Queen Mary University of London
School of Law

LAW OF FINANCE

Seminar Materials

2009/2010

The Law of Finance

Seminar Outlines 2009/2010

The structure of the course

The first seminars will be held in rotation starting from weeks 3 and 4 of the winter semester. Seminars are bi-weekly. Students must read the *Introduction* and parts of Chapter 1 of Hudson's *The Law of Finance* before the first seminar. This module is structured so that these materials will be covered in lectures before students are required to consider them for seminars.

The following seminars will form the basis of the assessment of this module.

Seminar No.	***Title***	***Date, depending on your group, week commencing***
1	Introduction	September / October
2	Financial regulation 1: fundamentals	13 October / 20 October
3	Financial regulation 2: conduct of business	27 October / 4 November
4	Market abuse and money laundering	17 November / 24 Nov.
5	Contract law issues	1 December / 8 Dec.
6	Lending transactions	15 December / 11 Jan.
7	Securities regulation	18 January / 4 February
8	Tort	25 Jan. / 1 February
9	Breach of fiduciary duty	8 February / 15 Feb.
10	Banking law: banker-customer relationship	1 March / 8 March
11	Banking Regulation and Reform	15 March / 22 March
12	Derivatives	No seminar

NB: Weeks commencing 3 November and 16 February are *reading weeks* so there are no seminars in those weeks – hence the chronological gaps in the schedule above.

A suggestion for organising your study

While your seminars are scheduled fortnightly, it is not recommended that you start preparing for your seminar the day before it takes place because this will probably not give you enough time to read, assimilate and understand the material. It is suggested that you work as follows:

- Read ahead before the material is covered in lectures
- Organise your lecture notes as soon as possible after the lecture
- Prepare for your seminar sufficiently far in advance that you are able to read all of the textbook, statutory, regulatory and case law material, and also so that you have time to think about it and to answer all of the seminar questions in advance of the seminar.

- Finalise your notes as soon as possible after the seminar, because that is when you will understand the material the best.

In essence, try to put the lectures and the seminars in the middle of your preparation, instead of treating them as being the beginning and the end of your preparation.

What to read for this course

This document is simply made up of the questions which you will consider for the larger part of your seminars – all of the reading, statutory material, regulatory material, case law and academic literature is set out in the Lecture Course Documents. These materials contain cross-references to the Lecture Course Documents to tell you which material which you are expected to have read. You are given references to Hudson's textbook in the Lecture Course Documents: if you are using other textbooks casebooks, then you should rely on the indexes and tables of cases to identify the appropriate parts of those books.

"Focusing on paragraphs …"

The law of finance is potentially enormous. So, for the purposes of this course it is important that you are focused on the particular issues and the particular paragraphs of the textbook on which the course is asking you to focus, as well as that you learn about the law of finance generally. So, at the beginning of each seminar's materials you are referred to the requisite chapters of the textbook and to other reading material but, importantly, you are also told on which paragraphs in particular you are asked to focus for the material which will assessed in the examination. Of course, you should read whatever interests you beyond the set materials, but your seminars will focus on the identified reading.

How to study for this module

You must bring your casebooks, detailed notes and/or copies of judgements (depending on how you are choosing to study) to seminars. In the Course Documents, material with ** *must* be read in full if you want to learn successfully; material marked with * should be read in detail, but a casebook would suffice. All other material mentioned in the Course Documents should also be considered to identify their core principles.

It will be assumed that students have a good knowledge of the material before the seminar. As is mentioned in the Lecture Course Documents, it is not permissible for students to attend seminars unprepared and so seek to rely on the hard work of their colleagues. Students may be excluded from any seminar for which they have not made a genuine effort to be prepared.

The aim of this hand-out is to guide your preparation for seminars. This does not necessarily cover everything that you may want to read or to consider: you are encouraged to follow your own path beyond the core material. However, the manner in which material is covered in lectures and in seminars should guide you as to material considered to be important enough to be assessed in the examination. The seminars aim to follow the pattern of the lectures. The seminars can only focus on the most important cases and issues: for that, you should be guided by the lectures. The seminar will concentrate on the problems which you are referred to below.

It may not be possible to consider all of the problems for each seminar in class – your seminar leader will guide you on this matter. Your seminar leader will focus on

the most important aspects of each topic and therefore you should be guided by their advice. However, you must prepare all of the seminar questions in advance. You are expected to have read and prepared answers to the problem questions and other material in advance of the seminars, in part to save time in reading through the questions from scratch each time.

Seminars are about your learning, they are not meant to be about teaching

Importantly, the seminar is intended to give you an opportunity to discuss the material in these seminars, to ventilate any problems you have or any further material you have read, and importantly to make your learning an active process in which you can discuss the material. The purpose of seminars is not to lecture you all of the material again. For the most part, lectures are about teaching; whereas seminars are about learning. You should be able to answer your own simple questions with a little research, or by reading the cases again closely, or by using a dictionary or something of that sort. Your seminar leader is not expected to give you another lecture nor to teach you the material again. Alastair Hudson and Magdalena Latek will provide you with material in lectures and in seminars to help you to structure you work, and will give you feedback on your ideas and your in-course assessments: so, you will receive a lot of support. However, you must assume responsibility for your own learning, and ensure that you come to seminars prepared and with your own active knowledge of the material. Of course you should ask questions about anything which remains unclear, but you should attempt first to resolve those questions before the seminar.

This course is built on the idea that knowledge of one topic is a necessary foundation to learning the next topic. That is why ensuring you know, understand and have formulated your own views on the material is essential to getting the most out of the topics to come. Treating seminars as another teaching session, and leaving the moment when you confront the material until the revision period, is therefore a poor learning style. Learning is all about a *moment* at which you confront the material and formulate your own views about it. Ideally, that moment should come before the seminar, and then the seminar allows you to test your ideas in common with the other people in your seminar group.

How to spot an examination-style question

Questions which are indicated with an asterisk (*) before their number are the sort of questions which are similar to the type of questions which might be asked in an examination, or which contain elements which will tend to appear in the examination. Other questions are asked so as to guide you in your preparation for your seminars in this course, and to help to structure discussion in seminars. There is a specimen exam paper attached to the Course Documents.

Assessment

The problem questions in these seminar materials are questions which could be part of an examination. A specimen examination paper is attached to the Course Documents.

During the module, students will be invited to attempt two assessments, as contained in these materials: one in each semester.

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Seminar 1

Introduction

This seminar comes before some seminar groups will have had their first lecture. Its principal purpose is to explain how this course will operate, and to introduce you to the study of finance law. This is a new course, so we are keen to re-assure as to how it will operate and to show you how the material fits together.

The material for discussion is set out in Chapter 1 of the Course Documents.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Introduction	Pages li-lix
Hudson	Chapter 1: "Components of the Law of Finance"	1.01-1.29

Questions

1. What are the sources of finance law?

2. Does finance law exist, or are we making it up as we discuss it?

3. What happened in the global financial crisis 2007-09? How will you find out about that crisis and how will you stay up-to-date with the development of regulatory proposals in relation to the financial system during this module?

4. What do finance lawyers do?

5. Why are you studying this module? What do you hope to get out of it?

Seminar 2

Financial Regulation: fundamentals

The purpose of this seminar is to introduce the idea of what financial regulation is intended to achieve, and to consider in outline terms the effect of the global financial crisis of 2007-09. By the end of this seminar you should understand the roots of FSA financial regulation, the EU Lamfalussy process, and be able to discuss critically the overlap between the global financial crisis and the current regulatory structure. These issues will keep returning in later seminars and so you should develop your opinions on these regulatory structures in a number of different contexts through the course.

Detailed reading for this seminar is in Chapter 2 in the Course Documents.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 3: "The relationship between substantive law and financial regulation"	3.01-3.34
Hudson	Chapter 7: "EU Financial Regulation"	7.01-7.21
Hudson	Chapter 8: "UK Financial Regulation 1"	8.01-8.45

Questions

*1. What is the difference between regulation and substantive law?

*2. What is the purpose behind "high-level" regulatory principles? What are the advantages and disadvantages of using (i) high-level principles and (ii) light-touch regulation?

3. How has regulatory policy developed in the EU?

4. In what ways might we say that EU financial services policy moved towards an Anglo-Saxon regulatory model?

5. What are the FSA's regulatory objectives?

*6. What type of regulatory goals is the FSA required to pursue by statute, and are those the sort of regulatory goals which we might expect from a financial regulator?

Seminar 3

Financial regulation 2: conduct of business

The objective of this seminar is to analyze the core prohibition in s.19 FSMA 2000 and in particular conduct of business regulation.

For the appropriate material for this seminar, you should see Chapter 3 in the Course Documents.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 9: "Financial Regulation 2"	9.01-9.37; 9.44-9.46; 9.56-9.63
Hudson	Chapter 7: "EU Financial Regulation"	7.22-7.38
Hudson	Chapter 10: "Conduct of Business"	10.01-10.47

Questions

1. How is financial regulation in the UK structured? Which markets are regulated and how?

2. What were the new developments in relation to client care which were introduced by MiFID?

*__3.__ How does conduct of business regulation seek to protect investors?

NB: *Conduct of business regulation is a feature of many parts of this course, including the aspects relating to contract law. So, an important later question will be: how does conduct of business inter-act with the substantive law?*

4. What types of financial product are covered by FSA regulation? To what extent is ordinary banking activity (i.e. operating bank accounts, as opposed to investment activity) covered?

*__5.__ Gerald was aged 60. He had a history of alcoholism and was a season ticket holder at Queen's Park Rangers Football Club. He had a personal fortune of

£20 million which he had amassed since 1990 in developing private homes and selling them (he watched Sarah Beany's programmes on television religiously). After buying and selling his first development property in Ealing in 1990, Gerald had dealt in over two hundred more.

Before becoming a self-employed property developer, Gerald had worked for East Bank as a foreign exchange trader from 1980 to 1990.

Gerald decided to use half of his personal fortune to trade in shares, bonds and derivatives with River Bank from January 2008 onwards. Gerald filled in a "New Client Questionnaire for Private Individuals" for River Bank and gave the following information. (Text in bold is the bank's pre-printed form; text not in bold gives Gerald's answers.) The following are the only significant answers given.

Name:
Gerald Geraldson
Address:
Huge Mock Tudor Mansion, Ugly Little Village Full of Footballers, Hertfordshrie.
Date of Birth:
10 August 1950
Would you describe yourself as: an expert investor / a novice investor / an investor with some experience:
An epxert investor.
If you are an "expert investor", what is your experience in investment matters, please give dates and any information you can:
I was an investment manager with East Bank for ten years. I managd USD 280 million for various clients in total on various foreign exchange desks.
What is your purpose in investing with River Bank:
to make as much moneyy as possible.
What is the aggregate size of investment which you will be seeking to make:
About GB£ 10 million.
What proportion of your net worth does this constitute?:
About fifty per cent.
Are you a private investor?:
Yes.
From the table in the Promotional Leaflet you have been sent, in which markets are you intending to invest?:
Derivatives; Stcok lending; Equityies, Bonds.
Have you had a personal meeting with one of our investment advisors?:
No.
<u>Warning</u>: This information is provided for regulatory purposes. It is very important that you give full and honest answers to all questions so that River Bank can ensure that you receive a suitable service. River Bank accepts no liability for circumstances in which money is lost as a result of insufficient information being given.
You should remember that your investment can go down as well as up.

River Bank classified Gerald as an elective professional client.

River Bank sold Gerald the following products with the following results:-

(i) A complex derivative product which has only been recently developed. Gerald was emailed a document which contained a fourteen mathematical formula "explaining" how the derivative functioned. The derivative was dependent on the Russian rouble which fell unexpectedly in value. Gerald's investment lost £40,000.

(ii) An investment in General Motors shares, two weeks before newspaper stories began to circulate about General Motors needing an investment from the US government or else needing to seek bankruptcy protection. In a telephone conversation with a River Bank trader, Gerald had agreed "to invest in established companies in established industries".

River Bank did not let Gerald know that the bank would take a 3% commission on the sale of the General Motors shares. Consequently, it has emerged that acquiring the shares by means of the transaction which earned the bank 3% commission, it would have been possible to have acquired those shares for £10,000 less. Furthermore, River Bank have not kept copies of any other documentation of their transactions with Gerald due to a failure in one of their computer servers.

Questions

(a) What should River Bank have done to comply with COBS (i) in relation to any client and (ii) in relation to Gerald?
(b) What should River Bank have decided if they knew about all of Gerald's background?
(c) What other questions, if any, do you think River Bank should have asked (i) Gerald, and (ii) all of its clients?
(d) What breaches, if any, might there have been under River Bank's COBS obligations on these facts?
(e) Advise Gerald as to his potential actions for his losses, from memory, under the general law? I.e. what sorts of liability might be available?

[*The sorts of issues raised in this question could come up in an exam question, although the exam question would not be nearly as long as this. See the specimen exam paper and the First Assessment for a clearer idea.*]

6. Do the 'best execution' and 'best interests' principles create fiduciary duties?

Law of Finance

First Assessment

The **hand-in date** for this assessment is in your seminar in Week 9 or 10 (as appropriate, according to your timetable and assigned group). Essays which are handed in late will not be marked - absolutely no exceptions.

Either

1. "The stated objectives of the UK financial regulatory regime conceal the fact that financial regulation is intended only to pretend to ordinary investors that the markets are safe places into which there money can be poured. In truth, UK financial regulation is merely a light touch presence which can have very little effect on the natural behaviour of financial markets. The Financial Services Authority in particular offers merely a sticking plaster for a financial system which is terminally ill. The true nature of financial regulation is therefore different from what it might otherwise appear to be."

Discuss.

Or

2. Susan is the daughter of a very well-known bond trader, Michael Edwards, who died in January 2006. Susan has a BA in Economics from LSE and an MBA from the London Business School. She worked for Dirty Bank in corporate finance for two years and then for Yellow Bank in corporate finance for five years. In January 2004, Susan left Yellow Bank to work with her father as he invested his personal fortune of about GB£100 million in the bond markets. Her father made most of the investment decisions; but Susan specialised in making investments of GB£ 500,000 or less (without supervision from her father) in companies which she had encountered in her corporate finance work. After her father's death, Susan managed the family investment portfolio in the same way as her father had done, but relying entirely on bond investment advice from Blue Bank.

In January 2007, Susan decided to shift the entire portfolio of GB£100 million to Sword Blade Bank who were renowned for taking aggressive positions in new markets, and for earning their clients high returns on their investments. Susan told Sword Blade Bank that she wished to seek a higher return for the family investment portfolio than the average 8% which they had earned hitherto. Susan instructed Sword Blade Bank that she wanted to retain control of the investment portfolio, as opposed to granting discretionary control of it to Sword Blade Bank. However, in practice Susan accepted every piece of investment advice which she received from Sword Blade Bank which did not relate to investments in shares in companies of which she had knowledge from her days in corporate finance.

All of the information set out above was made known to Sword Blade Bank. However, Sword Blade Bank did not seek any other information from Susan.

Sword Blade Bank suggested the following investments. First, an investment of GB£4 million in “high octane equity swaps” contracts which Sword Blade Bank had developed in house to speculate on the respective performance of “credit default swaps” between different companies in emerging markets. Susan agreed when she learned that some of these products had earned a return of 17%. By the present date, however, due to the financial crisis in autumn 2008 those swaps have not generated any money at all because they were all required to be paid through the now insolvent Lehman Bros. It is not expected that anything will be paid until the Lehman Bros insolvency proceedings have progressed further.

Second, an investment of GB£10 million in the shares of Red Bank in December 2008. Red Bank is a UK bank which posted a loss of GB£4 billion in 2008 and which was seeking to avoid having to grant shares to the UK government in exchange for sufficient capital to keep it solvent. Those shares fell from the original purchase price of 100p to 12p, but have since risen to 95p at present prices.

Advise Sword Blade Bank on its conduct of business obligations in relation to the Edwards family investment portfolio.

Seminar 4

Criminal Law: Market Abuse and Money Laundering

For the appropriate cases for this seminar, you should see Chapter 4 in the Course Documents.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 13: "Criminal law in the law of finance"	
Hudson	Chapter 14: "Insider dealing"	14.01-14.81
Hudson	Chapter 15: "Money laundering"	15.01-15.41

Questions

1. What sorts of activity constitute "market abuse"?

2. Why do we criminalise insider dealing? Would the regulation of market abuse by the FSA be a more promising avenue for the protection of the integrity of the markets?

***3.** Consider the criminal liability of the following people.

(a) Carcetti was Chief Executive of the Italian company "Baltimori", an electronics giant in Europe and competitor of Wire plc. Daniels was Chief Executive of Wire plc. Carcetti and Daniels met in Milan on 1 November 2008 to discuss the possibility of a takeover of Wire by Baltimori. This meeting was held in secret at the house of a mutual friend of both parties. Carcetti bought himself 100,000 shares in Wire plc on 2 November after the meeting seemed promising.

(b) Suppose the following further information comes to light. First, that shares in Wire plc stood at 100 pence at the opening of business on 2 November 2008. Secondly, that on 3 November Carcetti had lunch with the Milan business correspondent of a London newspaper that same day when he ostentatiously placed a copy of Wire plc's accounts on the restaurant table when the journalist asked "do you see any prospects for the consolidation of businesses in the electronics sector in

Europe?"; such that the correspondent published a story the next day under the headline "Hints of Takeovers on the Wire", which suggested that Wire plc was likely to be taken over. Thirdly, that the value of shares in Wire plc rose to 150 pence by 5pm on 3 November 2008. Fourthly, that Carcetti sold his shares on 4 November for 155 pence.

(c) The success of Wire plc as a business depended on the success of its planned future product "Super Bug" which was to be sold to the law enforcement community if its technology turned out to be reliable.

Herc was the Director of Research and Development for Wire plc. Herc entered into a "put option" with Monster Bank on 5 November 2008 whereby he could sell his holding of 200,000 shares in Wire plc to Monster Bank for 140 pence. At the same time he also entered into a "call option" which entitled him to buy 200,000 shares in Wire plc from Monster Bank for 120 pence.

On 6 November 2008 Herc made a statement during a filmed interview for a financial newspaper's web-site that he was "concerned that Super Bug technology would not be profitable". The share price of Wire plc fell to 110 pence as a result. Immediately, Herc exercised his put option selling his shares for 140 pence to Monster Bank on 6 November.

On the evening of 6 November 2008 he issued a press release to say he had misspoken and that he had meant to say he was "concerned that Super Bug technology would not be profitable *for the next six months, but that it would be very profitable in 2009*". The share price rose back to 150 pence when this news filtered around the market. Herc exercised his call option and acquired 200,000 shares in Wire plc under the call option from Monster Bank for 120 pence.

4. In what way do you think that criminal law is concerned with the following in relation to financial transactions:

- Punishment
- Market integrity
- Investor protection
- Ensuring a level playing field for all investors
- Enhancing the UK economy
- Good ethics in the markets?

There may not be time to consider the following question, which relates to money laundering. You will be guided by your seminar leader:-

5. Consider the criminal liability of all of the following people.

Cheryl was the manager of a bureau de change on the Strand in London. The bureau de change was part of a chain of bureaux owned by Quicky Cash Ltd. The sole shareholder of Quicky Cash Ltd was Dimitri.

The bureau de change passed about £30,000 in various currencies through it on an average business day. On various days in December 2008, Dimitri met a series of very large, muscular men in leather coats in the bureau on the Strand. These men carried sports bags or briefcases containing large numbers of used banknotes, which were mostly Russian roubles but some were US dollars. These banknotes were converted into sterling. In the aggregate, each man usually carried the equivalent of about £20,000 in cash. Dimitri had arranged for the bureau to carry a much larger stock of sterling banknotes in late November.

The first occasion on which this happened was 1 December. Dimitri reassured Cheryl that it was nothing out of the ordinary, just a friend of his who had brought his money to London while he had taken a job here so as to avoid the risk of Russian banks refusing to transfer his money to a London bank. Cheryl thought that was a sensible explanation.

On 3 December, Dimitri brought another man to Cheryl's desk at the bureau and told her a similar story. Cheryl thought that was an unlikely coincidence but she was frightened of Dimitri's temper and thought she had to obey him as the owner of the company. Later she asked Dimitri if the two deposits were really legitimate.

On 5 December, Dimitri brought in a third man but took him to the desk of a co-worker, Angela, instead of to Cheryl's desk. Angela did not ask any questions and simply changed the money.

It emerges that all of the moneys changed at the bureau were the product of drug deals in Moscow.

6. What are the policy goals of money laundering? Is it too draconian?

***7.** What is the purpose of criminal law in relation to finance?

Seminar 5

Contract Law Issues

The purpose of this seminar is to analyze a number of contract law issues which arise in the context of finance law and to introduce a number of issues which will occur and recur in later seminars. This law will be familiar to you from Common Law 1, although the contexts in which they are applied (and some of the key cases) will be new to you. However, this law is built on the same principles which you studied in Common Law 1.

For the appropriate cases for this seminar, you should see Chapter 5 in the Course Documents.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 17: "Formation of contracts"	17.14-17.33
Hudson	Chapter 18: "Validity of contracts"	18.01-18-21; 18.39-18.54
Hudson	Chapter 19: "Master agreements"	19.02-19.26; 19.36-19.55
Hudson	Chapter 23: "Taking security"	23.01-23.12
ISDA	ISDA Master Agreement 2002	ss.5, 6.

Questions

1. Why would the nature of transactions created between bank traders be likely to cause offer and acceptance problems?

2. How would you advise a bank to organise its trading activities in the light of the law on mistake, offer & acceptance, and misrepresentation?

***3.** Consider the "Instructions to Counsel" (enclosed with these Seminar Materials) which asks you to advise in the case of *Prendergast v Sword Blade Bank plc*.

Importantly: these materials are full of contradictions, spelling mistakes, and confusions – just as instructions to counsel and the testimony of the parties often are.

This exercise requires you to assimilate the facts, to identify the issues, and perhaps to consider what sorts of further evidence you would require and/or what you would ask in cross examination of these witnesses.

These facts raise issues of contract law and, significantly, they also raise questions of conduct of business regulation too.

A problem question could consider the same sorts of issues, but it would not be anything like this long!

4. Why are master agreements used? What are the benefits of a master agreement structure?

5. What are the strengths and weaknesses of the various means of taking security? [This question may need to be held over to next time.]

Seminar 6

Loan transactions

For the appropriate cases for this seminar, you should see Chapter 6 in the Course Documents.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 19: "Master agreements and common contractual terms and conditions"	19.27-19.35 19.56-19.85
Hudson	Chapter 33: "Ordinary Lending"	33.01-33.44
Hudson	Chapter 34: "Syndicated Lending"	34.01-34.20 34.42-34.45
Hudson	Chapter 35: "Bonds"	35.01-35.14 35.22-35.23

Questions

1. How effective are loan covenants at protecting lenders? What sorts of risks are protected by loan covenants.

2. Beyond loan covenants, how might lenders protect themselves against the risks associated with borrowers?

***3.** Consider the "Instructions to Counsel to Advice in relation to a Loan Agreement" relating to "*Karen Walker plc and River Bank plc*" [enclosed with the attachments to these Seminar Materials].

[An exam question could be based on such a set of facts, but it would be much shorter.]

***4**. What are the roles of a syndicated loan agent and a bond trustee; and what is the difference between them?

5. In what circumstances can a lender's claim to immediate repayment be resisted?

Seminar 7

Securities regulation

For the appropriate cases for this seminar, you should see Chapter 7 in the Course Documents.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 37: "The Fundamentals of UK Securities Law"	Generally.
Hudson	Chapter 38: "Prospectuses and Transparency Obligations"	38.01-38.33
Hudson	Chapter 41: "Liability for Securities Issues"	41.14-41.16 41.36-41.40
FSA	Prospectus Rules	

Questions

1. What was the purpose of the Lamfalussy process at the EU level?

2. What is the purpose of the Prospectus Directive?

3. Wire plc is intending to issue shares to the public at large by admission of those shares to trading on the Main Market of the London Stock Exchange. Wire plc is in the business of manufacturing covert surveillance equipment for use by police and security services. Wire plc was validly incorporated in the UK in 2008 as a public company. This will be the first issue of its shares to the public. The board of directors is comprised of Daniels (Chief Executive Officer), Greggs (Chairman), Herc, and Carver, none of whom have any professional qualifications but all of whom have experience in managing small manufacturing companies. Herc and Carver have degrees in electrical engineering and are therefore the directors in charge of product development and design.

Advise Wire plc as to its regulatory responsibilities under the prospectus rules.

***4.** As before, Wire plc is intending to issue shares to the public. The process of preparing the prospectus has begun. Consider the following facts, and advise all the board and all the parties mentioned as to the preparation of the prospectus, including the suggested wording at the end.

(a) Wire plc has developed a new genre of surveillance devices known as "The Super Bugs" which have a common design feature which makes them particularly robust. As a result they can be concealed in small objects regularly left on the street (like tin cans or tennis balls) or around buildings under surveillance. The Super Bug has no patent yet, although a patent application has been lodged. Herc believes that the patent will not be awarded because it is very similar to a process used by another company; although Carver believes that there are enough differences between the two designs to constitute a separately patentable process.

(b) Greggs has commissioned a report from expert accountants, the Barksdale Group, which suggests that if the Super Bug design receive a patent and has successful field tests, then it should acquire about 50% of the market for "bugs", and so should generate annual profits of £40 million. If the patent application or the field tests are unsuccessful, then it is suggested that Wire plc will not establish such a large market share and consequently that its annual profits are likely to be less than £5 million. The report mentions the name of Stringer, a senior partner of the Barksdale Group, although he did not approve the final version of the report despite being involved in much of its preparation.

(c) The board of directors of Wire plc is hopeful that Bunk will join the company as its chief research officer. Bunk is very well known in the law enforcement community in Europe and the USA, and so would grant Wire plc an enormous amount of goodwill and investor confidence, even though the company is new. Bunk is still haggling over his salary and so he has not yet signed a contract of employment with Wire plc; he has told the board of directors that he is considering alternative offers.

McNulty, the solicitor advising the company, prepared language for the prospectus which read:

> "The board of directors of Wire plc are confident that the pending patented process for the Super Bug will establish the company as one of the leading surveillance equipment companies in Europe. The level agreement reached with Mr Bunk to act as to the way in which he will become involved with the future of Wire's business plan demonstrates the standing of this company in the international surveillance equipment marketplace. Mr Stringer of the Barksdale Group has therefore been able to predict profits of at least £40 million per annum."

(McNulty has since gone on record as saying: "What did I do?".)[1]

[1] If you have never watched *The Wire* on television then this comment will not make much sense, but it does not really matter to the problem.

Seminar 8

Tort

For the appropriate cases for this seminar, you should see Chapter 8 in the Course Documents. You should also note that much of the material which forms the focus of this seminar was discussed in the last seminar on Securities Regulation.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 25: "Fraud and undue influence"	25.01-25.35
Hudson	Chapter 26: "Negligence and other liability in tort"	26.01-26.52
Hudson	Chapter 41: "Liability for Securities Issues"	41.01-41.81
FSA	Prospectus Rules	

Questions

1. In the law of finance, to what extent is *Caparo v Dickman* still good law given regulatory developments?

***2.** *The facts are the same as in Questions 3 and 4 in the previous seminar's materials relating to Wire plc.*

Wire plc issued shares to the public using the language which McNulty drafted for the prospectus in the preceding question on 1 September 2008. Bunk in fact took work elsewhere; and the patent application was refused, but is currently under appeal. This information was made public on 1 October 2008.

The strategy for the issue of shares in September 2008 was, however, changed: the investment bank leading the issue process advised the placement of shares with a small number of expert investors, including Marlo, who all relied on the terms of the prospectus. Marlo sold his shares on 15 September 2008 to Bubbles, at a total loss to Marlo of £10,000. The reason

for the loss was the publication of the news that a competitor of Wire plc was awarded a patent for its equivalent of the Super Bug range of products, and therefore shares in Wire plc fell in value. Bubbles had relied on the statements made in the prospectus. By 2 October 2008, the market value of shares in Wire plc had fallen by 50% and so Bubbles suffered a total loss of £50,000.

Advise Marlo and Bubbles.

[Your advice should consider both the common law and liability under s.90 FSMA 2000.]

3. In what circumstances might a ratings agency or an investment bank be liable for losses suffered in relation to the sorts of transactions which arose in the lead-up to the financial crisis of 2007-09?

***4**. Billy is a trader working on the equities desk at Shrew Investments, a UK resident stockbroking firm regulated by the FSA. Billy held two classes of shares in December 2008 which he wanted to sell so that he could book profits and increase his personal bonus for the year. (The contract between Shrew and its clients provided: "Shrew Investments shall bear no fiduciary duties to its clients in equity or at common law except in cases of dishonesty".)

The first shares were ordinary shares in Alpha plc traded on the London Stock Exchange. Billy had met a friend of his from school, Sidney, in *The Bear and Bodkin* pub in Whitechapel. Sidney told Billy that there was a rumour that the CEO of Alpha plc had been embezzling funds from the company and fabricating accounts to cover up his actions. Consequently, those who had heard the rumour expected that Alpha plc would soon suffer a halving of its share price. This rumour became public knowledge on the next morning. The next morning Billy disposed of all of the shares he held for Shrew at their open market value to the ten clients over whose funds he had complete discretion.

The second shares were ordinary shares in Beta plc traded on the London Stock Exchange. On the US Bloomberg TV network, there had been a programme which had recommended Beta plc as a good buy for private investors. Billy had been instructed to acquire those shares in the first place by his director and so had not bothered to find out about the company. Beta plc was considered by most market analysts to offer a "40:60 risk" of above average profits but a "50:50" risk of earning no profits for the next five years if it did not acquire patents over its new products. All of this information was readily available in analysts' reports on Billy's desk and in the financial press. Billy did not read any of it. Billy sold all of the Beta shares to the private clients over whose funds he had complete discretion.

Both sets of shares have since halved in value. Alpha's products were found to cause harm to customers and so need to be scrapped. The CEO's activities did not become public. Beta did not secure the patent protection it needed. Billy sold the shares at a profit and so had a further £10,000 added to his bonus.

Advise Billy and Shrew Investments.

[clue: this problem is about negligence and common law fraud.]

Law of Finance

Second Assignment

The **hand-in date** for this assessment is in your seminar in Week 9 or 10 (as appropriate, according to your timetable and assigned group). Essays which are handed in late will not be marked - absolutely no exceptions.

Do whichever question you want.

1. "The financial crisis of 2007-09 was entirely avoidable. It demonstrated that the law of finance and the regulation of finance were either comprised of inappropriate principles or were badly implemented. The culture of finance law must change, and its lawyers must accept their obligations as risk managers."

Discuss.

2. Laura was a solicitor advising China Lion plc which was seeking to offer shares to the public for the first time in June 2009. China Lion plc has had an average annual turnover (i.e. sales) of about £100 million. China Lion plc manufactured china crockery and imported tea from China to the UK. China Lion plc usually earned 70% of its profits from the import and sale of tea in the UK. The crockery business provided cheap crockery to the restaurant business, and this activity had seen its profits halve during the recession in 2007 and 2008. Therefore, the company's total turnover for 2009 was about £85 million, with sales from importing tea constituting about 82% of the group's profits in 2009.

The company began manufacturing importing exquisite porcelain figurines for sale in the UK from January 2009. This new business venture was part of the luxury goods market. That market sector had come under pressure during the recession. The distinctive aspect of China Lion's porcelain figurines are their use of the artist Solon's unusual designs which are based on ancient Chinese artworks. Somewhat optimistically, the company proceeded with manufacture of the figurines without having completed a licensing contract entitling the company to use Solon's designs. Solon refused his permission at a meeting in July 2009. It is not clear whether this was just an attempt to raise the amount of money which Solon would be paid, or whether he genuinely intended to withhold his permission permanently. The company spent £10 million on the manufacture of figurines in 2009. None of them will be put on sale until the licence dispute is resolved.

China Lion plc's tea plantations are in difficulties. They own four major plantations of roughly equal size and profitability. In March 2009 it was announced (and reported in the financial press) that the soil in the X plantation had been polluted by the dumping of chemicals in the river which passes through the plantation from a factory upstream. On 1 April 2009 it was announced that plans for a dam would go ahead which would mean that the Y plantation will be flooded during 2011 to form a reservoir. It is unclear whether or not China Lion plc will be compensated for the loss

of Y plantation in a way that will pay for the acquisition of equivalent land elsewhere or for loss of profits. The CEO of China Lion plc issued a press release on 2 April 2009 which stated: "China Lion plc is in regular discussion with the Chinese authorities about compensation for the loss of the plantation and those discussions are proceedings perfectly satisfactorily."

Laura prepared a prospectus containing the following statements:

- Concerns about the loss of Y plantation in the financial press have been overblown because perfectly satisfactory compensation will be paid by the Chinese government, meaning that there will be little impact on China Lion plc.
- Environmental scientist Prof Andreas Andersson completed detailed environmental assessments of the other three plantations between August 2008 and February 2009 and declared that the soil was ideal for tea development.
- China Lion's business has been robust even during a deep, global recession. The expansion into luxury goods will meet the upswing in the global economy which is expected in 2010. The use of designs by world famous artists (likely to include giants like Solon) will create an exquisite range of ornaments to rival global brands like Wedgwood and Lladro.

The prospectus was authorised by the FSA. The shares were issued on 1 December 2009. Ben acquired shares in China Lion plc in the after-market on 1 January 2010. Afterwards, the Chinese authorities issued a statement that they had made no promises about compensation. Solon appeared on television and mentioned that he would not give his permission for the sale of the figurines. Consequently, the share price in China Lion plc fell 10% from the issue price, and 20% from the price which Ben had paid for the shares.

Advise Ben.

3. "Private law should adopt principles from financial regulation so as to formulate a kind of finance law which is free from some of the unnecessary difficulties which have hampered the development of private law outside the financial sphere."

Discuss.

Seminar 9

Breach of Trust and Fiduciary Duty

For the appropriate cases for this seminar, you should see Chapter 9 in the Course Documents.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 27: "Breach of Trust"	27.01-27.44
Hudson, *Equity & Trusts*	Chapter 19: Tracing Chapter 20: Liability of Strangers	*
Thomas & Hudson, *Law of Trusts*	Chapter 30: Liability of Strangers	*

**The relevant chapters of Equity & Trusts and Thomas & Hudson, Law of Trusts will be made available on-line or in the library – listen for announcements in the lectures. Otherwise they are available in the Short Loan collection in the library.*

Questions

1. In what circumstances will a bank or an investment firm be a fiduciary? Should investment firms be able to exclude their liability for fiduciary duty?

2. In what circumstances will investment advisors face liability for (a) dishonest assistance and (b) knowing receipt?

***3.** Joanne was a senior trader with Sword Blade, an investment firm with 100 traders in the UK, and also one of the thirty members of the board of directors. Sword Blade is regulated by the FSA. Joanne had personal responsibility within the bank for all investments made through Suntopia.

Hector contacted Joanne in March 2008 by telephone. He introduced himself as the trustee of a group of Suntopian investment trusts which raised investments from Suntopian investors. Hector asked Joanne to invest £5 million on behalf of this trust. The documentation which Hector provided to

Joanne disclosed that the investors were ordinary members of the public in Suntopia. That documentation also disclosed that the trust's total investment capital was about £100 million.

During 2008 the first investments came from Hector as anticipated and were paid into the trust's account held with Sword Blade. The profits were returned to Suntopia and were paid into the trust's accounts in Suntopia.

Then in December 2008 Hector flew to London to meet Joanne for the first time. He told Joanne that he expected the trust's activities and investor base to expand hugely in the coming months and that he would be passing all of his investment business through Sword Blade. Joanne said she was very interested in providing whatever services Hector needed. Hector then told Joanne that he wanted to invest the entire £100 million from the Suntopian trust through Sword Blade over the next five months, in amounts of £20 million per month. The capital investments and their profits were, however, to be changed into US dollars and paid in small parcels into a number of different bank accounts in Hector's name in Panama, in the Cayman Islands and in the British Virgin Islands.

Joanne agreed to the arrangement. She asked no further questions about the trust's activities. She earned her usual commission from Sword Blade in relation to this business. When asked by her fellow directors how she had acquired such large investments from Hector, she replied: "My personal moral code in relation to clients is that I follow their instructions completely. Hector has instructed me to maintain complete confidentiality." The other directors were very angry at this, demanding more information, but Joanne refused to change her mind.

Later that day, it transpired that Hector had stolen the entire £100 million from the trust. Both he and the money have now disappeared.

Advise the beneficiaries of the trust (paying attention also to the regulatory obligations of the parties (if any)).

***4.** "The manner in which the judiciary imposes fiduciary liability is different from the obligations which are created by financial regulation in many contexts. It is the case law which is moving in the wrong direction." Discuss.

There might not be time to consider this problem (which relates to tracing). You will be guided by your seminar leader.

5. Arthur was the sole surviving trustee of the Croker family trust. Arthur took £1 million from that trust in breach of trust. Arthur has claimed latterly that this money was a loan, but it was undisclosed to the beneficiaries and not documented.

On 1 September 2008, Arthur paid the £1 million into his own current bank account #3030 with Bridger Bank. That money was mixed with £200,000 which Arthur was holding on trust for his wife, Bernice.

On 2 September, Arthur used £100,000 from #3030 to acquire shares in Insolvency Practitioners plc. Those shares have since trebled in value.

On 3 September, Arthur used £300,000 from #3030 to acquire shares in Static plc. Those shares have not changed in value.

On 4 September, Arthur used the remaining money to invest in Lehman Bros.

The terms of Bernice's trust were that "Arthur should invest half that amount in any professional organisation which was likely to make profit from a recession and the other half in any company which is likely to hold its value".

On 5 September, Bernice declared a trust over "any money that Arthur holds on trust for me for the benefit of my children".

Advise the beneficiaries of the Croker family trust.

Seminar 10

Banking Law – the banker / customer relationship

For the appropriate cases for this seminar, you should see Chapter 10 in the Course Documents.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 30: "The banker and customer relationship"	30.01-30.38
Hudson	Chapter 31: "Payment methods"	31.01-31.30

You are expected to have read the problem questions and to have prepared answers to the problem questions in advance of the seminar.

Questions

1. Why would it ever have been thought that bankers were trustees in relation to their customers? Is it a more convincing analysis to use contract law instead?

2. Under traditional banking law. in what circumstances will a bank not be obliged to treat their customers' affairs in confidence? How does that tally with money laundering law (especially a bank's obligations to report under s.328 POCA 2002) considered in seminar 4.

***3.** Pratchett was a customer of Dragon Bank. He had held a current account and deposit account with Dragon Bank for ten years. Pratchett's business is providing training courses in business ethics and regulatory compliance for independent financial advisors. This involves him travelling around the country extensively, such that he is often away from home for extended periods.

In January 2009, unbeknownst to Pratchett, his current account details had been illegally obtained by criminals in the USA using "spyware" technology to read the contents of his desktop computer's hard drive. The criminals were using that account (among many others) to launder money from drug-related crime in New Jersey. A large number of small, overnight deposits were made into that account and the money removed the next day. There were sixty transactions of this sort (including a deposit or a withdrawal of about £500 on each occasion) in two months. The desktop computer was left switched on at

the home-office which he rarely used in the early part of 2009 because he was travelling so much. Because he was travelling, he never read any of his hard copy bank statements.

On 20 February 2009, Vimes (an employee of Dragon Bank) became aware of the payments into and out of Pratchett's account due to a report generated by Dragon Bank's "Oversight" software which spotted suspicious patterns in client accounts. Vimes organised for a report of the suspicious activity to be made to the authorities further to s.328 of the POCA 2002.

Consequently, Pratchett's accounts were frozen for three weeks. Bank staff were precluded from giving Pratchett any information in response to his annoyed mobile telephone calls as he travelled the north of England delivering training seminars. As a result of having his accounts frozen, Pratchett failed to make a monthly instalment payment on his car which put him in breach of his contract such that the car was repossessed, requiring him to spend £3,000 on hiring a replacement car. Pratchett also failed to pay a deposit on office premises which he had intended to lease, which he maintains has cost him £500 in storing the new office equipment he had bought elsewhere, and which he claims lost him the opportunity to gain work from "up-market, new clients who would have been impressed by my new offices" in the amount of £10,000.

Coincidentally, Vimes was in a relationship with Weatherwax, another employee of Dragon Bank who worked in the branch with which Pratchett kept his accounts. Vimes told Weatherwax about Pratchett's accounts being frozen, but would not tell her precisely the cause. The next day at work, Weatherwax was telephoned by another client, Carrot, who had been in negotiations with Pratchett to enter into a partnership. Carrot asked whether or not Practchett had set up a standing order on his business account to share some IT expenses with Carrot. Weatherwax answered: "Well, he won't have done because his account has been frozen." Carrot answered in surprise: "Really. Why would that be?" Weatherwax answered: "Well, I understand they only do that sort of thing when the account holder is mixed up in serious criminal activity like drugs or prostitution." Carrot left the bank and instructed his solicitor to terminate the partnership negotiations with Pratchett immediately. Pratchett claims that the loss of this partnership will cost him £30,000 in new business each year and lost him the chance to cut his business overheads by £20,000 per annum.

Now the authorities acknowledge that Pratchett was not consciously involved in any sort of criminal activity.

Advise Pratchett.

***4.** Nicholas Jenkins (aged 63) was an actor's agent who employed Pamela Flitton (aged 28) as his personal assistant (PA) in January 2009 after his previous PA of twenty years retired. Pamela had an impressive cv and excellent references. Nicholas had met her at a party celebrating the opening of a new art gallery in Cork Street, where Pamela had been working as a waitress. They had begun talking, which turned into flirting, and Jenkins said he was looking for a new PA. It was Jenkins's practice to trust his PA implicitly with the cheque book for his business account. Jenkins owned the

business and therefore he owned the money in that bank account absolutely. The account was held with Widmerpool bank.

Pamela had fabricated most of her cv and had given Jenkins forged references at her ten minute interview. Jenkins gave her the cheque book to the business bank account in her second week working for him. All seemed well for the first month. Pamela kept the appointments diary impeccably, made coffee well, and typed acceptably well.

In her fifth week, Jenkins wrote a cheque which was made payable to a client: "*Mr Finkin*", for an amount of "*Two hundred pounds only*". He signed it, and gave it to Pamela to post to Finkin together with a letter which Pamela was typing. Pamela decided to alter the cheque. She altered the words "Pay *Mr Finkin*" to "Pay *Ms Flitton*": the letters "ink" were slightly crudely changed to "litt" but because Pamela used Jenkins's thick nibbed fountain pen, the change was not too obvious. She also changed the amount of "*Six hundred pounds only*" to "*Seven hundred pounds only*" where there was a large gap in the original between the words "six" and "hundred", where there was no dot over the "i" in "six" in the original, and where the "x" in "six" in the original was written so that the top half of the "x" was much larger than the lower half, due to Jenkins's handwriting. The cheque was honoured by Widmerpool Bank and paid into Pamela's account with Quiggin Bank.

Finkin telephoned two days later inquiring where the cheque was. Slightly perplexed, Jenkins wrote another cheque and accepted Pamela's explanation that the cheque must have been lost in the post. Jenkins did not check his bank statement which arrived one week later, because that showed that the cheque had been paid out by Widmerpool Bank.

Pamela altered three more cheques which were payable to Finkin in the same way. However, on these occasions she sent a cheque to Finkin from her own bank account, and therefore simply kept the excess by which she had falsified the cheque. By chance, Finkin and Jenkins met in Waitrose a little while later, and Finkin observed how odd it was that he was being paid out of Pamela's personal bank account.

Jenkins now seeks your advice.

5. If you buy shoes from a website which leads to someone stealing your credit card details and gambling away the money in your bank account somewhere in Nevada, so that your credit card company rings you really early on a Saturday morning to ask if you've been gambling on your laptop in a hotel in Nevada (even though they've just rung you at home), so that you get a new credit card with a different number, and you then go and buy more shoes on that same website so that your details are stolen again by some guy gambling on a website from a laptop in a seedy motel in Nevada, should your bank really be required to protect your confidentiality and replace all the money in your bank account on the second occasion? In general terms: at what point should the law oblige banks to protect customers, and at what point should we take responsibility for cyber-crime for ourselves?

Seminar 11

Banking Regulation and Reform

For the appropriate materials for this seminar, you should see Chapter 11 in the Course Documents. Because this area is in flux at present, you will be given advice about further reading in the lectures and it is expected that a large amount of possible reading will be made available on Blackboard.

This area is also the culmination of a large number of themes you have been following through the course so far. Therefore, the reading is intended (as the earlier discussion in lectures and seminars has been) to offer you a large number of possibly pathways so that you can follow the themes, arguments and contexts which interest you most.

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 29 "Banking Regulation"	29.01-29.78
Hudson	Chapter 32 "Lessons from the Banking Crisis of 2008"	32.01-32.34

Questions

1. What caused the banking crisis? How should the crisis be understood?
2. To what extent was the banking crisis really a crisis of banking regulation?
3. How are banks currently regulated in the UK? Is this suitable?
4. Does the tri-partite arrangement offer a useful means of regulation?
5. What were the policies and objectives behind the Banking (Special Provisions) Act 2008 and the Banking Act 2009?
6. What are the principal proposals for reform?
7. What do you think (a) is, (b) should be, the future for finance law?

Topic 12

Financial Derivatives and Taking Security

For the appropriate cases for this seminar, you should see Chapter 12 in the Course Documents. *This topic is an important part of finance law, although it can be very technical and involves an enormous amount of material. Consequently, we decided that it was outwith the material which would be considered in the seminars. However, as part of your education in finance law (particularly if you wanted to practise in the area, and possibly if you wanted to understand some of the technical issues in the banking crisis) that would be a serious omission. So, Topic 12 is included as an elective part of the course which will be covered in lectures and for which some sort of seminar arrangement will be made by Prof Hudson for students who are interested. This Topic 12 could also form part of your essay writing in the examination.*

Reading:-

Source	*Chapter*	*Focusing on the following paragraphs*
Hudson	Chapter 43: "Financial Derivatives Products"	43.01-43.55 [For info only]
Hudson	Chapter 44: "Documentation of financial derivatives"	44.01-44.07 44.41-44.56
Hudson	Chapter 45: "Collateralisation"	45.01-45.04 45.31-45.62
Hudson	Chapter 46: "Termination of financial derivatives"	46.01-46.23 46.28-46.50

Background reading:
Alastair Hudson, *The Law on Financial Derivatives* (4e, Sweet & Maxwell, 2006)
Alastair Hudson, *Swaps, Restitution and Trusts* (Sweet & Maxwell, 1999)

Questions
1. What is the purpose of the ISDA Master Agreement? How successful is it?
2. How is security taken in derivatives transactions?
3. Should over-the-counter derivatives be regulated?

The End
ASH

Additional documents attached to the hard copy of the Seminar Materials: (1) *Prendergast v Sword Blade Bank plc* materials; (2) Karen Walker plc and River Bank plc materials (3) Marking Scheme