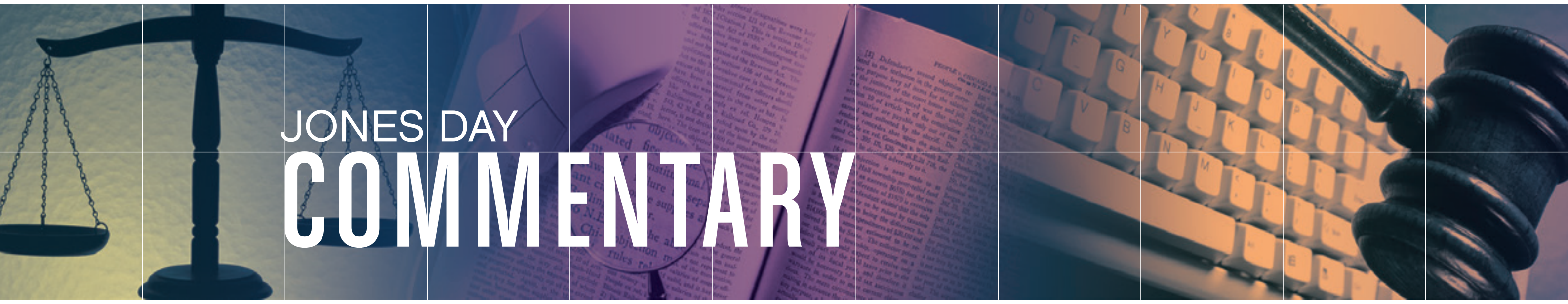
MAY 2013



FINANCIAL SERVICES AND MARKETS— A PERFECT LITIGATION STORM?

For companies operating in the UK financial services sector, recent regulatory reform, greater access to justice and developments in collective action regimes are likely to change the litigation landscape. The process of seeking and obtaining compensation is being made easier.

The date of 1 April 2013 may come to be seen as a watershed in the regulation of the UK financial services industry. Whilst it may be true that not much will change in the way of day-to-day supervision of firms, this may not be the case at the “sharp” end where the new regulators, particularly the Financial Conduct Authority (“FCA”), will be eager to make their mark and publicly demonstrate a new regulatory mindset and vigour. We are likely to see greater exercise of enforcement powers (in particular, the imposition of higher fines and consumer redress schemes) as well as increased use of “regulatory” litigation by consumers (individuals and businesses) as a means of enforcing private rights and recovering compensation. Actions for damages may come to be seen as making an important contribution to the regulation of the markets and the maintenance of effective competition. Together, enhanced regulation and enforcement and the threat of regulatory litigation will form part of the drive towards cultural change and higher standards of conduct in the industry.

REGULATOR IMPOSED REMEDIES

Consumers of financial services do not need to bring proceedings themselves if consideration of their complaints and a remedy can be procured by the regulator. Section 404 of the Financial Services and Markets Act 2000 (“FSMA”) (as amended by Section 14 of the Financial Services Act 2010) enables the FCA to make rules requiring firms to operate a consumer redress scheme in respect of past business in circumstances where it concludes that there has been widespread or regular failure to comply with the Handbook rules. The FSA recently exercised this power to order a review by companies involved in the Arch cru funds debacle, which commenced on 1 April 2013.

The FCA will not be alone in looking for situations where consumer redress is or may be appropriate. Part 16 of FSMA allows designated consumer bodies to make a complaint to the FCA where a feature of a market appears to be harming the interests of consumers. Further, the Financial Ombudsman Service ("FOS") is authorised to make "mass detriment" references where there are perceived to be regular failings by specific firms that result in detriment to consumers. In each case, the FCA has 90 days to decide how to respond, and one likely response is for the FCA to impose a consumer redress scheme on the relevant firm(s) (as well as sanctions). Thus, increasing numbers of consumers may be compensated in appropriate cases without recourse to the courts or the FOS.

SELF-HELP REMEDIES

Consumers have also been afforded enhanced direct access to justice since 1 April 2013. "Access to justice" means what it says: those who have suffered loss should more easily be able to recover compensation at a proportionate cost. This principle applies as much in the field of financial services as elsewhere.

Probably the most significant outcome of the Jackson Review of Civil Litigation Costs in a commercial context was the introduction by Parliament of "damages based agreements" ("DBAs") from 1 April 2013. DBAs operate in a similar way to contingency fee agreements in the United States. As such, while third-party litigation funding and conditional fee agreements have been available in the UK for a number of years, lawyers can now be remunerated by reference to the damages recovered (up to 50 percent in commercial cases) as opposed to hours worked. This change is likely to increase the appetite for litigation, particularly at the higher value end of the market, and may create a type of "plaintiff bar" as seen in the United States. Litigants and funders will therefore be on the lookout for higher value, meritorious claims to pursue against companies with deep pockets, and financial services companies may, in the wrong circumstances, find that they fall within these criteria.

In the financial services sector, the allure of claims from a funding DBA perspective may be driven by whether they encompass alleged breaches of an actionable Handbook rule. The importance of a breach of a rule may be seen in one of two ways. First, a breach of many of the rules of the FCA, particularly the Conduct of Business rules, is actionable at the suit of a private person (Section 138D FSMA). This statutory right cannot be excluded by contract, and if a breach can be established, private persons need only prove that they have suffered loss as a result to become entitled to compensation. This has led a number of claimants in recent proceedings before the Commercial Court in London to rely only on Section 138D (and its predecessor, Section 150) and not any common law duties (see, for example, *Zaki V Credit Suisse*, 2013). Second, the English courts decided some time ago that regulatory requirements and standards afford "strong evidence" of what is expected of a competent professional in most situations (*Seymour V Ockwell*, 2005). Thus, any breach or possible breach of an actionable FCA rule may encourage lawyers to fund claims under DBAs whether or not their clients are private persons. In short, a new conduct regulator in the form of the FCA may, by increased activity and vigilance, create for litigants and a new class of litigation funders a more fertile ground for regulatory litigation based solely on breaches or possible breaches of the Handbook rules causing loss.

Moves towards "opt out" collective actions would also yield costs synergies to consumers and thereby increase the availability of redress when DBAs are inappropriate or unavailable. While English law and procedure have not generally facilitated collective actions of the kind seen in, for example, the United States and the Netherlands, an "opt out" regime nearly came into being in the UK during 2010 in the context of financial services claims.

Although these proposals were withdrawn at the last minute, the government maintained that they were "important and necessary measures" and has since decided that individuals, businesses and genuine representative claimant bodies such as consumer or trade associations should be able to bring competition law claims in an enhanced Competition Appeal Tribunal on a collective "opt out" basis. While these proposals contain significant differences from the US class action model (no awards of exemplary or treble damages; awards of costs can be made on the usual "loser pays" basis; contingency fees are not allowed), the introduction of a more comprehensive "opt-out" claims regime would represent a radical shift towards mass claims litigation and almost inevitably lead to increased damages awards for breaches of competition law.

Indeed, it would not require a significant shift in policy at the European or domestic level for collective redress on an "opt in" or "opt out" basis to be made available in other contexts where large numbers of consumers have lost money (in some cases, possibly small amounts of money) as a result of breaches of law or regulation.

The trend of promoting access to justice will continue, and there are likely to be further measures and decisions that are designed to facilitate and encourage the pursuit of claims by consumers of financial services in a manner most favourable to them. This was most recently demonstrated by the English High Court's controversial decision to allow complainants to bring "top up" civil proceedings notwithstanding that they had accepted a final and binding decision from the FOS in their favour awarding the maximum available compensation under the FOS Rules (*Clark V Focus Asset Management*, 2013). However, whilst this decision might promote enhanced access to justice, it could be perceived by paying defendants as forum shopping and double-dipping.

LAWYER CONTACTS

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