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BRIEFING

MISSING WORDS? COURT OF APPEAL CONSIDERS BANKS' DUTY TO EXPLAIN

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- IF A BANK CHOOSES TO EXPLAIN A PROPOSED TRANSACTION TO ITS COUNTERPARTY, IT MUST DO SO FULLY, ACCURATELY, AND PROPERLY
- IN OFFERING SWAP TRANSACTION, BANK MADE IMPLIED REPRESENTATION IT WAS NOT MANIPULATING LIBOR

The financial crisis, mis-selling of interest rate hedging products ("IRHPs") and manipulation of the London Inter-bank Offered Rate ("LIBOR")[1], have all hit the headlines over the last decade. These issues have also been at the heart of recent civil claims before the English courts.

"*PAG v RBS* … MAY HAVE SIGNIFICANT RAMIFICATIONS FOR FUTURE CLAIMS AGAINST FINANCIAL INSTITUTIONS BEFORE THE ENGLISH COURTS."

In *Property Alliance Group Ltd* ("PAG") *v The Royal Bank of Scotland Plc* ("RBS"), PAG brought wide-ranging claims against RBS, including allegations that RBS had mis-sold IRHPs, fraudulently misrepresented the risks inherent in them, and fraudulently manipulated the LIBOR rates to which the IRHPs were fixed. Although Mrs Justice Asplin (as she then was) dismissed each of PAG's claims in the High Court in December 2016[2], PAG appealed the decision.

This briefing addresses two of the key issues considered in the March 2018 judgment of the Court of Appeal in *PAG v RBS*[3], which may have significant ramifications for future claims against financial institutions before the English courts.

Background

PAG's business was operating and developing property. RBS provided revolving credit facilities to it, some of which were fixed at interest rates referencing three month GBP LIBOR. Between 2004 and 2008, PAG purchased IRHPs from RBS,

[1] LIBOR is set by reference to submissions by banks on a Contributor Panel and represents the average interest rate at which those banks can borrow funds from other banks. LIBOR is used as a benchmark for setting interest rates, as an alternative to the Bank of England base rate, for example.
[2] [2016] EWHC 3342 (Ch)
[3] [2018] EWCA Civ 355

ostensibly to hedge against the risk that interest rates on its facilities with RBS might rise. Broadly, PAG would receive payments from RBS if three month GBP LIBOR rose, but would pay sums to RBS if it fell. PAG could terminate the IRHPs before their maturity, but would have to pay substantial break costs to RBS if it elected to do so.

Following the advent of the financial crisis, four key events occurred:

1. LIBOR rates fell sharply and have remained low ever since. As a result, PAG found itself having to pay out significant sums to RBS under the IRHPs.
2. In 2011, PAG terminated the IRHPs, incurring break costs of over £8m.
3. In 2012, the Financial Conduct Authority ("FCA") identified errors in the way that banks had been selling IRHPs, which led to banks agreeing to a full review of their sales of IRHPs to unsophisticated counterparties, in order to provide compensation to those who were found to have been victims of mis-selling. Sophisticated counterparties fell outside this review, but some commenced mis-selling claims against banks in the English courts.
4. The FCA also conducted investigations into the manipulation of LIBOR. It levied fines against several banks, including a fine of £87.5m against RBS for "significant failings" in relation to LIBOR. RBS accepted that: (i) its traders had manipulated Swiss Franc and Japanese Yen LIBOR submissions in order to benefit RBS's derivatives trading positions, and (ii) its Swiss Franc, Japanese Yen and US Dollar LIBOR submissions had taken into account the profit and loss of RBS' money market books. No specific findings were made against RBS in relation to GBP LIBOR.

"PAG ARGUED THAT RBS WAS OBLIGED TO PROVIDE IT WITH EITHER ITS INTERNAL "WORST CASE" ESTIMATIONS OF BREAK COSTS, OR WORKED EXAMPLES OF THE POTENTIAL BREAK COSTS ACROSS DIFFERENT SCENARIOS."

The Claims

Against that background, PAG commenced proceedings against RBS in 2013. Its claims were rejected by Mrs Justice Asplin in the High Court in December 2016 and PAG appealed. Although the Court of Appeal considered a number of issues, its decisions in respect of two of PAG's claims may have a significant impact upon future claims before the English courts:

(A) Was RBS liable for negligent mis-statement for failing to provide PAG with information about potential break costs?

PAG argued that RBS was obliged to provide it with either its internal "worst case" estimations of break costs, or worked examples of the potential break costs across different scenarios. RBS's failure to do so, PAG said, amounted to a negligent misstatement because it rendered the information which was provided incomplete and inaccurate.

In effect, PAG's primary claim relied upon the principle in *Hedley Byrne*[4], which is as follows: if, in the ordinary course of business, Party A asks Party B for information or advice, and Party B is not under an obligation to provide the information or advice but nevertheless does so without disclaiming responsibility for it, Party B may be held to have assumed responsibility for the accuracy of the information or advice and be under a duty not to misstate. If Party B breaches that duty, Party A may have a cause of action in negligent misstatement against Party B for the foreseeable financial losses or damages which it incurs as a result.

[4] *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465, as expanded upon in in *Bankers Trust International Plc v PT Dharma Sakti Sejahtera* [1996] CLC 518.

PAG’s secondary case was that RBS had breached its common law duty to take reasonable care when providing information to ensure that it is both accurate and fit for the purpose for which it is provided, and thereby enable the recipient to make a decision on an informed basis. This has been described as a ‘mezzanine’ duty[5], a somewhat controversial idea which might arguably increase a bank’s obligations to its customers, even when it is not acting in an advisory capacity. Similar lines of argument have found success in civil law jurisdictions, such as Italy, in which the onus has been placed on financial institutions to provide sufficient information to potential purchasers of their products.

The Court of Appeal re-stated the general law regarding the duties owed by a bank to its counterparties. In the ordinary course, a bank owes no duty to explain the nature or effect of a proposed transaction to its counterparty. However, if a bank does choose to give an explanation of the transaction or tenders advice, it owes a duty to give that explanation “fully, accurately and properly”. How far that duty goes will be fact sensitive and will vary depending on the specific circumstances and the explanation or advice which has been tendered.

“THE COURT OF APPEAL CONFIRMED THAT THERE IS NO DISCRETE ‘MEZZANINE’ DUTY UPON A BANK.”

Helpfully, the Court of Appeal confirmed that there is no discrete ‘mezzanine’ duty upon a bank and stated that this was an expression “best avoided”. However, there remain a variety of factual circumstances in which a financial institution may be under common law duties and could incur tortious liability.

On the facts, the Court of Appeal held that RBS was under a duty not to misstate, but that there had been no breach of that duty: there was no error in the way that RBS had explained the terms of the IRHPs, how break costs might be incurred and how they would be calculated. There was no duty to provide worst-case scenarios or RBS' own worst-case calculations. Although it is possible that some financial institutions may assume such a duty, on the facts of this case, RBS was not under a wider duty to disclose the possible or probable size of future break costs.

(B) Had RBS fraudulently made an implied representation that it was not manipulating and did not intend to manipulate LIBOR?

Perhaps the most intriguing part of the case, certainly from the perspective of future claims which might arise before the English courts, was whether RBS had given an implied representation that it was not manipulating and did not intend to manipulate LIBOR. Further, if RBS had made such a representation, had it been breached?

Claims alleging misrepresentation in relation to LIBOR have been the subject of limited consideration by the English courts, including in interlocutory applications such as in *Graiseley Properties Ltd v Barclays Bank Plc*[6]. The decision of the High Court in *PAG v RBS* had seemed to shut the floodgates on claims of this nature. The High Court held both that RBS had not made any implied representation in relation to LIBOR and, even if such a representation had been made, there was no evidence that it had manipulated GBP LIBOR. The Court of Appeal took a different approach. It held that, in offering IRHPs referencing LIBOR, RBS was making an implied representation that it was not manipulating and that it did not intend to manipulate

[5] *Crestsign Ltd v National Westminster Bank Plc* [2014] EWHC 3043 (Ch)
[6] [2013] EWCA Civ 1372

LIBOR. Indeed, such a representation “would probably be inferred from a mere proposal of the swap transaction”.

The IRHPs entered into by RBS and PAG were, however, fixed to GBP LIBOR, which RBS had not been found to have manipulated: the findings of the FCA were with regards to Japanese Yen, Swiss Franc and US Dollar LIBOR, while the High Court had concluded that there was no evidence that RBS had manipulated GBP LIBOR. The Court of Appeal treated RBS’ manipulation of other LIBOR currencies as distinct from its actions in relation to GBP LIBOR and warned against “island-hopping”. As a result, in this case, the Court of Appeal agreed with the High Court and held that RBS had not breached the implied representation.

“THE COURT OF APPEAL’S DECISION MARKS A RELATIVELY RARE OCCASION ON WHICH THE HIGH STANDARD FOR AN IMPLIED REPRESENTATION WAS HELD TO HAVE BEEN MET.”

Nevertheless, the Court of Appeal’s decision marks a relatively rare occasion on which the high standard for an implied representation was held to have been met. Clear words or clear conduct on the part of the representor is required for a representation to be implied. Without seeking to water down that requirement, the Court of Appeal also approved the following test to determine whether an implied representation had been made, holding that one should "consider whether a reasonable representee would naturally assume that the true state of facts did not exist and that, if it did, he would necessarily have been informed of it”.[7]

Conclusions

The *PAG v RBS* case demonstrates the evidential difficulties inherent in bringing claims reliant upon implied terms or tortious duties of care. Nevertheless, the Court of Appeal’s judgment is important for three principal reasons:

1. The Court of Appeal helpfully set out the principles which will determine whether or not a defendant, and particularly a financial institution, may owe duties of care to potential counterparties. Although the full extent of those duties will arise from the precise factual circumstances, there is now further clarity as to the factors which the courts will consider when assessing mis-statement claims.
2. It remains the case that providing a well-drafted disclaimer with the advice or information, may offer significant legal protection to the party providing the advice or information.
3. The Court of Appeal’s decision to hold that RBS had made an implied representation that it was not manipulating and did not intend to manipulate LIBOR could have a significant impact upon future claims before the English courts. Although the FCA did not make any finding against RBS in respect of GBP LIBOR, other banks have made admissions and have been fined in relation to such manipulation. Several banks (including RBS) have also admitted manipulating LIBOR rates in currencies other than Sterling. Although claims which have not already been commenced could face a limitation defence, or at least a battle about when limitation periods started to run, the English courts can now expect to hear further claims alleging that banks have made and breached representations that they would not manipulate and did not intend to manipulate LIBOR. The evidential hurdle is significant but the potential quantum of those claims may be very significant indeed.

[7] Per Colman J in *Geest Plc v Fyffes Plc* [1999] 1 All ER (Comm) 672.

FOR MORE INFORMATION

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