Swaps: signs of a shift?

3 Verulam Buildings' Gregory Mitchell QC and Alexia Knight on what lies ahead for banks

Banks have had a bruising few years. After litigation over bank charges and the payment protection insurance (PPI) scandal, very serious allegations surfaced, regarding the alleged mis-selling of interest rate hedging products (IRHPs) and, more recently, regulatory investigations on LIBOR and forex manipulation. This article considers some of the legal challenges for banks as the Financial Conduct Authority (FCA) review closes.

STATUTORY DUTIES

IRHPs are regulated investments: banks that advise on and/or sell them have a statutory duty to comply with the rules in the FCA's Conduct of Business Sourcebook Rules (COBS). A 'private person' receiving such services may claim damages under the Financial Services and Markets Act (FSMA) s138D for breach of those rules. Under the relevant regulations, a right of action is only available to a company if the loss complained of is suffered otherwise than in the course of 'carrying on business of any kind'.

In *Titan Steel Wheels v The Royal Bank of Scotland*, Mr Justice David Steel held that the words 'of any kind' required a broader interpretation than in other uses of 'in the course of business'. That the swaps were not integral to the claimant's manufacturing business did not mean that they were not entered into in the course of business.

This interpretation may be ripe for reconsideration. In *MTR Bailey Trading v Barclays Bank*, the swap covered a loan to the company, as well as a personal loan granted to Mr Bailey. Lord Justice Kitchin granted permission to appeal a summary judgment determination because the effect of Titan 'is to rob the provision of its substance because most companies will be in business of some kind. [MTR] has persuaded me that this issue does merit consideration by this court and it is one upon which the company has a real prospect of success'. The Law Commission's 2014 proposals of assessing the sophistication of a company before deeming it to be non-private, or alternatively allowing breach of high-level principles to be actionable under FSMA s138D, may yet materialise.

COMMON LAW DUTIES

Contractual duties aside, English courts have traditionally been reluctant to oblige banks to explain the operation of financial instruments. In 1995, Mr Justice Mance in

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Bankers Trust International v PT Dharmala Sakti Sejahtera held that a bank's duties were a question of fact. More recently, *Green & anor v The Royal Bank of Scotland* confirmed at first instance and on appeal that the bank owed a Hedley Byrne duty not to misstate, but that (a) on the facts, the bank had not assumed an advisory duty of care; and (b) there was no common law duty equivalent to the duty to explain risks under COBS rule 5.4.3.

On the facts of *Crestsign v National Westminster Bank & anor*, advice had been given, albeit the victory was pyrrhic, because the terms of the contract precluded liability. *Crestsign* confirms that a bank 'which undertakes to explain the nature and effect of a transaction owes a duty to take reasonable care to do so as fully and properly as the circumstances demand'. That duty does not extend to tendering advice on products not being offered, but includes (adopting Mance J's language), a duty 'to give that explanation or tender that advice fully, accurately and properly'. An appeal is pending, challenging the effectiveness of the contractual terms in the light of the Unfair Contract Terms Act (UCTA) 1977 and raising the question of whether The Royal Bank of Scotland had a wider duty to explain other products and to fully explain break costs, which (as in many cases) were much greater than anticipated because IRHPs preceded the massive decline in rates after the banking crisis.

CONTRACTUAL ESTOPPEL

Contracting parties may allocate risk under their contract, and may agree to preclude duties of care and liability from arising, with limited intervention by the courts.

In *Crestsign* (criticised by Paul Marshall as not being an estoppel, there being no requirement for reliance or detriment, or indeed unconscionability), despite holding that the bank 'did provide negligent advice, but they successfully excluded any duty not to do so', the clauses in question were held to be basis clauses, alternatively giving rise to a contractual estoppel, that was not subject to UCTA.

On this view, basis clauses are different to exclusion clauses and are not subject to the same statutory regulation: in principle a basis clause precludes the antecedent relevant duties from ever arising. The court observed: 'The end result is that by the time the swap contract was entered into, what [the bank] was saying in effect was: "Although I recommend one of these products as suitable, the banks do not take responsibility for my recommendation; you cannot rely on it and must make up your own mind." I do not see anything unrealistic about that, nor does it mean the documents must be exemption clauses not basis clauses.' *Crestsign* continues the authorities stemming from *Peekay Intermark & anor v Australia and New Zealand Banking Group* and *JP Morgan Chase Bank & ors v Springwell Navigation Corp*, while arguably overlooking the effect of s13 UCTA and the 'but for' test for exclusion clauses propounded in *Smith v Eric Bush*.

This is an unsatisfactory area of law for customers: it appears that however strong the argument that an advisory relationship has been entered into, appropriate wording can exclude any duty of care arising at all in relation to both past and future conduct. The editors of *Banking Litigation* (3rd ed 11-081, new edition forthcoming) opine that contractual estoppels may be vulnerable to estoppel by convention: 'a party to a contract acts upon a false understanding of its rights and obligations and the other party acquiesces in that performance, the latter may be estopped "by convention" from relying on their original agreement if this would be unjust or unconscionable'. Whether an IRHP claimant will be able to displace boilerplate terms with an estoppel by convention on the facts remains untested.

LIBOR ALLEGATIONS

The Court of Appeal in *Graiseley Properties & ors v Barclays Bank* granted permission to appeal, accepting it was arguable that there was an implied representation by Barclays Bank's pre-contractual conduct that it was not attempting to manipulate LIBOR. Graiseley having settled, the focus is on *Deutsche Bank & ors v Unitech Global & ors* and *Property Alliance Group v The Royal Bank of Scotland* as to whether the misrepresentation argument will be sustainable. Parties will be watching closely, not just as to findings on the representations themselves, but also on vital elements of such claims, including the attribution of knowledge and of the availability of rescission (where claimants could unwind the contract and reverse all payments made under a fully performed transaction, even where payments may have no connection with the misrepresentation or its consequences). While the regulatory investigations and findings can be used to prove the fact of LIBOR manipulations, causation is a significant hurdle, which is why these valuable claims are formulated as claims for rescission for misrepresentation.

CHALLENGING THE FCA REVIEW

Litigation has arisen over the FCA review, which itself offered the opportunity for redress to customers who cannot rely on s138D FSMA. For reviewable sales, an independent reviewer must approve the assessment of a customer's basic loss. Consequential losses are assessed separately. *Suremime v Barclays Bank* offers a glimmer of light to customers dissatisfied with that process. Suremime sought to amend its claim to allege contractual and tortious duties to conduct the review in accordance with the FCA's agreement, and a tortious duty to Suremime as a 'disappointed beneficiary' of Barclays' review agreement with the FCA, by analogy with *White v Jones*.

His Honour Judge Havelock-Allan QC held Suremime's claims in tort had a realistic prospect of success. In particular: 'That there may be public law remedies with which to challenge the way in which the FCA review has been implemented is

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not necessarily a bar to a private law duty of care being owed.' It mattered not that the claimant could sue for the original mis-selling, or that the claim was not otherwise statute-barred.

The limitation period for a claim for breach of duty under the review would run from the date of the bank's breach of its obligations under the agreement with the FCA, potentially giving claimants a new weapon. Moreover, it was stated (*obiter*) that: 'It seems to me that [Suremime] is arguably right in saying that a complaint about the mis-selling of a swap and the way in which the bank had offered inadequate redress through the process of the review is a complaint which could be made under DISP1.4.1R.'

LIMITATION

As with PPI claims, many historic claims are being commenced. The Limitation Act 1980 imposes a primary six-year limitation period from the moment a customer suffers loss, which will usually be when the customer entered into the contract complained of.

In *Kays Hotels v Barclays Bank*, Mr Justice Hamblen considered a hotelier that had entered into a collar in August 2005 and become payer thereunder in November 2008.

The claimant's response to Barclays' summary judgment application was that it had not wanted 'excessive risk' (implicitly admitting it accepted some risk) and that by s14A the claim was in time. Hamblen J held that even in the case of constructive knowledge: '[Section 14A] is an objective test, but it is a test that has to be considered in the context of the circumstances applicable to the person in question… These are all matters that depend on a full factual picture and mean that the issue is not appropriate for summary determination.'

In other cases, expectations of 'no risk' transactions, complaints to the defendant/the Financial Ombudsman Service prior to the alleged date of knowledge, or evidence of a contemporaneous declaration signed by the claimant may demonstrate subjective knowledge.

Importing a subjective element into s14A(10) means knowledge for the purpose of s14A exists only when the claimant deemed the payments made by it under the IRHP to have (or be likely to) become 'excessive'. The risk of the use of s14A by a potential claimant to avoid the ordinary limitation period at will by pleading that it wanted to avoid 'excessive' or 'unwarranted' risk and then defining its understanding to assert that this risk only materialised within three years of when the claim was issued is obvious. On Hamblen J's approach, this is a triable issue, arguably exposing defendants to the 'sword of Damocles' that Lord Scott in *Haward & ors v Fawcetts & ors* sought to avoid.

Perhaps, the courts should focus on when the claimant could reasonably have discovered the product's true features. With two commercial parties bargaining at arm's length, is it reasonable to gain knowledge that a product is unsuitably risky as (or even after) it has crashed? Should there be an expectation of some due diligence by the customer? This would result in a date of knowledge being a more easily and objectively ascertainable moment under s14A(10).

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