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Investor alert

The impact of limitation periods on claims in relation to stuctured finance investments

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Time is running out to bring certain types of claims against advisers and financial institutions in relation to investments made in the last days before the onset of the global credit crisis in 2007.

Limitation periods

Even if the investor has not yet suffered a crystallised financial loss (but merely a market value loss – a discussion of which will be the subject of the next newsletter in this series), the time limit for bringing a claim in respect of that loss will not only have started to run, but may in fact be about to expire.

Most systems of law impose a time limit in which to bring a civil claim to protect potential defendants against old, stale claims. Under English law the majority of claims that an investor may have in respect of financial products are likely to have a time limit, a limitation period, of 6 years. If a claim is commenced in the English court after the applicable time limit has expired, a defendant is likely to have a complete defence, regardless of the merits of the claim.

Heads of claim

Claims in respect of underperforming financial products will generally fall into one of four categories: mis-selling, mismanagement, disputes over the interpretation of documents, and pricing/valuation disputes. In legal terms, these will be classified as claims in contract or in tort, or in the case of misrepresentation, a claim under statute (the Misrepresentation Act 1967). In England and Wales, the Limitation Act 1980 provides that each of these types of claim has the same limitation period of 6 years, unless the contract was entered into by deed, in which case the limit is 12 years.

When does the limitation period start to run?

The key issue is to identify when the limitation period starts. In each of the relevant types of claim the general rule is that time runs from the date when all the elements of the claim have arisen – in technical terms, when the cause of action accrues. In contract claims the cause of action accrues when a breach of contract takes place. A claim for breach of contract does not require loss or damage to have occurred. In contrast, in the case of a tortious claim such as breach of duty to advise, or negligent misstatement, the claim is only complete when loss occurs as result of the breach. Time starts to run from the time the loss is suffered. For a claim under the Misrepresentation Act 1967, time runs from the date the claimant enters into a contract in reliance on the misrepresentation.

For tortious claims for breach of duty or negligence, there are also two complicating factors. The first is commonly referred to as 'latent damage'. If the claimant is unaware of all the material facts required to complete the claim, time does not start to run. In such a case, the limitation period will be the later of (a) 6 years from when the cause of action accrued (i.e. the date damage is caused) or (b) 3 years from the date when the claimant knows or ought to have known: (i) the material facts about the loss suffered; (ii) the identity of the defendant; and (iii) that the loss was attributable in whole or in part to the act or omission that is alleged to constitute negligence. There is a 15 year long-stop from the date of the defendant's negligent act or omission.

A claim for loss for breach of contract does not require loss or damage to have occurred

However, there are risks in relying on this latent damage provision as it is not necessary for the claimant to have precise details of the alleged negligence or to identify conclusively the acts or omissions that caused the loss in order for the 3 year time period to start to run. The claimant need only to have sufficient information to make it reasonable to commence investigations into the potential claim against the defendant. Recent cases have shown that waiting for all details to be discovered can be fatal to the claim. The other complication for negligence claims is in identifying the date at which loss has been suffered.

In cases where a claimant has acted upon negligent advice and entered into a flawed transaction, it is likely that time will start to run from the date of the transaction. It is irrelevant that the claimant does not suffer an actual loss at that time. The actual financial loss may come later but the English court will view the damage as being suffered at the time the claimant is committed to the transaction that leads to the financial loss. Only if the ultimate loss is entirely contingent on some external factor will time be delayed. Several cases in the English courts have denied claimants' arguments that their loss was contingent, holding that the only contingent element was the quantum of the loss, the reason for the loss being the entry into the flawed transaction.

Limitation periods

If there is any element of fraud alleged then time can also be delayed if the claimant can show that the defendant deliberately concealed any fact relevant to the claimant's right of action.

The impact of the domestic laws of the claimant

One further consideration for a contract claim in particular is whether English law is in fact the appropriate source of the limitation period. If the contract is governed by foreign law, then the English court will apply the limitation period provided for by the governing law, unless to do so would create undue hardship or be contrary to public policy. If the contract has no express governing law clause, this introduces further uncertainty as the appropriate governing law will need to be identified before calculating the appropriate time limit for bringing a claim.

The initial statement therefore that investors may have 6 years in which to bring a claim, disguises considerable uncertainty in any particular transaction. It is best therefore to assume the worst case scenario is likely to apply and act quickly to protect the right to pursue a legitimate claim before time runs out.

Standstill or 'tolling' agreements

Investor claimants and investment bank respondents may agree in some cases to suspend or "freeze" the continuation of a relevant limitation period that is imposed either by statute or by the relevant contractual documentation. This may occur in cases where either (1) the investor is investigating whether a potential claim exists in relation to a particular investment, but needs more time to complete those investigations; or (2) the parties are already in the process of negotiating a settlement of a dispute between them. In either case the claimant and respondent might agree that the continuation of the limitation period be frozen in order to avoid the need for the investor to commence formal legal proceedings (and the publicity that would necessarily follow). From a strategic viewpoint a respondent investment bank may well wish to avoid the existence of such a dispute becoming public, in circumstances where it would expect to be able to settle the claim.

There may be other circumstances in which one could envisage such an agreement to suspend the continuation of the relevant limitation period. For example, the liquidator of a potential respondent investment bank may agree to this in order to give it time to assess the merits of the claim asserted against the bank in liquidation. Alternatively, an investment bank that was in the process of being acquired by a third party might also wish to agree to a freeze on the continuation of the limitation period in order to give the acquiring entity time to assess the merits of the claim.

Moreover, there may be situations in the context of an

Only if the ultimate loss is entirely contingent on some external factor will time be delayed investment product where evidence exists of some breach of contract or of a tortious act but where evidence of damage has yet to emerge. In the event that proof of damage and quantum of loss (e.g. a write down of principal) may not emerge until after the expiry of the relevant limitation period, the parties may agree to a suspension of the continuation of the relevant limitation period in order to await the final outcome of the transaction (e.g. the maturity of the bond).

All of the above comments are subject to the general observation that the particular facts and circumstances of each claim will differ from any others. It is therefore important to proceed without delay in considering the relevant limitation periods that might apply to the possible claims that may exist in relation to any specific investment product and the merits of any request for a standstill/tolling agreement in relation to any such claims.

Conclusion

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David Doble Solicitors was established in London in 2005 to provide legal advice to institutions within Europe and beyond, investing in complex structured financial instruments.

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In the aftermath of successive shocks to the global financial system, we continue to see increasing numbers of institutional investors turning to litigation to protect and recover their investments, particularly as we run up to the end of the limitations period in UK law. As a result of this, and based on feedback from clients, David Doble Solicitors has developed an affiliation with Withers Worldwide, a firm specialising in financial services litigation advice. Withers is a conflict-light firm, and its ability to represent clients against all but a small number of the leading banks means that it is well placed to assist institutional investors in pursuing their claims. We are working closely with financial services partner Andrew Wass, who brings experience as a former market participant (running a FOREX options desk in Tokyo) to bear in successfully litigating in this arena.

Withers Worldwide has offices in London, New York, BVI, Geneva, Greenwich CT, Hong Kong, Milan, New Haven, Singapore and Zurich.