In this case, the relevant defendant's obligation to pay the claimants for an interest in an inactive mine was deferred until the defendants obtained regulatory approval and a 'senior debt facility' to restart operations. In the event, the defendants were unable to obtain a senior debt facility and instead procured the sums necessary to restart the mining operations by means of intra-group loans. The defendants argued that the obligation to pay had not yet been triggered. The claimants argued that the senior debt facility trigger had been rendered unnecessary, either by operation of the 'futility principle' or because of the parties' presumed common intention, had they contemplated obtaining finance from a source other than a senior debt facility.

While the Court of Appeal considered the term 'futility principle' to be misleading, it held that it forms part of the usual rules of contractual interpretation so that, in certain circumstances (depending on the terms of the contract), a condition precedent might, as a matter of construction and in light of subsequent events, no longer apply or cease to have effect.

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2 [2018] EWCA Civ 2407.

In the circumstances of the case, the Court of Appeal upheld the High Court's finding that the defendant's obligation to pay had not yet been triggered. There existed a 'clear commercial logic' to distinguishing between different forms of financing, and the contract drew an express distinction between the 'senior debt facility' and intra-group loans. As such, the court found that confining a trigger for payment to the provision of a senior debt facility alone was not unreasonable or nonsensical, that doing so was 'plainly' a deliberate choice and that the parties must have contemplated that an alternative source of finance might have to be used.

Issues as to the potential 'nonsensical' nature of particular contractual interpretations have also arisen as a result of the emergence of negative interest rates in recent years. In *Netherlands v. Deutsche Bank*,³ the Court of Appeal considered whether the standard form ISDA 1995 credit support annex provided for the payment of a negative rate of interest.

Under the terms of the annex, the Dutch State was required to pay interest to the bank at a rate equal to the Euro Over-Night Interest Average minus four basis points. From June 2014, this rate fell below zero for the first time and the Dutch State brought a claim against the bank requesting payment of the negative interest.

The Court of Appeal upheld the High Court's ruling⁴ that the annex did not provide for the payment of negative interest, but found that the High Court had 'adopted too simplistic an approach' in reaching that decision, as it had focused only on the absence of an express obligation to pay negative interest. The Court of Appeal found four further reasons for its construction of the annex: (1) the background materials to the standard form documents did not show that ISDA intended negative interest to be payable; (2) negative interest being payable would have created inexplicable asymmetries in the operation of the other terms of the annex; (3) one term of the annex indicated that zero was the lowest rate of interest possible; and (4) nothing in the annex indicated that negative interest was contemplated or intended by the parties.

Similarly, the approach to force majeure and exceptions clauses is likely to come under increasing scrutiny following the discontinuation of LIBOR as the benchmark rate for interest rate transactions and with Brexit on the horizon. A recent case dealing with such clauses is *Classic Maritime v. Limbungan Makmur*.⁵

In this case, the Court of Appeal had to decide whether a charterer was entitled to rely on an exceptions clause in a shipping contract that it was unable to perform due to a dam burst. The Court of Appeal rejected the argument that there is a general principle that there is no need for a party invoking a force majeure clause to show that 'but for' the supervening event, they would have been able to perform their obligations under the contract. Instead, the court emphasised that the key is the wording of the particular clause and, on the proper construction of the clause in this case, the charterer did have to show that 'but for' the dam burst it would have been able to perform its contractual obligations. At the time of writing, an application for permission to appeal is being made to the Supreme Court.

3 [2019] EWCA Civ 771.

4 [2018] EWHC 1935 (Comm).

5 [2019] EWCA Civ 1102.

ii Rectification

The Court of Appeal has comprehensively reviewed the English law of rectification in *FSHC Group Holdings v. GLAS Trust Corp.*⁶

The case concerned the rectification of two deeds by which the claimant had acceded to pre-existing security agreements in a corporate acquisition, but had also acceded to additional, onerous obligations. The claimant sought rectification of the deeds to exclude these additional obligations. The Court of Appeal held that the deeds should be rectified, following a comprehensive analysis of the law of rectification (which had been left in a state of some uncertainty following *Chartbrook v. Persimmon Homes*).⁷

There was no dispute that, in order to rectify a bilateral document such as a contract, there must be a common intention that the document was intended to mean one thing, when its terms provided for another. However, Lord Hoffmann in *Chartbrook* had indicated (*obiter*) that the test for ascertaining the mistaken intention was purely objective rather than subjective. In *FSHC*, the Court of Appeal clarified that, in assessing the common intention, rectification of a written contract would be ordered where: (1) the document fails to give effect to a prior concluded agreement; or (2) the parties had a common intention in respect of a matter that, by mistake, the contract failed accurately to record (where the mistaken intention is the subjective, rather than objective, intention of the parties).

The Court of Appeal noted that the subjective standard, which had been the generally accepted test pre-*Chartbrook*, imposes a higher barrier to successfully claiming rectification than the objective standard, but held that this was merited as it promotes the ‘certainty and security of commercial transactions’.

iii Implied duties

The courts have continued to explore the consequences of the Supreme Court’s 2015 decision in *Braganza v. BP Shipping*⁸ that, in certain circumstances, a term may be implied into a contract imposing a duty on one party to act rationally when exercising a decision-making power.

In *Lehman Brothers Finance (in liquidation) v. Klaus Tschira Stiftung*,⁹ the High Court considered the determination of loss following an ‘automatic early termination event’ in the 1992 ISDA master agreement.

Under the ISDA, the non-defaulting party is entitled to select the methodology for calculating loss. However, the court held that it was clear that such selection on the part of the non-defaulting party is subject to an implied *Braganza* duty of rationality. The non-defaulting party in this case had sought to determine its loss following Lehman Brothers’ bankruptcy by reference to the cost of uncollateralised replacement transactions. The court held that it was not rational for them to have done so, because the contracts that were governed by the ISDA had been collateralised and because the non-defaulting party would not have been able to enter into uncollateralised replacement transactions.

In *UBS v. Rose Capital Ventures*,¹⁰ however, the High Court refused to imply such a term into a mortgage deed pursuant to which receivers had been appointed by a lender

6 [2019] EWCA Civ 1361.

7 [2009] UKHL 38.

8 [2015] UKSC 17.

9 [2019] EWHC 379 (Ch).

10 [2018] EWHC 3137 (Ch).

over a property. The mortgagors argued that the lender was fettered by a duty to exercise its powers rationally. The High Court, however, emphasised that only decisions that give rise to a conflict of interest between the decision-maker and the other party to the agreement in relation to an ongoing relationship are amenable to the implication of a *Braganza* duty. Further, relational contracts, such as employment contracts, are more likely to have *Braganza* duties implied than arm's-length commercial agreements, such as mortgage documents.

Outside the realm of the *Braganza* duty, the courts have generally continued to show a reluctance to imply duties into financial contracts. In *Standish v. Royal Bank of Scotland*,¹¹ the claimants sought to argue that there was an overarching implied 'Customer Agreement', which governed the loan agreements they had entered into with the bank and that this agreement contained implied duties of good faith that prevented the bank from enforcing its express rights under the loan agreements. The claimants also argued that, following *Medforth v. Blake*,¹² the bank owed a further duty of good faith as a consequence of having security by way of a mortgage over land under the loan agreements. The High Court held that the claim was bound to fail and struck it out on the basis that there was no reason to imply the existence of the 'Customer Agreement' and that the duty implied in *Medforth* related to receivers in possession rather than mortgagees who had not exercised, or even threatened to exercise, their security.

iv Consideration

The recent case of *Simantob v. Shavleyan*¹³ illustrates that the courts are increasingly willing to find commercial agreements between parties to be based on good consideration and, therefore, valid.

In this case, the appellant and respondent agreed to a variation to a settlement agreement by which the respondent would pay a lower sum than the total then owed. The Court of Appeal accepted that the consideration for the variation was that the respondent would forbear from claiming that a clause in the settlement agreement providing that the respondent would pay the appellant US\$1,000 per day when in default was a penalty clause and so unenforceable. In fact, the court later found that the argument that the relevant clause was a penalty clause did not have a realistic prospect of success, but that was unknown and, therefore, irrelevant at the time the variation was agreed. Therefore, forbearance from bringing a claim that did not have a realistic prospect of success was enough to establish consideration, reinforcing the general proposition that consideration need not be objectively valuable so long as the parties believe at the time that it does have value.

v Guarantees

The courts have investigated unsuccessful attempts made by guarantors to escape liability under guarantees.

The guarantor in *Barclays Bank v. Price*¹⁴ argued that he had not received a valid notice of demand within the time set out in the guarantee because the only notice he had received over-stated the amount said to have been guaranteed (£55,500 rather than £55,000). The

11 [2018] EWHC 1829 (Ch).

12 [2000] Ch 86 (CA).

13 [2019] EWCA Civ 1105.

14 [2018] EWHC 2719 (Comm).

court was unimpressed by the argument, holding that the notice was sufficiently clear to a reasonable recipient and that the minor mistake in the amount demanded did not relieve the guarantor of liability to pay.

In *General Mediterranean v. Qucomhops Holdings Ltd*,¹⁵ the Court of Appeal considered the scope of the equitable duty imposed on a creditor to protect security so that, if a guarantor were to be called upon, the guarantor could assume the creditor's rights to the security in turn.

In this case, the borrower and guarantor argued that the lender, who had security over the shares and assets of the borrower's subsidiary, had breached its duty to protect this security by not taking any steps in the subsidiary's administration, rendering the security worthless or unenforceable, or both.

The court held that, while the scope of the duty was broader than a mere duty to perfect the security, it was not an absolute duty to ensure that the guarantor could have recourse to the security. While the creditor may be required to go to some limited expense in protecting the security, it was not required to incur any sizeable expenditure or run any significant risk in so doing.

On the facts, the court dismissed the appeal on the grounds that it was unclear what steps the lender could have taken, nor how its failure to take such steps could have resulted in the negation of the security.

vi Third-party rights

In *Chudley v. Clydesdale Bank*,¹⁶ the Court of Appeal held that under the Contracts (Rights of Third Parties) Act 1999, individual investors could enforce a contract between the bank and an investment company for the holding of investors' money.

The investors had invested money in a fraudulent scheme. However, they subsequently discovered a letter of instruction to the bank from one of the vehicles of the fraud (which had been accepted by the bank) requiring that a segregated client account be opened and that the monies paid into that account were to be paid out only on receipt of a letter of undertaking. No such account had been opened nor had any letter of undertaking been received. The question was whether the investors could take the benefit of the letter of instruction and rely on the bank's breach of that letter.

The Court of Appeal held that they could do so, pursuant to the 1999 Act. The investors were clearly identified as being part of the class of those investing in the fraudulent scheme, and the purpose of the letter of instruction was to benefit those investors by ensuring their monies were held in a segregated account subject to conditions of payment. Therefore, the letter of instruction was enforceable by the investors against the bank even though the investors had not known of its existence at the time.

III RECENT LEGISLATIVE DEVELOPMENTS

Brexit has been dominating the parliamentary agenda over the previous year, with the result that there have been few significant domestic legislative developments.

In terms of wider EU law, on 1 January 2019, the EU Securitisation Regulation came into effect, setting EU-wide rules aimed at significantly reforming the EU securitisation

15 [2018] EWCA Civ 2416.

16 [2019] EWCA Civ 344.

market. The Regulation, which in general applies only to securitisations issued on or after 1 January 2019, repeals the patchwork of existing legislation applicable to specific sectors (such as banks, insurers and fund managers) and consolidates these provisions into a new, harmonised securitisation regime applicable across all sectors. The Regulation also introduces the concept of ‘simple, transparent and standardised’ securitisation, which is subject to a lighter regulatory regime than other securitisations.

IV CHANGES TO COURT PROCEDURE

i Disclosure pilot scheme

In response to concerns over the cost, scale and complexity of disclosure in High Court litigation, for two years from 1 January 2019, a disclosure pilot scheme is running in the Business and Property Courts (including the Commercial Court) with the aim of encouraging a more proportionate approach. The pilot will give practitioners the opportunity to provide feedback on how the changes are working before they become permanent.

Key aspects include:

- a* the codification of the parties’ duties to preserve documents, including a requirement to send hold notices to relevant employees (both current and former), agents and other relevant third parties;
- b* the introduction of an ongoing duty to disclose known adverse documents (unless they are privileged) regardless of any disclosure order made;
- c* the requirement that, at the same time as serving their statements of case, parties provide an ‘initial disclosure’ of the key documents they have relied on and key documents that are necessary for the other party to understand the case they have to meet (though this is not required if the ‘initial disclosure’ passes a threshold number of pages or documents, which is likely to be the case in most large or complex claims);
- d* the requirement for the parties to identify a list of ‘issues for disclosure’, against each of which the parties and the court are to consider one of five models of ‘extended disclosure’ (replacing the previous default position of the courts generally ordering ‘standard disclosure’);
- e* the introduction of an express duty to consider the use of technology to conduct cost-effective disclosure; and
- f* the introduction of an express duty to avoid providing documents that have no relevance to proceedings (i.e., ‘document dumping’).

ii Witness Evidence Working Group

As with disclosure, concerns have been raised in relation to oral evidence at trials, with the judiciary increasingly questioning whether, in commercial disputes, the benefits are proportionate to the time and cost incurred. Witness statements have become in many cases lengthy recitations of the documents, prepared by the legal team rather than concise statements of a witness’s oral evidence in their own words; similarly, cross-examination frequently consists of a series of closed questions focusing more on the credibility of the witnesses than on the development of the factual story. In circumstances where the facts are increasingly available from the documentary evidence and research shows that the evidence of even truthful witnesses may still be fallible, certain members of the judiciary have recommended placing little reliance on witness evidence.

In light of this, the Business and Property Courts have established a Witness Evidence Working Group to review the current rules. In late 2018, the Working Group circulated a survey to court users seeking views on proposals to abolish witness statements and return to oral examination-in-chief, to abandon the process of witness evidence altogether in favour of pre-trial US-style depositions, to limit witness evidence to those allegations that cannot be proven by documentary evidence, or, most controversially, to lift privilege in the production of witness statements. The Working Group is yet to publish a response to the survey.

V INTERIM MEASURES

i Freezing orders and cyber fraud

In *CMOC v. Persons Unknown*,¹⁷ the High Court agreed for the first time to grant worldwide freezing orders against ‘persons unknown’ in a cyber fraud case where unknown hackers accessed a company’s emails and misdirected its monies.

In a judgment¹⁸ given following the trial of the fraud claims, the same judge confirmed that the court’s general power to grant injunctions against ‘persons unknown’ extends to freezing injunctions, especially where the goals of such injunctions are to: (1) notify banks of the fraud so that they will freeze accounts; (2) obtain information from those banks to support the claims being advanced; and (3) increase the possibility of the claimant eventually recovering the sums of which it has been defrauded.

Given the increasing complexity of cyber fraud and the difficulties involved in identifying the perpetrators, these freezing orders against ‘persons unknown’ may be expected to become increasingly common.

ii Without notice applications and the duty of full and frank disclosure

A series of cases have shown the importance when seeking freezing injunctions or permission to serve out of the jurisdiction of carefully fulfilling the duty of full and frank disclosure at the ‘without notice’ stage, failing which the courts are ready to set aside the orders.

In *PJSC Commercial Bank Privatbank v. Kolomoisky*,¹⁹ the High Court set aside a worldwide freezing order on the basis that the claimant had failed to explain material facts to the judge at the without notice hearing, particularly the fact that a very substantial proportion of the sums paid away by the bank had been repaid, and the fact that the English companies against which the claims were advanced and which were being used as ‘anchor defendants’ had a much less central role in the alleged fraud than appeared from the material presented to the judge at the without notice stage. At the time of writing this case is on appeal to the Court of Appeal.

A similar outcome occurred in *The Libyan Investment Authority v. JP Morgan Markets*,²⁰ where the claimant sovereign wealth fund had obtained permission to serve out of the jurisdiction on parties alleged to have been instrumental in a fraudulent and corrupt scheme to procure a high value trade between the sovereign wealth fund and Bear Stearns (now JP Morgan Markets). The defendants alleged that the claimant had failed to comply with its

17 [2017] EWHC 3599 (Comm).

18 [2018] EWHC 2230 (Comm).

19 [2018] EWHC 3308 (Ch).

20 [2019] EWHC 1452 (Comm).

duty of full and frank disclosure at the without notice stage. The judge agreed, considering that the claimant had failed to draw the court's attention to the fact that the defendants had more than credible arguments that the claim was time-barred.

VI PRIVILEGE AND PROFESSIONAL SECRECY

It is well-established in English law that litigation privilege protects not just communications between lawyers and clients, but also communications between clients or lawyers and third parties created for the dominant purpose of litigation that is reasonably in contemplation. On that basis, in internal investigations, litigation privilege has been relied on to protect communications with employees (including notes of interviews) who would themselves fall outside the strict definition of the 'client' for the purposes of asserting legal advice privilege.

As noted in the second edition of this publication, following the 2017 decision of the High Court in *SFO v. ENRC*,²¹ there had been considerable debate over the limits of litigation privilege in the investigations context. In particular, the High Court had suggested that in the context of potential criminal proceedings, litigation might not be 'in reasonable contemplation' until the time of a decision to prosecute (which usually occurs late in the process once an investigation is largely complete). The effect, therefore, was that a significant body of communications created during an investigation that had previously been assumed to be covered by litigation privilege may now have been disclosable.

The Court of Appeal has now overturned that decision.²² The court held that the whole subtext of the relationship between the SFO and ENRC was the possibility, if not the likelihood, of criminal prosecution if the self-reporting process did not result in a civil settlement. In those circumstances, the distinction between civil and criminal proceedings was illusory. Further, the documents brought into existence by ENRC's lawyers and accountants, as well as the interviews of ENRC's employees conducted by its lawyers, were created for the purposes of investigating the allegations and so were brought into existence for the dominant purpose of litigation. As such, these materials were properly covered by litigation privilege.

There remain, however, complexities in this area. In *Byers v. Samba Financial Group*,²³ the High Court assessed whether, in the context of disclosure, correspondence between the defendant bank and its Saudi Arabian regulator was covered by litigation privilege. The question was whether the correspondence was created with the dominant purpose of information or advice in conduct of the litigation. The court found that where such correspondence was simply a request for approval or to update the regulator, the correspondence was not subject to litigation privilege. Where, however, its purpose was to seek advice from the regulator on how the company was to defend itself in the proceedings, it would be covered by litigation privilege. The decision is subject to an appeal at the time of writing.

21 [2017] EWHC 1017 (QB).

22 [2018] EWCA Civ 2006.

23 [2019] EWHC 951 (Ch).

VII JURISDICTION AND CONFLICTS OF LAW

Two cases have recently examined the English courts' stance on competing jurisdiction clauses where transactions are governed by ISDA master agreements.

In *Deutsche Bank v. Comune di Savona*,²⁴ the bank and an Italian local authority entered into a wide-ranging advisory agreement expressly subject to the exclusive jurisdiction of the Italian courts, and then entered into two swaps agreements under an ISDA master agreement expressly subject to the exclusive jurisdiction of the English courts. The Court of Appeal held that the swaps agreements were self-contained contracts to be interpreted on their own regardless of the prior advisory relationship, and so disputes arising in connection with those swaps, including whether the local authority had relied on advice from the bank when entering into them, fell to be determined by the English courts.

A similar fact-pattern was reviewed by the Court of Appeal in *BNP Paribas v. Trattamento Rifiuti Metropolitani*.²⁵ Here, the bank and the Italian company entered into a syndicated financing agreement, with the bank as lead bank, containing an exclusive Italian jurisdiction clause. The bank and the company then entered a swaps agreement, incorporating an ISDA master agreement containing an exclusive English jurisdiction clause. Even though the ISDA master agreement contained a clause stating that, in the event of conflict, the financing agreement should prevail, the court held that the relevant jurisdiction for claims of declaratory relief in relation to the swaps agreement was England since the financing agreement envisaged the parties entering into hedging agreements subject to ISDA master agreements with English (or New York) jurisdiction clauses, and so, taking a broad commercial view of the parties' relationship, where the dispute naturally arose from the swaps agreement, the English court would accept jurisdiction.

These cases reflect an established chain of authority that holds that, in complex transactions with competing jurisdiction clauses, the presumption is that the parties must have intended that the jurisdiction clause closest to the 'commercial centre of the transaction' would apply.²⁶

VIII SOURCES OF LITIGATION

i Mis-selling claims

While mis-selling claims against banks in relation to complex transactions or financial instruments will continue to generate litigation, the scope of such litigation has been much reduced since the Court of Appeal's 2018 decision in *PAG v. RBS*²⁷ that, in the absence of an advisory relationship, a financial institution will owe no duty to explain the effect of a proposed transaction. The Supreme Court has now refused permission for a further appeal.

A key example of the court's unwillingness to find that a bank's customer was misled by the bank in respect of alleged manipulation of inter-bank offered rates is *Marme Inversiones 2007 v. Natwest Markets*.²⁸ There, the High Court applied the test for implied misrepresentation set down in *PAG v. RBS* in the course of examining alleged misrepresentations in respect

24 [2018] EWCA Civ 1740.

25 [2019] EWCA Civ 768.

26 See, for instance, *UBS v. HSH Nordbank* [2009] EWCA Civ 585.

27 [2018] EWCA Civ 355.

28 [2019] EWHC 366 (Comm).

of EURIBOR. The court found that the representations relied upon by the claimant were too vague and imprecise. Further, even if the representations had been made, the claimant had given no real thought to how EURIBOR was set and would have been unaware of the representations themselves, so would not have relied on them and would not have altered its conduct, meaning that no loss had been suffered in any event.

ii Multilateral Interchange Fee claims

Claims arising from historical Multilateral Interchange Fee (MIF)s charged by Mastercard and Visa continue to be a significant source of litigation. The largest potential claim is an application issued in 2016 for permission to bring an opt-out consumer class action against Mastercard under the UK's new competition collective proceedings regime. The proposed class covers all UK-resident individuals over 16 who purchased goods or services from UK businesses that accepted Mastercard between 1992 and 2008 (estimated to be 46.2 million individuals); the applicant is seeking damages of approximately £14 billion including interest.

In 2017, the Competition Appeal Tribunal had refused the application on the basis that the applicant had not established an effective methodology (nor the availability of data) for the calculation of pass-on of the overcharge to the class-members, nor had they established a plausible means of distributing an aggregate damages award so as to reflect the loss suffered by individual claimants.²⁹ On appeal, however, the Court of Appeal found that the Competition Appeal Tribunal required too high a standard in relation to the evidence required and erred in requiring that the distribution be carried out by some means that corresponds to individual loss, finding that the application should instead be remitted back to the Competition Appeal Tribunal for re-hearing.³⁰

Mastercard has subsequently been granted permission to appeal to the Supreme Court. Practitioners are awaiting the outcome of this case with interest. It is expected to play a key role not only in clarifying the operation of the new collective proceedings regime, but also in energising or curtailing the growth of competition class actions in the UK.

iii Foreign exchange claims

Similarly, the European Commission investigation into manipulation of the foreign exchange (FX) market, culminating in an infringement finding against five banks in May 2019, looks likely to be the source of significant litigation. To date, claims have been filed against a number of banks in respect of losses suffered by specific institutional investors and, as with the MIF claims above, an application for an opt-out follow-on collective proceedings order has been filed with the Competition Appeal Tribunal with a proposed class covering investors participating in institutional foreign exchange trading. The claim is estimated to be worth more than £1 billion.

29 [2017] CAT 16.

30 [2019] EWCA Civ 674.

IX EXCLUSION OF LIABILITY

It is well established that a bank will be liable to its customer in negligence if it makes a payment in circumstances where it has reasonable grounds for believing that the request is an attempt to misappropriate the funds of its customer – referred to as a *Quincecare* duty.³¹

In *Nigeria v. JP Morgan Chase Bank*,³² the High Court considered whether this *Quincecare* duty may be defeated by entire agreement, exclusion and indemnity clauses in the bank mandate. The court held that as the *Quincecare* duty was a valuable and important duty, it required particularly clear wording to be excluded, which was not satisfied by the standard-form wording in the bank mandate. Shortly before publication, the Court of Appeal affirmed this decision.³³

The question of the impact of the *Quincecare* duty is likely to come under increased scrutiny by the courts following the 2017 case of *Singularis Holdings v. Daiwa Capital Markets Europe*³⁴ where, as discussed more fully in the First and Second Editions of this Review, the court for the first time found a bank liable for breach of the duty. At the time of writing, the case is on appeal to the Supreme Court (though the appeal, as argued, relates to defences raised by the bank, rather than the existence of the duty).

X OUTLOOK AND CONCLUSIONS

i Brexit

At the time of writing, the negotiation of the UK's withdrawal from the EU remains ongoing, with the default position being exit without a deal on 31 October 2019. This has caused significant uncertainty in the UK legal community, with key concerns remaining as to choice of jurisdiction, recognition and enforcement of judgments, and the potential absence of any transitional period to implement new domestic legislation.

Nevertheless, as recently emphasised by the Chancellor of the High Court in a speech to European colleagues, the fundamental strengths of the English legal system remain, including legal certainty, well-established procedure, the flexibility of the common law to adapt rapidly, and the presence of a highly skilled judiciary. In a reflection of this, the available data does not suggest that the volume of cases being brought in the UK courts has yet been affected by Brexit.

ii Continued reform of court procedure

In any event, the economic and legal uncertainty fostered by Brexit may be expected to act as an incentive for continued reform of court procedure in the UK. As discussed in Section IV, initiatives such as the disclosure pilot scheme and Witness Evidence Working Group are already focusing on finding ways to reduce the cost and complexity, and increase the efficiency, of court proceedings in the UK. Further, the specialist Financial List, which was introduced in 2015 in the Business and Property Courts, continues to provide a useful forum for particularly valuable, technical or significant disputes related to financial markets, ensuring that they are heard by judges with relevant experience or expertise.

31 Derived from *Barclays Bank plc v. Quincecare Ltd* [1992] 4 All ER 363 (Comm).

32 [2019] EWHC 347 (Comm).

33 [2019] EWCA Civ 1641.

34 [2017] EWHC 257 (Ch).

This trend towards procedural flexibility may be expected to continue in line with the judiciary's focus on ensuring that the UK remains an attractive jurisdiction for resolving international commercial disputes.

iii Cases to watch

As set out in Section VIII, significant attention will be focused on the outcome of Mastercard's appeal to the Supreme Court in relation to the application for the collective proceedings order against it. If the Supreme Court affirms the Court of Appeal's claimant-friendly approach, the burden for bringing collective proceedings will have been significantly lowered with a consequential increase in the potential exposure for banks, financial institutions and other parties at risk of competition infringement findings.

UNITED STATES

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I OVERVIEW

The US continues to be an active forum for banking-related litigation. Financial institutions continue to experience litigation exposure to financial product-related suits, as well as antitrust and other claims arising out of an active litigation landscape. Litigation derived from international sanctions violations has also been on the rise, though a ruling that claims against foreign corporations, including foreign banks, cannot proceed under the Alien Tort Statute may hinder future claims of this kind by private civil plaintiffs. Banks must continue to be attuned to privilege laws in multiple jurisdictions to guard against the potential disclosure of confidential information in private litigation in the US. In addition, the adoption of the General Data Protection Regulation in the EU, and its equivalent in the UK, raise questions regarding the protection of data located abroad in US litigation.

Though much of the litigation arising out of the foreign exchange (FX) market regulatory investigations has settled, including antitrust class actions, new suits have been filed based on investigations in other markets. Courts have heightened the requirements for actions to proceed on a class-wide basis by implying additional requirements into the class certification rule, which curbs class actions and the accompanying settlement pressures. In addition, both Congress and the Supreme Court continue to support the validity and broad scope of arbitration agreements, including by permitting the use of class action waivers in arbitration agreements, which continues to be a method widely used by financial institutions to control dispute resolution arising out of consumer contracts and limit exposure to costly class actions. The government has also taken actions to begin a rollback of rules promulgated pursuant to the Dodd-Frank Wall Street Reforms Act (Dodd-Frank), including by amending Dodd-Frank to narrow its application and proposing various rule changes.

II SIGNIFICANT RECENT CASES

Two significant decisions have issued in the application of the Anti-Terrorism Act, as amended in 2016 (the ATA), which provides both primary and secondary liability in civil cases brought by private US persons injured by a terrorist act. First, the Ninth Circuit Court of Appeals interpreted primary liability under the ATA to adopt the traditional element of proximate causation, which requires that the services provided by the financial institution were a substantial factor in causing the terrorist act, and that the terrorist act should have

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been reasonably foreseeable to the financial institution.² Second, the Second Circuit Court of Appeals, the federal court that hears the majority of banking litigation cases, recently reaffirmed that secondary liability requires defendants be at least ‘generally aware’ that the banking services provided were directly assisting foreign terrorist organisations.³

III RECENT LEGISLATIVE DEVELOPMENTS

i The federal system

The United States legal system is divided into federal and state jurisdictions. The federal government consists of three branches: legislative, executive, and judicial. The majority of regulators that oversee financial matters (e.g., the Department of Justice, the Federal Reserve, and the Securities and Exchange Commission (SEC)) are parts of the federal government, broadly defined, although states also have their own bank regulatory regimes. The federal government and the state governments are considered to be separate sovereignties and, accordingly, have concurrent legal regimes. Each of the 50 states has an independent court system and its own body of law. As a result, banks are subject to both federal and state law, which apply with equal force, but may differ in their requirements, with federal law taking precedence where applicable. Some states take a particularly active role in bank regulation; for example, as would be expected, New York and its Department of Financial Services maintain a dynamic presence in US banking regulation, and have done so during the decrease in activity by federal agencies.

A recent ruling has the potential to jeopardise the ongoing viability of the Consumer Financial Protection Bureau (CFPB), which is a federal agency overseeing banks, among others, to ensure fairness and transparency for mortgages, credit cards, and other consumer financial products and services. In a non-banking lawsuit brought by the CFPB and the Attorney General of the State of New York, the district court found the CFPB unconstitutional.⁴ The court held that the structure of the CFPB violates the separation of powers between the executive, legislative, and judicial branches set out in the constitution because it is an independent agency with substantial executive power headed by a single US director who is removable by the President only for cause.⁵ That decision, which is subject to appeal, is contrary to an earlier decision of a prominent court of appeals and is likely to be decided by another court of appeals in the near future.⁶ The Supreme Court has, for the time being, declined to address the issue but is likely to once a split among the courts of appeals has become entrenched.⁷

2 See, e.g., *Fields v. Twitter, Inc.*, 881 F3d 739, 744-46 (9th Circuit 2018); *Rothstein v. UBS AG*, 708 F3d 82, 97 (2d Circuit 2013).

3 *Siegel v. HSBC N Am Holdings, Inc.*, No. 18-2540-CV, 2019 WL 3719976, at *6 (2d Circuit 8 August 2019); Weiss, 2019 WL 1441118, at *11; See, e.g., *O’Sullivan v. Deutsche Bank AG*, No. 17-CIV-8709, 2018 WL 1989585, at *6 (SDNY 26 April 2018); *Taamneh v. Twitter, Inc.*, 343 F. Supp. 3d 904, 917 (ND Cal 2018).

4 *Consumer Fin Prot Bureau v. RD Legal Funding, LLC*, 332 F Supp 3d 729, 783-85 (SDNY 2018).

5 *id.*

6 *PHH Corp v. CFPB*, 881 F3d 75 (DC Circuit 2018) (*en banc*) (reversing panel decision holding CFPB unconstitutional); see also *CFPB v. All Am Check Cashing Inc et al*, 18-60302 (5th Circuit 2018) (granting interlocutory appeal to decide constitutionality of CFPB).

7 *State Nat’l Bank of Big Spring v. Mnuchin*, 139 S Ct 916 (2019) (denying petition for writ of certiorari).

ii Recent legislation

Significant banking legislation, the Economic Growth, Regulatory Relief, and Consumer Protection Act (S.2155), was enacted by the Trump administration in 2018 and revises Dodd-Frank and the Consumer Protection Act of 2010 (CPA) in an effort to reduce the burden on small to medium sized banks and bank holding companies. It limits the application of Dodd-Frank's enhanced prudential standards to banks with \$250 billion or more in global assets as compared with the current \$50 billion threshold, and by exempting holding companies with \$10 billion or less in global assets from certain requirements and rules, including the Volcker Rule which, among other things, prohibits banks from making certain investments with their own funds and from making certain speculative investments. The impact of S.2155 will depend heavily on its implementation by regulators.

Following the passage of S.2155, on 20 August 2019, Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) announced amendments to the Volcker Rule that narrow and simplify the proprietary trading prohibition and significantly reduce compliance burdens, including by limiting significant compliance programme requirements to institutions with the largest trading operations and exempting instruments held for 60 days or longer. Additionally, the Final Rule will expand the exception for trading outside of the United States to limit impact on foreign activity of foreign banks.⁸ Separately, on 8 April 2019, the Federal Reserve Board, FDIC, and OCC released two proposals specifically addressed toward tailoring the application of enhanced prudential standards to large foreign banking organisations by dividing such foreign banking organisations into four separate categories based on the level of risk associated with the organisation, which then permits the US to regulate the organisations accordingly. The extent to which these proposed changes to the regulations will be implemented in light of industry comments remains to be determined.

At the state level, little legislative activity has occurred recently, which is generally attributable to the secondary role of the states in banking regulation. The State of New York, however, has implemented new cybersecurity regulations that apply to companies operating under New York banking, insurance or financial services laws. Those regulations generally require the development of cybersecurity programs and policies, limitations on access to data systems, use of qualified personnel, preparation of an incident response plan, and notification of the New York State Department of Financial Services within 72 hours of a cybersecurity event. These requirements, and the increase in cybersecurity attacks generally, will likely result in increased litigation in this area for banks that experience such attacks. Cybersecurity attacks can also result in banks becoming plaintiffs when the banks' customers' information is compromised as a result of cybersecurity attacks on third parties. The success of such suits, however, is highly dependent on variations in the laws of the many states and the existing contracts under which a bank may have a right of action.⁹

8 'Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds' (20 August 2019), <https://www.fdic.gov/news/board/2019/2019-08-20-noticedis-a-fr.pdf>.

9 Compare *Cnty Bank of Trenton v. Schnuk Markets, Inc*, 887 F3d 803 (7th Circuit 2018) (upholding dismissal of claims by financial institution against store from which data was breached because of economic loss doctrine precluding recovery outside contractual relationships) and *First Choice Fed Credit Union v. Wendy's Co*, No. CV 16-506, 2017 WL 1190500, at *1 (WD Pa 31 March 2017) (upholding decision by Magistrate Judge denying Wendy's motion to dismiss claims brought by banks for breach of customers'

IV CHANGES TO COURT PROCEDURE

Financial institutions will frequently encounter litigation in the form of a class action brought on behalf of numerous plaintiffs. Under Federal Rule of Civil Procedure Rule 23, which governs class actions in federal court, plaintiffs must affirmatively demonstrate several requirements: numerosity of parties, commonality of questions of law or fact, typicality of the representative plaintiffs' claims relative to the class, and fair and adequate representation of the class. In addition, certain courts have interpreted Rule 23 to contain an implicit 'ascertainability' requirement, meaning that the members of the proposed class must be readily identifiable based on objective criteria that will not require individual determination.¹⁰ Such requirements provide an additional, useful basis for banks to defeat plaintiffs' use of a class action in instances where the individuals allegedly harmed, or the harm itself, is difficult to define. Further, pursuant to a recent Supreme Court ruling, once an initial proposed class action is defeated there may be grounds for defending subsequent class actions on the basis of the statute of limitations, as pending class certification does not necessarily protect subsequent class actions asserted by putative class members, or even named class members, from expiring limitations periods.¹¹

In future, class actions may become increasingly rare in cases between parties with contractual relationships as such contracts often include mandatory arbitration provisions without providing for class actions or class-based arbitration. The enforceability of provisions in arbitration agreements explicitly precluding class claims has been upheld by the Supreme Court and in 2018 Congress nullified a CFPB rule prohibiting class action waivers.¹² Further, the Supreme Court recently held that class-based arbitration is not permitted where the arbitration agreement is silent on the matter, or merely ambiguous as to whether class-wide arbitration is permitted.¹³ We can therefore expect to see continuing use of arbitration agreements with class action waivers to block class actions in US courts.

V INTERIM MEASURES

Banks will frequently encounter asset-freezing orders – injunctions or attachment orders requiring restraint of assets held by the bank – in connection with litigation to which the bank is not a party. There is variation among US jurisdictions as to the extent of a financial institution's obligation to freeze assets held outside the US in response to such orders. In New York, for example, the 'separate entity rule' allows New York courts to freeze only those assets located within the US.¹⁴

credit and debit card information) with *In re Arby's Rest Grp Inc Litig*, No. 1:17-CV-0514-AT, 2018 WL 2128441, at *14 (ND Ga 5 March 2018) (declining to dismiss claims based on the economic loss doctrine in suit by financial institutions under Georgia law against restaurant from which data was breached).

10 See, e.g., *In re Petrobras Secs*, 862 F3d 250, 264-65 (2d Circuit 2017); *Sandusky Wellness Ctr, LLC v. Medtox Sci, Inc*, 821 F3d 992, 995 (8th Circuit 2016); but see *Mullins v. Direct Digital, LLC*, 795 F3d 654, 658 (7th Circuit 2015) (rejecting ascertainability requirement).

11 *China Agritech, Inc v. Resh*, 138 S Ct 1800, 1804 (2018).

12 See, e.g., *Epic Sys Corp v. Lewis*, 138 S Ct 1612, 1632 (2018); *DIRECTV, Inc v. Imburgia*, 136 S Ct 463 (2015); *Am Express Co v. Italian Colors Rest*, 570 US 228 (2013); *AT&T Mobility LLC v Concepcion*, 563 US 333 (2011).

13 See *Lamps Plus, Inc v. Varela*, 139 S Ct 1407 (2019); *Epic Sys Corp v. Lewis*, 138 S Ct 1612, 1632 (2018).

14 *Motorola Credit Corp v. Standard Chartered Bank*, 24 NY3d 149, 156 (2014).

With regard to post-judgment execution on assets or injunctions in aid of such execution, recent changes to personal jurisdiction law, discussed in greater detail in Section III, *supra*, have limited the power of US courts to enforce such orders against non-parties for assets located outside the forum. Following the *Daimler* decision,¹⁵ ‘a district court can enforce an injunction against a nonparty [bank] only if it has personal jurisdiction over that nonparty, which will generally not exist over foreign banks with respect to their non-US activities.’¹⁶ Even if personal jurisdiction exists, financial institutions may still raise principles of international comity as a further defence, particularly when the bank is a nonparty that would not expect US law to apply.¹⁷ That defence, however, has become increasingly limited as courts have held that it requires compliance with both nations’ law be strictly impossible.¹⁸

VI PRIVILEGE AND PROFESSIONAL SECRECY

i Bank examination privilege

In the US, banks benefit from a privilege protection for confidential information shared with their bank regulators, known as the bank examination privilege. Banks are heavily regulated by a patchwork of state and federal agencies, which frequently obtain confidential information related to a bank’s operations and performance in the exercise of their oversight duties. Such confidential information is often sought in litigation by third parties against banks, and the bank examination privilege may be used to protect this information from disclosure.

The bank examination privilege belongs to the regulatory agency. It is up to the bank and its outside counsel to preserve the privilege when responding to subpoenas or discovery requests for documents covered by the privilege. Documents covered by the privilege should not be produced in parallel private litigation or to requests from non-banking agencies, unless the privilege has been waived by the applicable regulator or production has been ordered by a court following its review. In practice, outside counsel should notify the regulator of the request, and typically file under seal documents over which the privilege is being asserted for in camera court review. Outside counsel should be attuned to the bank examination privilege to minimise the risk of unnecessary disclosure, particularly in the current environment where banks are investigated and sued in myriad forums by a multitude of agencies and private litigants.

ii Attorney–client privilege

Privilege over documents prepared during internal investigations

In general, attorney–client privilege applies only to communications made in confidence for the purpose of obtaining legal advice. US courts have conducted fact-intensive analyses to determine whether the privilege applies. In at least one prominent US jurisdiction, the court has made clear that the correct test was whether ‘one of the significant purposes’ of

15 *Daimler AG v. Bauman*, 134 SCt 746 (2014).

16 *Gucci Am, Inc v. Weixing Li*, 768 F3d 122, 134 (2d Circuit 2014) (emphasis added).

17 *Id.* at 138–42; see also *Peterson v. Islamic Republic of Iran*, 876 F3d 63, 94 No. 23 (2d Circuit 2017).

18 See *In re Bernard L. Madoff Inv Sec LLC*, 917 F3d 85, 102 (2d Circuit 2019) (reversing dismissal on international comity where conflict between nations’ insolvency laws did not render compliance with both nations’ laws ‘impossible’); see also *B & M Kingstone, LLC v. Mega Int’l Commercial Bank Co*, 15 NYS3d 318, 324 (NY App Div 2015) (refusing to quash subpoena on comity grounds where party failed to show that it would face liability in its home country if required to comply with subpoena).

the investigation was to obtain or provide legal advice.¹⁹ Application of that standard to company responses to data breaches, however, has reached inconsistent results as to whether a subsequent investigation by a forensic firm produces privileged information.²⁰ In this context, a bank's counsel should ensure not only that internal investigations are led by attorneys and have adequate attorney oversight but that the attorneys are acting solely for the client rather than as an agent of the government.²¹ In addition, careful attention should be given to which documents are provided to counsel in connection with requests for legal advice as such documents are not categorically protected as privileged, even though the request for legal advice may be.²²

In addition, given the tendency of regulators, beyond the bank's primary supervisor, to vie with one another to take the lead in investigating potential wrongdoing, care should be taken when disclosing to regulators documents prepared by counsel during an internal investigation. At least one court has recently held that 'oral downloads' of information given by the law firm to the Securities and Exchange Commission are not privileged and therefore must be turned over from the company to former employees of the company.²³ Furthermore, when documents are disclosed to a regulator (e.g., the Department of Justice) that is not the bank's supervisory regulator, the bank examination privilege does not apply and such disclosure would constitute waiver of privilege for private litigation and other regulatory investigations.

Cross-border considerations

Maintaining attorney–client privilege becomes an even thornier issue when cross-border considerations enter the picture. Given the global nature of most banks, this issue will increasingly be encountered in banking litigation practice. Foreign courts may refuse to apply US privilege law, subjecting documents created during an internal investigation to disclosure to private litigants.²⁴ Moreover, in litigation in the US, depending on which country's privilege laws apply following a choice of law analysis, there is a possibility that attorney–client privilege may not attach at all.²⁵ Given the global scope of many investigations and litigations, counsel should be attuned to the increased risk of exposure to disclosure of documents created during an investigation, both in litigation proceedings in the US and abroad.

19 *In re Kellogg Brown & Root, Inc.*, 756 F3d 754, 758-59 (DC Circuit 2014).

20 Compare *In re Premera Blue Cross Customer Data Sec Breach Litig.*, No. 3:15-md-2633-SI, 2017 WL 4857596 (D Or 27 October 2017) (finding that documents prepared by forensic firm after data breach were not privileged), with *In re Experian Data Breach Litig.*, No. 8:15-cv-01592, 2017 WL 4325583 (CD Cal 18 May 2017) (finding similar documents were prepared in anticipation of litigation and therefore protected work product).

21 *United States v. Matthew Connolly and Gavin Campbell Black*, No. 16 CR. 0370 (CM), 2019 WL 2120523, at *10 (SDNY 2 May 2019) (denying motion for relief because information obtained in Black's forced interview was not used in obtaining criminal conviction).

22 *ACE Sec Corp v. DB Structured Prod, Inc.*, 55 Misc 3d 544, 557, 40 NYS3d 723, 733 (NY Sup. 2016) (citing *FHFA v. HSBC N Am Holdings, Inc.*, 2014 WL 1327952, at *2 (SDNY 3 April 2014)).

23 *United States Sec & Exch Comm'n v. Herrera*, No. 17-20301-CIV, 2017 WL 6041750, at *1 (SD Fla 5 December 2017).

24 See *RBS Rights Issue Litigation* [2016] EWHC 3161 (Ch).

25 See e.g., *Wultz v. Bank of China Ltd.*, 979 F Supp 2d 479 (SDNY), on reconsideration in part, No. 11 Civ 1266(SAS), 2013 WL 6098484 (SDNY 20 November 2013) (applying Chinese privilege law, which essentially leaves materials unprotected, to all communications except those related to US legal matters).

iii Subpoenas

International reach

Traditionally, warrants and subpoenas issued by the US government carry territorial limitations and, thus, do not extend to information located outside the United States.²⁶ Based on that traditional rule, the Second Circuit quashed a government warrant seeking customer emails held by a US company overseas on servers in Ireland. The government appealed that decision to the Supreme Court, which heard oral arguments on the matter in February 2018. Shortly thereafter, however, Congress passed the CLOUD Act, which explicitly declares that a provider of electronic communication service or remote computing service is required to comply with the provisions of the Act, regardless of whether the records are located outside of the United States.²⁷ Given the focus of the law on providers of communication or computing services, it is unclear at the time of writing how the extraterritorial reach of the law may affect banks located abroad, if at all. The Act includes provisions that permit a subpoena to be quashed or modified if it would require the provider to violate foreign law, or is otherwise improper based on the comity analysis laid out in 18 USC §2703(h)(3). Those provisions will likely prove critical in protecting records stored abroad from the reach of subpoenas, particularly in light of the European Union's recently enacted General Data Protection Regulation, but may have little practical effect in protecting such information from the reach of general party discovery under the Federal Rules.²⁸

Personal jurisdiction

The recent developments in personal jurisdiction case law post-*Daimler*, discussed in greater detail in Section III, have provided banks with another tool to defend against subpoenas because they restrict general personal jurisdiction to where an entity is 'at home' there, limiting the ability of litigants to obtain worldwide discovery from banks that merely have US branches with no connection to the underlying action.²⁹ However, that rule is not as strictly followed in New York state courts where international branches of a bank have been subject to an information subpoena where the bank failed to show that the information sought could not also be accessed from the New York branch.³⁰

Separate entity rule

In New York, the separate entity rule has also been a defence against subpoenas seeking information for accounts held outside of the US, though outcomes in the subpoena context have differed from the outcomes in the injunction and attachment context.³¹ Recent cases

26 Matter of Warrant to Search a Certain E-Mail Account Controlled and Maintained By Microsoft Corp, 829 F3d 197 (2d Circuit 2016).

27 CLOUD Act §103(a)(1).

28 See, e.g., *In re LIBOR-Based Fin Instruments Antitrust Litig*, No. 11 CIV 5450 (NRB) (SDNY 8 November 2018) (Dkt No. 495) (ordering banks to produce relevant documents, with limited exception for redacting irrelevant personal data).

29 *Leibovitch v. Islamic Republic of Iran*, 852 F3d 687 (7th Circuit 2017).

30 *B & M Kingstone, LLC*, 15 NYS3d 318.

31 Compare *Motorola Credit Corp v. Standard Chartered Bank*, 24 NY3d 149 (2014) (holding separate entity rule bars attachment of assets in custody at bank's branches outside of New York) with *B & M Kingstone, LLC*, 15 NYS3d 318 (ordering compliance with information subpoena directed at bank branches outside of New York).

have left open the question of enforcement of information subpoenas on foreign banks with operations in New York,³² with at least one court refusing to apply the ‘arcane rule’ to an information subpoena,³³ and thus the issue remains unresolved.

VII JURISDICTION AND CONFLICTS OF LAW

In the US, personal jurisdiction – or the power of a particular court to hale in an entity to answer for a claim – is either general, meaning that a court can hear any claim against that entity, or specific, meaning that the court can hear only claims ‘arising out of or related to the defendant’s contacts with the forum.’³⁴

i General personal jurisdiction

Traditionally, courts were permitted to exercise general personal jurisdiction over an entity with ‘systematic and continuous contacts’ to the state where the court was located, which, in practice, meant that foreign banks were routinely subject to suit wherever they had a branch or representative office, subject only to discretionary rules of *forum non conveniens*. In 2014, the Supreme Court substantially limited the power of the US courts over foreign entities in *Daimler AG v. Bauman*,³⁵ ruling that general personal jurisdiction could only be exercised over a company if the forum court is within the company’s state of incorporation, or the state of the company’s principal place of business, absent exceptional circumstances.³⁶ Since *Daimler*, the Supreme Court has made clear that the defendant must truly be ‘at home’ in the forum state for general personal jurisdiction to exist.³⁷ While *Daimler* has spawned much litigation, plaintiffs have been unsuccessful in articulating ‘an exceptional case’ in which the defendant’s operations were so substantial and of such a nature that would warrant deviation from this rule, and even the presence of 2,000 miles of railroad and over 2,000 employees in a US state was held to be not enough to support general jurisdiction when the suit was unrelated to any of that in-state activity.³⁸ Thus, the majority of US courts now do not have general personal jurisdiction over foreign banks that are not incorporated in the US and do not have their headquarters there.³⁹

Plaintiffs have sought to avoid the impact of *Daimler* by advancing theories based on consent to jurisdiction – specifically by arguing that obtaining a business licence to operate

32 See, *Vera v. Republic of Cuba*, 91 F Supp 3d 561 (SDNY 2015) (holding that neither the separate entity rule nor Daimler restrictions applied and therefore ordering a Spanish bank to comply with a subpoena for information from branches outside New York, reasoning that the bank had consented to general personal jurisdiction by registering as a foreign bank branch in New York in compliance with New York’s statutory regime), rev’d on other grounds *Vera v. Republic of Cuba*, 867 F3d 310, 315 (2d Circuit 2017); see also Nypl, 2018 WL 1472506, at *2-4 (refusing to exercise jurisdiction over banks based on the presence of branch offices).

33 *B & M Kingstone, LLC*, 15 NYS3d 318.

34 *Helicopteros Nacionales de Colombia, SA v. Hall*, 466 US 408, 415 No. 8 (1984).

35 571 US 117 (2014).

36 *Daimler AG*, 571 US, 136.

37 *Daimler AG*, 571 US, 138 No. 18.

38 *BNSF Ry Co v. Tjyrell*, 137 S Ct 1549 (2017).

39 See, e.g., *Brown v. Lockheed Martin Corp*, 814 F3d 619, 628-29 (2d Circuit 2016) (refusing to find an exceptional case where the defendant maintained a physical presence in the US state for over 30 years, ran operations out of that state and employed 70 workers there, and generated substantial revenue from its

within a state, as banks must to operate a local branch, should constitute consent to general jurisdiction there. States have issued conflicting opinions on this point.⁴⁰ In New York, the highest court has not determined whether a licence to do business in the state will function as consent to personal jurisdiction. However, an intermediate appellate court has held that, in light of *Daimler*, ‘it cannot be said that a corporation’s compliance with the existing business registration statutes constitutes consent to the general jurisdiction of New York courts.’⁴¹ Thus, while legislation is pending to impose consent to personal jurisdiction by registration in the state, even if passed into law, such a requirement could be void as unconstitutional.⁴²

ii Specific personal jurisdiction

Plaintiffs have also sought to compensate for the loss of general jurisdiction in cases where it would previously have existed as a matter of course by broader assertions of specific jurisdiction, which requires that the claims arise out of the defendants’ forum-related contacts, arguing that their suits ‘arise out of or relate to’ what are sometimes relatively minimal actions by the defendant company within the forum.⁴³ This strategy was envisioned by *Daimler* itself, which noted that ‘specific jurisdiction has become the centrepiece of modern jurisdiction theory.’⁴⁴ Specific jurisdiction can be heavily fact-dependent and, while some courts require that the in-forum conduct be the proximate cause of the injury, other courts only require the in-forum conduct to be a but-for cause.⁴⁵ Under either approach, the injury to the plaintiff must have a connection to the defendant’s conduct within the forum, thereby providing a causal constraint on the use of specific jurisdiction. Thus, specific personal jurisdiction often exists where the injury to the plaintiff arises out of conduct taken in, or purposefully directed to, the forum.⁴⁶ Because such conduct was not purposefully directed at a particular forum merely because it caused an injury there, one court recently declined to exercise specific personal jurisdiction over foreign banks that allegedly caused injuries in the US where the alleged

operations there); *Nypl v. JPMorgan Chase & Co*, 15-CIV-9300 (LGS), 2018 WL 1472506, at *4 (SDNY 22 March 2018) (refusing to find an ‘exceptional case’ for general jurisdiction based on foreign banks’ participation in criminal proceedings in the US and advertisements accessible to consumers in the US).

40 For example, courts in Delaware issued split decisions on whether registration operated as consent, before the Delaware Supreme Court – the state’s highest court, and the final arbiter of Delaware state law – ruled that registration did not function as consent. *Genuine Parts Co v. Cepec*, 137 A 3d 123, 148 (Del 2016).

41 *Aybar v. Aybar*, 93 NYS3d 159, 166 (NY 3d Dep’t 2019).

42 NY State Assembly, A5918, Reg Sess (NY 2017), <https://www.nysenate.gov/legislation/bills/2017/a5918>.

43 Much of the increase in specific personal jurisdiction litigation has centered on products liability and non-bank commercial activity-based jurisdictional fact patterns. See, e.g., *Bristol-Myers Squibb Co v. Super Ct of Cal*, 137 S Ct 1773 (2017).

44 *Daimler AG*, 571 US, 128 (citation omitted) (internal quotation marks omitted).

45 *SPV Osus v. UBS AG*, 882 F3d 333, 334 (2d Circuit 2018).

46 *Charles Schwab Corp v. Bank of Am Corp*, 883 F3d 68, 81-88 (2d Circuit 2018) (finding that personal jurisdiction exists for claims arising out of transactions in the US, but not for claims arising out of conduct undertaken abroad); see also *Nypl*, 2018 WL 1472506, at *5-6 (finding specific personal jurisdiction where the alleged injuries arose out of conduct for which the banks entered guilty pleas with the US Department of Justice admitting to actions directed at or occurring in US states, but refusing to extend that jurisdiction to foreign parent holding companies).

conduct involved manipulation of the Canadian Dollar Offered Rate in Canada.⁴⁷ While the relevant forum is most often the particular state in which the action is brought, certain types of claims aggregate all of a defendant's contacts with the US as a whole in determining whether the exercise of personal jurisdiction is permissible, including claims brought under the Securities and Exchange Act of 1934 (SEA) and the Commodities Exchange Act, the Racketeer Influenced and Corrupt Organizations Act (RICO), the Sherman Act, and certain bankruptcy-related claims.⁴⁸

One area that has spurred particularly interesting litigation is banks' use of correspondent bank accounts in New York to clear dollar transactions within the state. In New York, those accounts can provide a basis for specific personal jurisdiction, but only where clearing transactions form part of the plaintiff's claim and the bank knowingly made use of the correspondent account (i.e., the bank acted with knowledge of the nature of the underlying transaction for which the correspondent account is used to move dollars as payment).⁴⁹ In addition, correspondent accounts have been held to provide a basis for personal jurisdiction under New York law when the foreign bank is not a party to the US litigation but is served with a third party subpoena at least where there is a significant number of US correspondent accounts that it uses frequently.⁵⁰ This area of law continues to evolve, as courts grapple with the extent to which routine banking contacts, such as use of New York correspondent accounts, are sufficient to create specific jurisdiction over otherwise non-US-related claims.

iii Conflicts of law

Choosing the applicable law in cases in which a conflict of laws arise can be particularly complex within the US, and even more so in cases involving global banks, as courts must decide whether to use foreign, federal, or state law – and if state law is applicable, which of the 50 states' laws will apply. Different US jurisdictions apply different tests to resolve choice of law questions, in some instances looking to which body of law bears the most 'significant relationship' to the suit, while in other instances rigidly applying formulas that require, for example, a contract dispute to be adjudicated under the law of the place where the contract was formed.

47 *Fire & Police Pension Ass'n of Colo v. Bank of Montreal*, No. 18 CIV 342 (AT), 2019 WL 1344412, at *10 (SDNY 14 March 2019) (refusing to exercise specific personal jurisdiction over foreign banks that allegedly caused injuries in the US where the alleged conduct causing the injuries involved manipulation of the Canadian Dollar Offered Rate in Canada).

48 See 15 USC §78aa (providing for nationwide service of process for suits brought under the SEA); *Fire & Police Pension Ass'n of Colo v. Bank of Montreal*, No. 18 CIV 342 (AT), 2019 WL 1344412, at *10 (SDNY 14 March 2019) (recognising courts 'have applied nationwide contacts to determine personal jurisdiction for CEA and Sherman Act claims'); *PT United Can Co Ltd v. Crown Cork & Seal Co*, 138 F3d 65, 71 (2d Circuit 1998) (recognising RICO, 18 USC §1965, permits nationwide service of process for additional defendants alleged to have participated in a conspiracy where the court has personal jurisdiction over at least one defendant and the ends of justice so require); Federal Rule of Bankruptcy Procedure 7004(b) (establishing that service is sufficient to confer personal jurisdiction over any defendant in any proceeding related to a case under the Bankruptcy Code so long as it is consistent with the laws of the United States).

49 *Rushaid v. Pictet & Cie*, 28 NY3d 316, 338 (2016), reh'g denied, 28 NY3d 1161 (2017); see also *Licci ex rel Licci v. Lebanese Canadian Bank*, SAL, 732 F3d 161, 171 (2d Circuit 2013).

50 *NIKE, Inc v. Wu*, 349 F Supp 3d 346 (SDNY 2018); see also *Gucci Am, Inc v. Weixing Li*, 135 F Supp 3d 87, 93 (SDNY 2015).

VIII SOURCES OF LITIGATION

i Sanction violation suits

Recent years have seen a notable uptick in the number of civil suits brought in the wake of international sanctions violations. Thus, a US government finding, or admission by a bank, typically in a guilty plea, deferred prosecution agreement or civil settlement with bank regulators, that a company has violated a prohibition on commerce with Iran, for example, may well lead to private litigation.

Plaintiffs have primarily brought such claims under the Anti-Terrorism Act, but have also pursued those claims pursuant to common law or the Alien Tort Statute.⁵¹ Under the Alien Tort Statute, courts imply a private right of action by persons who are not US citizens for torts that violate ‘the law of nations or a treaty of the United States’.⁵² The Supreme Court has held that such actions cannot proceed against foreign corporations, including foreign financial institutions,⁵³ but such actions continue to proceed against domestic corporations and the precise standard distinguishing between domestic and foreign corporations has yet to crystallise.⁵⁴

Primary liability

The ATA, as amended in 2016, provides a civil cause of action for treble damages and attorneys’ fees for private US persons injured by a terrorist act.⁵⁵ Plaintiffs have used this provision to assert claims against banks for effecting wire transfers that either directly provided funds to terrorist groups or that transferred funds to intermediaries who allegedly eventually provided funding to terrorist groups.⁵⁶ Considerable litigation related to these claims is ongoing. ATA primary liability claims require three elements: (1) injury to a national of the United States (2) caused by reason of (3) an act of international terrorism. An act of international terrorism in turn requires both violation of an underlying criminal statute, which for financial institutions typically involves a claim of knowing or wilfully blind support to a foreign terrorist organisation by transferring funds to it, and conduct by the bank involving violence or danger to human life and apparent intent to influence or coerce a government or population. In *Linde v. Arab Bank*,⁵⁷ the Second Circuit held that, in applying these requirements, a financial institution’s provision of routine banking services to a foreign terrorist organisation or its members will not create civil liability unless the financial institution also knows that the funds it transfers will be used for terrorist activities.⁵⁸ Following that decision, one district court has held that allegations of defendants removing

51 See, e.g., *Ofisi v. BNP Paribas, SA*, 278 F Supp 3d 84, 92-93 (DDC 2017), vacated in part on other grounds 285 F Supp 3d 240 (DDC 2018).

52 28 USCA §1350.

53 *Jesner v. Arab Bank, PLC*, 138 S Ct 1386, 1407 (2018).

54 *Doe v. Nestle, SA*, 906 F3d 1120, 1127 (9th Circuit 2018); *Kaplan v. Central Bank of the Islamic Republic of Iran*, 896 F3d 501, 515 (DC Circuit 2018).

55 18 USCA §2333.

56 See, e.g., *Wultz v. Bank of China Ltd*, 32 F Supp 3d 486 (SDNY 2014); *Lelchook v. Islamic Republic of Iran*, Civil Action No. 15-13715-PBS, 2016 WL 7381686 (D Mass 20 December 2016).

57 *Linde v. Arab Bank, PLC*, 882 F3d 314, 329-27 (2d Circuit 2018) (explaining that ‘providing financial services to a known terrorist organisation may afford material support to the organisation’ but that such support does not equate to an ‘act of international terrorism’).

58 *Linde*, 882 F3d, 327.

information on payment messages that could alert authorities to involvement of Iranian agents and concealing the involvement of Iranian banks in letters of credit did not state an actionable claim for primary liability under the ATA, even though Iran was designated a state sponsor and supporter of foreign terrorist organisations.⁵⁹ Additionally, where the discovery process does not uncover factual development sufficient to show terroristic intent, which requires that the defendant's activities 'appeared to be intended to intimidate or coerce a civilian population, influence the policy of a government by intimidation or coercion, or affect the conduct of a government by mass destruction, assassination, or kidnapping,' defendants have successfully obtained judgment as a matter of law at the close of discovery and before trial.⁶⁰ Moreover, other courts have dismissed such claims even at the pleading stage for failure to allege the requisite terroristic intent.⁶¹

Claims brought pursuant to the ATA have also been successfully defended on grounds of lack of causation. As discussed in Section II, courts have interpreted the ATA to require both that the services provided by the financial institution were a substantial factor in causing the terrorist act and that the terrorist act was reasonably foreseeable to the financial institution.⁶² At least one other court, however, has interpreted the causation requirement less stringently, finding the requirement satisfied where a knowing contribution to a terrorist organisation was made, even if specifically designated for a nonviolent wing of the organisation.⁶³ Nevertheless, even that jurisdiction has subsequently dismissed ATA claims where the bank merely provided services to a country, Iran, that is a state sponsor of terror, as opposed to participating in direct donations to a known terrorist organisation.⁶⁴

Secondary liability

As the Second Circuit addressed in its *Linde* decision, the 2016 Amendments to the ATA create secondary liability for aiding and abetting such terrorist acts, which does not require proof that the banking services directly caused the terrorism-related injuries.⁶⁵ Instead, the causation requirement focuses on the link between the injury and the party whom the financial institution aids, as opposed to the injury caused by the financial institution itself. The other two requirements for secondary liability are that the financial institution was generally aware of its role in the terrorist act at the time the services were provided, and that it knowingly and substantially assisted the act. As more cases arise to which those amendments

59 *Freeman v. HSBC Holdings PLC*, No. 14CV6601 (DLI) (CLP), 2018 WL 3616845, at *63 (EDNY 27 July 2018).

60 *Weiss v. Nat'l Westminster Bank PLC*, No. 05CV4622DLIRML, 2019 WL 1441118, at *9 (EDNY 31 March 2019); see also *Strauss v. Credit Lyonnais, SA*, No. 06CV702DLIRML, 2019 WL 1492902, at *7 (EDNY 31 March 2019).

61 *Kemper v. Deutsche Bank AG*, 911 F3d 383, 390 (7th Circuit 2018); see also *O'Sullivan v. Deutsche Bank AG*, No. 17 CV 8709-LTS-GWG, 2019 WL 1409446, at *8 (SDNY 28 March 2019) (dismissing ATA claims where defendants provided banking and other services to Iranian entities, which were not plausibly alleged to have provided support for the terrorist attacks at issue).

62 See, e.g., *Fields v. Twitter, Inc.*, 881 F3d 739, 744-46 (9th Circuit 2018); *Rothstein v. UBS AG*, 708 F3d 82, 97 (2d Circuit 2013).

63 *Boim v. Holy Land Found for Relief and Dev.*, 549 F3d 685, 697-99 (7th Circuit 2008).

64 *Kemper v. Deutsche Bank AG*, 911 F3d 383, 390 (7th Circuit 2018); see also *O'Sullivan v. Deutsche Bank AG*, No. 17 CV 8709-LTS-GWG, 2019 WL 1409446, at *8 (SDNY 28 March 2019) (dismissing ATA claims where defendants provided banking and other services to Iranian entities, which were not plausibly alleged to have provided support for the terrorist attacks at issue).

65 *Linde*, 882 F3d, 328-29.

creating secondary liability are applicable,⁶⁶ the legal landscape for these types of claims will likely become clearer. Recently, the text of the statute, which requires that the injury arise out of an act of ‘an organization that had been designated as a foreign terrorist organization,’ has been interpreted strictly by its terms to not apply to an attack committed by a state sponsor of terrorism because such a sponsor is not itself a foreign terrorist organisation.⁶⁷ As discussed in Section II, it also appears likely that a preeminent defence to secondary liability will now hinge on whether the bank was at least ‘generally aware’ that the services provided were directly assisting foreign terrorist organisations to commit terrorist acts.⁶⁸ Courts have likewise found allegations that a defendant provided services to a country, or its business, subject to sanctions for sponsoring terrorism, insufficient where the defendant’s activities did not demonstrate a common purpose or plan with foreign terrorist organisations.⁶⁹

Additionally, there has been an effort by plaintiffs to pursue common law based claims, rather than statutory based claims, against banks for aiding and abetting human rights violations by foreign states, by violating US sanctions prohibiting transfers of funds to those states.⁷⁰ A court recently reversed the dismissal of such a claim under the ‘act of state’ doctrine, which bars a US court from sitting in judgment over the acts of a foreign government, but it remains to be seen whether those claims will survive further motion practice.⁷¹

ii Financial product-related suits

Banks have traditionally faced lawsuits related to the complex financial products they offer. Although those related to mortgage-backed securities are on the decline as many of these cases have settled in recent years, the litigation in this sphere has grown as banks create increasingly sophisticated financial products and derivative instruments. Litigation usually involves allegations of various forms of fraud, misrepresentation, breach of contract or breach of fiduciary duty, and in particular raising claims as to the suitability of the financial product. While such litigation often includes sophisticated parties, a proposed class action was recently filed against a large US bank based on a change in terms regarding the purchase of cryptocurrencies online using the bank’s credit cards by consumers.⁷² The complaint alleges that the bank changed its policies without notice to treat such purchases as ‘cash

66 The 2016 Amendments implemented by the Justice Against Sponsors of Terrorism Act apply to any civil action pending on or commenced after 28 September 2016 that arises out of an injury caused on or after 11 September 2001.

67 *Shaffer v. Deutsche Bank AG*, No. 16-CR-497-MJR-SCW, 2017 WL 8786497, at *1 n1 (SD Ill 7 Dec 2017), *aff’d sub nom. Kemper v. Deutsche Bank AG*, 911 F3d 383 (7th Circuit 2018).

68 *Siegel v. HSBC N Am Holdings, Inc.*, No. 18-2540-CV, 2019 WL 3719976, at *6 (2d Circuit 8 August 2019); Weiss, 2019 WL 1441118, at *11; See, e.g., *O’Sullivan v. Deutsche Bank AG*, No. 17-CIV-8709, 2018 WL 1989585, at *6 (SDNY 26 April 2018); *Taanneh v. Twitter, Inc.*, 343 F Supp 3d 904, 917 (ND Cal 2018).

69 *O’Sullivan v. Deutsche Bank AG*, No. 17 CV 8709-LTS-GWG, 2019 WL 1409446, at *9 (SDNY 28 March 2019); see also *Taanneh v. Twitter, Inc.*, 343 F Supp 3d 904, 916 (N D Cal 2018); but see *Miller v. Arab Bank, PLC*, No. 18-CV-2192 (BMC), 2019 WL 1115027, at *9 (EDNY 11 March 2019) (refusing to dismiss claims against bank that provided services directly to terrorist organisations, including by providing payments to the families of terrorists through a scheme the bank administered).

70 See *Ojisi v. BNP Paribas, SA*, 278 F Supp 3d, 92-93.

71 See *Kashef v. BNP Paribas SA*, No. 18-1304-cv, 2019 WL 2195619 (2d Circuit 22 May 2019) (reversing *Kashef v. BNP Paribas, SA*, 16-CV-3228, 2018 WL 1627261, at *2 (SDNY 30 March 2018)).

72 *Tucker v. Chase Bank USA NA*, 18-CV-3155 (KPF) (SDNY).

advances', which include fees and high interest rates, in violation of the Truth in Lending Act (TILA).⁷³ On 1 August 2019, the court permitted the breach of contract and TILA's clear and conspicuous disclosure claims to proceed.⁷⁴ Other courts have similarly permitted federal- and state-law based contract claims to proceed against banks regarding banking, and particularly online banking, practices.⁷⁵ Such cases demonstrate a growing trend of consumer claims against banks for fees and charges of which banks must be aware.

iii Antitrust violation suits: civil suits brought in the wake of antitrust investigations

There was a wave of private litigation borne out of regulatory investigation into financial markets, including, alleged London Interbank Offered Rate (LIBOR) fixing and FX manipulation. While an increasing number of these cases have settled, litigation continues against the non-settling banks. The banks secured a recent victory in the dismissal of certain claims arising from transactions executed outside the US, but claims under the Commodity Exchange Act were allowed to proceed.⁷⁶ Additionally, claims by a separate class of plaintiffs brought under the Sherman Act as well as California state antitrust laws have been permitted to proceed.⁷⁷ Still, other types of antitrust claims remain unresolved, including claims brought by additional classes of indirect-purchaser plaintiffs alleging collusion in the FX market⁷⁸ and classes of customers alleging that certain banks used 'last look', a trading practice using complex algorithms that allegedly cancel or delay the processing of FX orders in order to ensure the bank receives a more favourable transaction.⁷⁹

In the LIBOR sphere, federal antitrust claims that had previously been dismissed by a lower court for failure to plead antitrust injury were revived in 2016, following a reversal by the Second Circuit, which held that antitrust law did not require plaintiffs to show an injury causing harm to competition in order to allege a conspiracy among market participants when the conduct alleged constitutes a per se antitrust violation, as in the context of rate-setting.⁸⁰ In 2017, the Supreme Court denied a petition from the banks requesting it to review the Second Circuit opinion, so the case will proceed, focusing on whether plaintiffs are efficient enforcers of the antitrust laws – a requirement for antitrust standing. Earlier this year, the district court certified only a limited class of over-the-counter purchasers of LIBOR-based

73 *Id.*, 18 CIV 3155 (Docket Entry 1, 10 April 2018).

74 See *Tucker v. Chase Bank USA, NA*, No. 18 CIV 3155 (KPF), 2019 WL 3496642, at *1 (SDNY 1 August 2019).

75 See, e.g., *Tims v. LGE Cmty Credit Union*, No. 17-14968, 2019 WL 4019847 (11th Circuit 27 August 2019) (reversing dismissal of breach of contract claims under state and the federal Electronic Fund Transfer Act).

76 *In re Foreign Exch Benchmark Rates Antitrust Litig*, No. 13 CIV 7789 (LGS), 2016 WL 5108131 (SDNY 20 September 2016).

77 *Nypl v. JPMorgan Chase & Co*, No. 15 CIV 9300 (LGS), 2018 WL 1276869, at *4 (S.D.N.Y. 12 March 2018) (denying banks' motion to dismiss antitrust claims brought by individual plaintiffs who purchased allegedly price-fixed foreign currency from the Defendants at the benchmark rates).

78 *Baker v. Bank of Am Corp*, 16 CIV 7512 (LGS) (SDNY 28 April 2017) (Dkt No. 181) (dismissing dozens of banks pursuant to a stipulation between the parties).

79 See, e.g., *Alpari (US), LLC v. Credit Suisse Group AG*, 17 CIV 5282 (LGS) (SDNY 12 June 2018) (granting motion to compel arbitration).

80 *Gelboim v. Bank of Am Corp*, 823 F3d 759 (2d Circuit 2016), cert. denied, 137 S Ct 814 (2017).

instruments, but refused to do the same for other proposed classes, in part due to concerns of standing.⁸¹ To the extent the court certified classes, numerous defendants subsequently settled after being unable to obtain dismissal based on lack of personal jurisdiction.⁸²

In addition, reports of regulatory investigations, prior to any settlements, have spawned private litigation. For example, in the wake of reports of investigations into the potential manipulation of prices in the supranational, sub-sovereign and agency (SSA) bond market, various class actions were filed against several large financial institutions and individual traders alleging manipulation of prices SSA bond market in violation of the Sherman Act, 15 USC §1.⁸³ Those types of claims, however, have struggled to satisfactorily plead the requirements of antitrust standing, including that the plaintiff suffered an injury-in-fact as a participant in the market that was directly restrained because of an antitrust violation, and that the injury is the type contemplated by the antitrust statute.⁸⁴

More uniquely, one court has permitted claims based on allegations of spoofing, which is defined in Dodd-Frank as ‘bidding or offering with the intent to cancel the bid or offer before execution’⁸⁵ (at least when supported by collusive messages amongst traders) to move forward as an improper restraint of trade in violation of antitrust laws, namely the Sherman Act.⁸⁶ That same decision, however, likewise recognised the eventual difficulty in proving damages in such actions given uncertainty regarding the exact impact on foreign exchange rates. Courts have similarly recognised that such allegations may also fail substantively once past the pleading stage when the court no longer must accept all allegations as true.⁸⁷ Accordingly, at the time of writing, it is uncertain whether the spoofing claims will ultimately succeed.

IX EXCLUSION OF LIABILITY

i Causation

In order to hold a defendant civilly liable, plaintiffs must show that the defendant caused their injuries. This causal connection requirement frequently limits a defendant’s exposure to damages. Recently, however, in the securities fraud context, the Second Circuit has been more lenient with regard to allegations of causation at the initial motion to dismiss stage, including

81 *In re LIBOR-Based Fin Instruments Antitrust Litig*, No. 11 CIV 5450 (NRB), 2018 WL 1229761 (SDNY 28 February 2018).

82 *In re LIBOR-Based Fin Instruments Antitrust Litig*, No. 11 CIV 5450 (NRB) (SDNY 25 October 2018) (Dkt No. 494).

83 *In re SSA Bonds Antitrust Litig*, No. 16 CIV 3711 (ER), 2018 WL 4118979, at *6 (SDNY 28 August 2018) (Dkt No. 495).

84 *Id.*

85 7 USC §6c(a)(5)(C). *Sullivan v. Barclays PLC*, 13-CV-2811, 2017 WL 685570, at *12-13 (SDNY 21 February 2017).

86 *Sullivan*, 2017 WL 685570, at *12-13.

87 *Dennis v. JPMorgan Chase & Co*, 343 F Supp 3d 122, 156 & n110 (SDNY 2018), adhered to on denial of reconsideration, No. 16-CV-6496 (LAK), 2018 WL 6985207 (SDNY 20 December 2018); see also *Sonterra Capital Master Fund, Ltd v. Barclays Bank PLC*, No. 15-CV-3538 (VSB), 2018 WL 6725387, at *17 (SDNY 21 Dec 2018) (permitting antitrust claim to proceed only to the extent that one plaintiff could point to specific transactions on specific dates with one particular defendant).

by not requiring plaintiffs to rule out other causes of loss.⁸⁸ As a result, the plaintiffs must only give ‘some indication’ of a ‘plausible causal link’ between the loss suffered and the alleged fraud.⁸⁹ In the sanctions violation context, however, a greater causal connection between the provision of banking services and the sanction violation, or terrorist act, is necessary for primary liability, as discussed in Section VI.

ii Arbitration agreements

As discussed in Section IV, arbitration clauses are increasingly included in contracts. and recent holdings of the Supreme Court are likely to affect the number of class actions against large financial service providers, which often rely upon class action waiver provisions in contractual terms for credit cards, bank accounts, student loans, and other financial products and services.

X REGULATORY IMPACT

Agencies under the Trump administration continue to propose changes to and rollbacks of regulations, including banking regulations and guidance. With the notable exception of the changes to the Volcker Rule discussed above, the majority of these proposals, which touch on matters from security-based swaps to expanding bilateral netting provisions under the Federal Deposit Insurance Corporation Improvement Act of 1991 to include more entities as ‘financial intuitions’, have not yet been adopted as final rules.⁹⁰ Additionally, on 5 June 2019, the SEC finalised the Regulation Best Interest Rule, which more closely aligns the standards applicable to broker-dealers and investment advisers while recognising the fundamental differences between the two.⁹¹ Even without final rules, however, regulators continue to provide important guidance. On 2 May 2019, the US Department of the Treasury’s Office of Foreign Assets Control released ‘A Framework for OFAC Compliance Commitments’ providing general guidance on effective sanctions compliance programmes, which is based on recent settlements with two international banks.⁹²

88 See, e.g., *Charles Schwab Corp.*, 883 F3d 68, 93-95; *Loreley Fin (Jersey) No. 3 Ltd v. Wells Fargo Sec, LLC*, 797 F3d 160, 188 (2d Circuit 2015).

89 *Charles Schwab*, 883 F3d, 93 (quoting *Loreley*, 797 F3d, 187).

90 See ‘Proposed Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements,’ Release No. 34-85823; File No. S7-07-19; Board of Governors of the Federal Reserve System, Notice of Proposed Rulemaking: Netting Eligibility for Financial Institutions, 84 Fed Reg 18741, 12 CFR 231 (2 May 2019), online at <https://www.federalregister.gov/documents/2019/05/02/2019-08898/netting-eligibility-for-financial-institutions>.

91 See ‘EC Release No. 34-86031, at 34 (June 5, 2019) (to be codified at 17 CFR pt 240).

92 https://www.treasury.gov/resource-center/sanctions/Documents/framework_ofac_cc.pdf.

XI OUTLOOK AND CONCLUSIONS

The US continues to experience a period of great political uncertainty, and it is unclear what the implications will be for financial institutions. The Trump administration has already revised the tax code and amended portions of Dodd-Frank, which will lessen the regulatory obligations of banks – potentially significantly. Moreover, the administration has reduced the number of new regulations, and is likely to continue on that path. The practical effects for banking litigation may take some time to manifest themselves.

Similarly, while the Trump administration has appointed conservative and pro-business judges to the US Supreme Court and lower federal courts, how such appointments will translate into judicial decisions in particular cases remains to be seen. State attorneys general in places like New York and California have also declared their intention to take up the reins of investigatory activity previously conducted by federal regulators of financial institutions.

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