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WILL LIMITATION HOLD THE KEY TO FUTURE MIS-SELLING CASES?

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Financial Services analysis: Should banks take heart from the latest judgment on the mis-selling of financial products? Daniel French, a partner at Squire Sanders, considers the consequences of the Court of Appeal decision on a bank's alleged mis-selling of interest rate hedging products.

Original news

Green and another v Royal Bank of Scotland [2013] EWCA Civ 1197, [2013] All ER (D) 86 (Oct)

The claimants issued proceedings claiming that the Royal Bank of Scotland (RBS) had mis-sold them an interest-rate swap. They submitted that by giving inadequate disclosure of break costs, contrary to its duty under the Financial Services Authority's Code of Business Rules (the COB Rules), then in existence, RBS had failed to warn that those costs could be substantial and to explain clearly and fairly their true potential magnitude. The Court of Appeal, Civil Division, upheld the High Court's decision that the bank had not owed the claimants a common law duty of care which had involved taking reasonable care to ensure that they had understood the nature of the risks involved in entering into the swap transaction.

What is the background to the case?

During the height of the last boom, many businesses were concerned about rising interest rates and looking for ways to manage their risk so they could insulate themselves against cashflow uncertainty caused by interest rate fluctuations. Various financial institutions responded by offering interest rate hedging products, also sometimes referred to as 'swaps'.

There have been concerns raised that a number of customers may have been mis-sold or oversold these products by their lenders. Common complaints are that the products:

- were for a term that far exceeded the length of the existing variable-rate product
- were too complicated for the average customer to properly understand
- involved significant break costs for terminating the arrangement early which were not properly explained or highlighted

These complaints have led to a formal investigation by the Financial Conduct Authority (FCA) and a large-scale review into the issue is currently taking place.

In this instance, Mr Green and Mr Rowley entered into a £1.5m 10-year swap in 2005 to hedge against the interest rate risk they carried on their existing variable-rate loan. The hedging arrangement worked well for them until 2008 while interest rates were high. However, when interest rates dropped to their current historic lows, it started to cost them significantly more than it would have if they had been on the variable rate. On deciding that they wished to terminate the swap arrangement, they discovered they would incur a break cost of £138,650.

Mr Green and Mr Rowley chose to challenge the validity of the swap arrangement on the two main grounds that:

- the bank had negligently advised them as to how the swap product worked and the level of break cost payable, in breach of the COB Rules, and
- the bank had gone beyond merely offering the swap product but had positively recommended it, thereby creating a direct common law duty of care on the bank to properly advise the customer as to the suitability and affordability of the swap, which it failed to do

The High Court, having considered both the available evidence as to what had been said to the customer and the COB Rules, rejected both claims.

What is the significance of the case?

There are a large number of these products in existence. Currently there are more than 40,000 similar claims under consideration as part of the FCA's review. The Court of Appeal's decision in this case could have a significant bearing on how those claims are treated and could directly affect the appetite for litigation of those customers who believe they may have a claim.

The appeal revisits the important question of the extent of the bank's duty of care to its customers when selling such products and considers the fine line between selling a product and providing financial advice in such circumstances.

The decision also provides some guidance on how much reliance the bank is entitled to place on the COB Rules in limiting its liability. The case presented an opportunity to consider the correct limitation period that applies to such claims more closely and the point from which the limitation period starts. If it is when the product is originally sold, then many claims will be time-barred. If, however, it is the point at which the mis-selling is discovered, then many of these claims will still be within the relevant six-year limitation period.

Why was this appeal dismissed?

The appeal was on the narrow ground that the bank had failed to comply with the COB Rules by not clearly and fairly explaining the true potential magnitude of the break costs in a way that the customer could properly comprehend. The appellants argued this alleged breach of the COB Rules gave rise to a concurrent common law duty of care on the bank as advisor to the customer on the basis of *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465, [1963] 2 All ER 575.

The appeal was couched in these terms because the claimants had made a concession pre-trial that their possible claim against the bank for breach of its statutory duty to observe the COB Rules under the Financial Services and Markets Act 2000, s 150 (FSMA 2000) was time-barred. So the claimants had to perform some legal gymnastics to try to argue that those statutory obligations informed a more general common law duty of care, under which an action was still available.

The Court of Appeal gave this argument short shrift and unanimously concluded 'the bank did not cross the line which separates, on the one hand, the activity of giving information about and selling a product and, on the other hand, the activity of giving advice'. The court clearly rejected the notion that any common law duty of care was owed by the bank to its customer in this instance.

Is the case important in light of FCA work in relation to mis-selling of interest rate hedging products?

In some ways the decision is a damp squib, given the expectation surrounding it. This case turned very much on the evidence of what was said or not said at the time the product was originally put in place, and the extent that reliance was placed on those statements. For those customers who are already subject to the FCA review, it is unlikely this decision will affect the outcome of the redress they are ultimately offered, if it is concluded they were mis-sold a product.

The FCA had been invited to submit representations on the proper interpretation of the COB Rules in this case and there was much speculation that those submissions may colour future applications. In the end, since the court found no common law duty of care existed, there was no need for the FCA to make any submissions, so an opportunity to further clarify the extent of the bank's obligations under the COB Rules has been missed.

The case is material, in that it underscores the fact that the bank is entitled to rely upon the disclaimers contained in its standard terms and conditions, which exclude its liability as advisor to its customers. Although there had been some persuasive authority to this effect in a previous Scottish decision (*Grant Estates Ltd v Royal Bank of Scotland* [2013] CSOH 133), this is the first directly binding authority to that effect.

The decision also provides further guidance as to the limited parameters of the bank's common law duty of care to its customers in these cases, further defining the fine line between selling a product and providing financial advice.

From the perspective of the types of persons to whom this sort of product was sold, what are the implications of this decision?

For those who consider they may have a similar claim, this case will be disheartening. The decision turned very much on its facts, so it is unlikely to be the final word on these actions. The case highlights the evidential mountain that both claimants and defendants must climb to properly establish or defend a claim in circumstances where many of the products in question will be more than six years old and memories may be imperfect. This is not insurmountable but, given the complexity of the products, the costs at stake will increase the litigation risk for both parties. It remains to be seen whether solicitors will be prepared to risk taking on such cases on a contingent fee basis, given the amount of preliminary investigations that will be required to establish the merits of any claim.

Banks are being circumspect in their comments on the outcome, is there an element of relief or is this far from over?

The banks will be encouraged by this endorsement of their right to rely upon their standard terms and conditions in these cases. However, this decision is not a 'knock-out' blow to such claims since it is so fact-specific.

The banks will also take heart that the Court of Appeal declined to impose an onerous common law duty of care on them in this case--although that risk remains in different circumstances, and the extent of that possible duty of care will still turn on whether the bank had taken on the mantle of advisor rather than salesperson.

The court did not have to decide the important question of when the limitation clock starts to run in this case, as the claimants conceded pre-trial that the claim for breach of FSMA 2000, s 150 was statute-barred. There is some obiter comment that suggests the claimants should have resiled from their concession and sought to argue that the claim was still within the six-year limitation period. Doubtless this issue will come before the court for determination in due course--that question may well be more significant for those hoping to pursue a claim in future.

What would you recommend as the next steps for people who are in a similar position to Mr Green and Mr Rowley?

Two things. I would first seek advice on the limitation period affecting any claim they may have to ensure they properly preserve their claim, if appropriate. Secondly, the case highlights the importance of collating strong evidence in support of their claim, since the claim may well turn on what was said or unsaid at the time they bought their product.

My experience is that the affected lenders are sympathetic to customer concerns on this issue and are more than prepared to open a dialogue with their customers to seek a resolution. For those already subject to the FCA review, they would be best placed to await the outcome of that process before incurring significant legal fees challenging the position independently. However, they should ensure their limitation position is preserved in case they wish to litigate at a later date if they are not satisfied by any redress offered. For those 'sophisticated customers' who are outside of the scope of the FCA review, I would recommend they approach their lenders to discuss the matter in an open and frank way before commencing proceedings, since the costs of litigating such a claim could be prohibitive.

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