First reported case on swaps mis-selling resolved in bank's favour

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Banking & Finance analysis: What can be learned from the decision in Thornbridge v Barclays Bank Plc? David Bowden, freelance independent consultant, outlines the case and talks to Lisa Lacob, a barrister at 3 Verulam Buildings, about the consequences of this case.

Original news

Thornbridge Ltd v Barclays Bank Plc [2015] EWHC 3430 (QB)

The Mercantile Court in Manchester heard a contested trial over five days in which it was alleged that a bank had mis-sold a business customer an interest rate swap product. In a lengthy reserved judgment HHJ Moulder QC dismissed the claim and ruled in favour of the bank. This is the first reported case against Barclays Bank involving alleged mis-selling of an interest rate swap which has gone to trial.

Briefly, what was the background to this case?

David Bowden (DB): A company borrower claimed damages from the bank for losses arising from alleged:

- negligence,
- breach of contract, and
- breach of statutory duty

regarding information and advice given in respect of an interest rate swap the borrower had entered into in connection with a loan from the bank.

The bank required the borrower to execute an interest rate hedge, or accept a fixed interest rate. The borrower's director (Mr Harrison) discussed hedging with a representative (Mr Burgess) of the bank. Mr Burgess also sent Mr Harrison a written presentation entitled 'Interest Rate Risk Management Strategy'. The parties entered into a five-year vanilla interest rate swap agreement in May 2008.

The swap was intended to protect the borrower against interest rate rises. However, interest rates then fell to historically low levels and the borrower was unable to benefit from the falling rates. The swap proved expensive. The borrower alleged that the bank failed to provide adequate information regarding break costs, including by failing to give examples of the break costs applying when interest rates were very low and by failing to advise it that the swap may restrict its ability to refinance its lending. The borrower also alleged that the bank had failed to set out the comparative advantages and disadvantages of other hedging products.

What were the legal issues that the judge had to decide in this case?

DB: The court had to determine the following three key legal issues:

- o whether the bank had assumed an advisory duty
- o whether (if the relationship was advisory) the borrower was estopped from asserting such a relationship by a representation it made in the bank's standard form written agreement (the swap confirmation) that it was not relying on the bank's communications as investment advice, and
- o the applicable duties if the relationship was not advisory

Why did these issues arise?

LL: The customer alleged that the bank had given no indicative break costs examples. In fact, an example had been given (as a telephone call transcript showed) but there were issues as to the adequacy of that example given the fact that it was predicted on a small fall in rates. The bank had not provided any information to the customer about the effect of the hedging on its ability to refinance the loan, or move it to another lender, during the five-year term. When the customer expressed a desire to refinance, the break costs prevented it from doing so.

What were the main legal arguments put forward by the customer?

LL: The customer alleged that if a bank undertakes to advise on the merits of a transaction, it owes a duty to advise with reasonable skill and care. Also, that if information was accompanied by a value judgment or if it is provided on a selected rather than a balanced basis, it constitutes advice. The customer relied on the decision of HHJ Havelock-Allan QC in *Rubenstein v HSBC* (confirmed on appeal (*Rubenstein v HSBC Bank plc* [2012] EWCA Civ 1184, [2013] 1 All ER (Comm) 915)) and the Financial Conduct Authority's Perimeter Guidance, para 8.28.4(G).

As to contractual estoppel, the customer argued that the contract terms were clauses which excluded liability and which sought to re-write history and were therefore exclusion clauses which were subject to the test of reasonableness in section 2(2) of the Unfair Contract Terms Act 1977 (UCTA 1977). Further, the customer said UCTA 1977 applied as the clauses sought to exclude a duty of care and it relied on *Smith v Eric S Bush (a firm); Harris v Wyre Forest District Council* [1990] 1 AC 831, [1989] 2 All ER 514 in support of this. Even in the absence of an advisory relationship, if the bank does not provide an explanation or tender advice it owes a duty to give that explanation or tender that advice fully, accurately and properly. The scope of that duty depends on the particular circumstances.

What did the judge decide, and why?

LL: The judge dismissed the claims and gave judgment for the bank. She held, on the evidence (particularly transcripts of telephone conversations), that the bank had not recommended the swap.

Even if Mr Burgess had been given advice during the conversations (which the judge found he had not, on the basis that the swap was simply offered as a hedging option), the bank had not assumed an advisory duty. Mr Burgess's statements on likely movements in interest rates would reasonably have been understood by Mr Harrison to be predictions rather than formal advice. Even if Mr Burgess's views had amounted to advice, they had not gone beyond the daily interactions between an institution's sales force and its customers as Gloster J laid out in *JP Morgan Chase Bank v Springwell Navigation* [2008] EWHC 1793 (Comm) (confirmed on appeal (*JP Morgan Chase Bank v Springwell Navigation Corp* [2010] EWCA Civ 1221, [2010] All ER (D) 08 (Nov))).

The title 'Corporate Risk Advisory' had no significance when weighed against the actual discussions which took place between the bank's employees and the customer. The bank was not advising in return for a fee. Ultimately, the customer had made up its own mind about the transaction.

In relation to contractual estoppel, the court applied the decisions in *Springwell*, *Titan Steel Wheels Ltd v Royal Bank of Scotland Plc* [2010] EWHC 211 (Comm), [2010] All ER (D) 137 (Feb) and *Barclays Bank plc v Svizera Holdings BV* [2014] EWHC 1020 (Comm), [2015] 1 All ER (Comm) 788 and held that the clauses in the swap confirmation defined the basis on which the parties transacted business.

Even if the clauses were exclusion clauses and UCTA 1977 applied, the clauses were not unreasonable as:

- there was no relative inequality of bargaining power between the parties
- the customer was a shrewd businessperson who had considerable experience dealing with banks, and
- the clauses removed a grey area between giving information and giving advice

Applying the *Hedley Byrne* principle there was no broad duty to provide information in the absence of an advisory relationship. The court considered two recent swap mis-selling decisions in arriving at this conclusion:

- *Green v Royal Bank of Scotland* [2013] EWCA Civ 1197, [2013] All ER (D) 86 (Oct), and
- *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch), [2015] 2 All ER (Comm) 133

DB: It should be noted that the decision in *Crestsign* is under appeal and due to be heard by the Court of Appeal over three days in April 2016.

LL: Although the bank had no common law duty to provide full information, it had a duty not to mislead when providing break cost examples. The bank could not, however, be criticised for failing to give illustrations showing greater falls in interest rates—it was only with hindsight that one could suggest that such low rates were reasonably to have been foreseen. The judge found that a reasonable person at the time would not have predicted the scale of the decline in interest rates. There was also no indication that the borrower might want to refinance the loan or terminate the swap within five years such that break costs would be a concern.

There was a duty not to mislead regarding the products' competing advantages and disadvantages. There was one misleading statement in the written presentation in respect of interest rate caps—namely that break costs would be payable on a cap. However, the judge ruled that this had not caused the borrower's loss. She ruled that on the evidence, Mr Harrison had paid no attention to products other than the swap and so had not been misled by any information failings in relation to those products.

The swap itself had not been unsuitable to the business. It had done what it was supposed to do because it had limited the borrower's exposure to rising interest rates. Mr Burgess had not misstated the position.

To what extent is the judgment helpful in clarifying the law in this area?

LL: The judgment confirms the law on contractual estoppel as set out in *Springwell* and subsequent cases. It also confirms that, absent an advisory relationship, a bank has no duty to provide a full, accurate and proper explanation of the costs and risks of particular products—only a duty not to misstate or mislead.

To some extent, *Thornbridge* can be seen as a move backwards from the *Crestsign* decision, where Deputy Judge Tim Kerr QC recognised that the duty to provide information may be wider than this. The judgment also followed *Titan Steel Wheels* in confirming that the customer (a company) had no direct right of action for breach of the bank's regulatory duties under the FCA's Conduct of Business Rules.

DB: This was a reserved judgement given following a five-day trial. On the evidence, this was a good case for the bank to run to trial. It is not surprising therefore that the bank allowed this case to run its course. Although there is now a favourable ruling for the bank in the public domain, this does not mean that other swaps cases that are pending will resolve in the same way. The case illustrates quite well how fact-specific these sort of cases are as well as the court taking time to consider the oral testimonies to see how they align with the contemporaneous documentation provided.

What practical lessons can those advising take away from the case?

LL: When considering whether there has been a breach of duty by a bank in relation to the sale of a hedging product, one needs to carefully consider the actual discussions between the customer and the bank and the statements made orally and in written presentations. These need to be analysed in order to identify whether there was a positive false or misleading statement made by the bank about the risks or effect of the product. If so, one must investigate whether the customer would in fact have entered in to the transaction had the customer known the truth.

DB: It is frustrating in some ways that banks and those advising them have such short memories. In *Scarborough Building Society v Humberside Trading Standards* [1999] GCCR 2165, the Court of Appeal had to look very closely at whether interest rates would fall off a cliff. This was an appeal from a decision of Stipendiary Magistrate Neville White sitting in Humberside Magistrates' Court in 1996. The magistrate had before him an expert's report from Professor Zis, a professor of economics at Manchester Metropolitan University. Professor Zis said that:

- interest rates may come down to 1% per annum
- the lowest rate in the UK until then had been 2% in 1939 when war was declared
- Japan then had base rates of 0.5%, and
- there was nothing to preclude UK base rates going lower

Surprisingly, the magistrate rejected the expert evidence saying 'there was no possibility, not even a remote possibility, that the variable rate would fall to 1% within the foreseeable future'. Lord Justice Staughton, while acknowledging that the appeal raised a 'short point of quite exceptional difficulty' was constrained by the finding of fact below and dismissed the appeal. The point is well made, however, that banks had evidence put before them 20 years ago that interest rates could fall to 0.5%. It is remarkable that they chose to ignore this or conveniently forget it when putting illustrations together in the boom times of the early part of the millennium which did not show such movements.

Interviewed by David Bowden.

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