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Court of Appeal grants Holmcroft Properties permission to appeal in 'skilled persons' judicial review case against KPMG

*The Queen (on the application of Holmcroft Properties
Limited) v. KPMG LLP, the Financial Conduct Authority and
Barclays Bank PLC
C1/2016/1159*

Article by David Bowden

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Executive speed read summary

Holmcroft Properties and a connected company were granted substantial finance by Barclays Bank to acquire a nursing home. The borrowing was secured by a 1st legal charge in the bank's favour. The bank also sold it an interest rate hedging product. Both companies had current accounts with the bank. The bank called in the loan and appointed LPA receivers. Holmcroft Properties said its financial distress was caused by the losses from the mis-sold IRHPs. It quantified its losses at £5.2million. The bank rejected the claim for compensation for these consequential losses but made an offer of limited compensation which Holmcroft Properties rejected. The bank appointed KPMG to produce a 'skilled person' report under s166 of the Financial Services and Markets Act 2000. The skilled person upheld the bank's finding. Holmcroft Properties then brought a claim for judicial review against KPMG saying that although it was a private firm of accountants, it was exercising a public law function here under FiSMA 2000. Holmcroft Properties said judicial review should extend to the manner in which the skilled person conducted their investigation, made its report and should cover its claim for consequential losses. The Divisional Court rejected the application for judicial review in February 2016 but it said 'it had *not found this question to be easy to resolve*'. The Court of Appeal has now granted Holmcroft Properties permission to appeal and this appeal will be heard later in 2017. Separately at its AGMs in 2015 and 2016 the CEO of the FCA was questioned about these skilled persons reports and was forced to concede that words in his evidence given in Parliament to HM Treasury Select Committee '*were not as clear as they should have been*'.

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C1/2016/1159 23 February 2017
Court of Appeal (Civil division)

What were the financial details of the arrangements between Holmcroft Properties and the bank?

In March 2005 Barclays advanced £2 million to Holmcroft Properties and £0.4million to Holmwood Nursing Home Limited ('HNHL') to support the purchase of the freehold land, buildings, and their fixtures & fittings at the Holmwood Nursing Home for £2.7million. The loan to Holmcroft Properties was repayable by monthly instalments over 17 years. The freehold land and buildings were bought by Holmcroft Properties and the fixtures and fittings by HNHL. Holmcroft Properties let the nursing home to HNHL on a 25 year lease at an annual rent of £285k.

An interest rate hedging product ('IRHP') in the form of an interest rate collar expiring on 31 March 2015 was entered into between Holmcroft Properties and the bank in respect of its borrowing only. Both facilities were secured by a 1st legal charge over the nursing home. Both loans were later restructured as a 20 year repayment loan of £2.4 million to Holmcroft Properties on 21 March 2007. The bank made further advances to Holmcroft Properties which were repayable at short notice. All borrowings were secured by first legal charges over all properties.

Both Holmcroft Properties and HNHL operated current accounts with the bank and each had an overdraft facility. On 10 April 2008 Holmcroft Properties entered into a second IRHP with the bank. This was an interest rate swap agreement to hedge £1.5million until 10 April 2011. The bank calculated that as at 28 April 2011 the total payments made were:

- £167,592.44 under the collar, and
- £146,424.64 under the swap when it expired on 11 April 2011.

What losses does Holmcroft Properties claim?

The consequential losses claimed by Holmcroft Properties are all said to flow from the bank's decision made and implemented in May 2011 to refuse to renew and/or call in its advances to Holmcroft Properties and to appoint Law of Property Act receivers over its properties. The decision to call in advances was made on 11 May 2011 and receivers were appointed on 17 May 2011. Holmcroft Properties' case on causation is on 2 grounds:

- But for the hedging payments, Holmcroft Properties would have had a credit balance on its current account, and
- The bank and KPMG were wrong to treat the financial difficulties of HNHL as having any material impact on the position of Holmcroft Properties.

Holmcroft Properties quantifies its loss at £5.2million. The bank rejected any claim for compensation made by Holmcroft Properties.

What happened when then bank appointed KPMG to prepare a 'skilled person' report?

Holmcroft Properties claims it was mis-sold certain these IRHPs by Barclays Bank. The bank undertook with its regulator's successor in title, the Financial Conduct Authority ('FCA'), that it would set up a scheme to provide redress to certain customers who had been wrongly sold these products. The bank agreed that an independent party, KPMG, should oversee the implementation and application of the scheme and that the bank would make no offers of compensation save with the approval of KPMG. KPMG were engaged by the bank to provide a 'skilled persons' report to it under section 166 of the Financial Services and Markets Act 2000.

KPMG could only approve offers if it considered that they were 'appropriate, fair and reasonable'. The Applicant said that it was made an offer by the bank which was inadequate, did not satisfy these criteria because it did not include compensation for loss which it alleged was consequential on the mis-sale. It submitted that the bank did not deal fairly with its application for consequential loss and says that KPMG acted in breach of public law principles under the 2000 Act. by approving the offer made to it by Barclays.

What happened in the Divisional Court?

Mr Justice Kenneth Parker heard extensive oral submissions from all 4 parties at a hearing on 24 April 2015 - **CO/5690/2014**. At the end of that hearing he ordered that permission be granted to Holmcroft Properties to bring this judicial review. The actual hearing was ordered to be heard by a Divisional Court instead of a single judge of the Administrative Court.

The Divisional Court had to decide whether in the circumstances KPMG was amenable to judicial review. If so, whether it acted in breach of the public law principles to which it was subject in approving the bank's offer. Lord Justice Elias and Mr Justice Mitting J on 24th February 2016 sitting in the Divisional Court **[2016] EWHC 323 (Admin)** dismissed the application for judicial review. The Divisional Court said the accountant's duties were conferred by a contract and governed by private law with Barclays Bank.

However the Divisional Court said that it had '*not found this question to be easy to resolve but ultimately we consider that KPMG's duties do not have sufficient public law flavour to render it amenable to judicial review*'. Its reasons included:

- It accepted that '*KPMG was clearly "woven into" the regulatory function*' and that as a '*matter of substance it could veto any offer which it did not approve and effectively compel Barclays to tailor its offer accordingly*'. However this was '*more than a mere private arrangement and the Bank would never have conferred the veto power upon KPMG unless required to do so by the FCA*' and the bank '*did not have a free hand in the appointment - it had to be approved by the regulator*'.
- There was a '*clear public connection*' between KPMG's function and the regulatory duties carried out by the FCA but this '*does not of itself suffice to render it amenable to judicial review*'.
- The FCA had a '*number of more draconian powers it could have exercised*' but it had chosen here to '*adopt an essentially voluntary scheme of redress*'. The FCA simply '*reserved the right to use more draconian statutory powers should the need arise*'. For the purpose of obtaining the s166 report, the FCA '*did need to employ its statutory powers*' but '*KPMG's role in the individual case, as vital as it was, could not have been imposed upon Barclays by the FCA in the exercise of its regulatory powers*'.
- KPMG's powers were '*conferred by contract is important*' and '*KPMG had no relationship with the customers at all*'. Further KPMG '*were not actually appointed by the FCA to do anything at all*'.
- Where private arrangements are used to secure public law objectives this '*does not bring those arrangements into the public domain sufficient to attract public law principles*'.
- The FCA had no '*regulatory obligation to carry out the role which KPMG played had there been no willing skilled advisor*'.
- The FCA was '*not disqualified by the arrangements from taking a more active role in particular cases*'. However the FCA would '*potentially be subject to judicial review if it failed to regulate in an appropriate manner*' with the Divisional Court noting that it did not '*underestimate the difficulty of establishing a breach in any particular case*'.

What was the criticism of the Divisional Court judgement?

The judgement of the Divisional Court was something of a shock as the result meant a back-tracking in the availability of judicial review that had been established 30 years ago in *R v. Panel on Take-Overs and Mergers, ex parte Datafin* **[1987] QB 815** in which the Court of Appeal ruled that if a body is exercising public functions, even though the mechanism for carrying out those functions is contract, it may be subject to judicial review. In *Datafin* the Court of Appeal held that the Panel on Take-Overs and Mergers

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was subject to judicial review because it was '*established under authority of the Government*'. The powers that it exercised were in effect mandatory and coercive.

Lord Justice Lloyd LJ said in *Datafin* said that he did '*not agree that the source of the power is the sole test whether a body is subject to judicial review*' and that the '*source of the power will often, perhaps usually, be decisive*'. However he noted that in '*between these extremes there is an area in which it is helpful to look not just at the source of the power but at the nature of the power. If the body in question is exercising public law functions, or if the exercise of its functions have public law consequences, then that may... be sufficient to bring the body within the reach of judicial review*'.

The Divisional Court itself seemed to be uncomfortable with the result because not only did it say it had not found the issue easy to resolve, but there were also 2 other issues which concerned it:

- Whether there may be a contractual right for a customer to sue a bank in contract if an offer made is not fair and reasonable on the basis that a customer could, by accepting a standard offer to be subject to the scheme, create a contract with the bank under which the bank was obliged to make a fair and reasonable offer, and
- Would there be adverse consequences if we were to find that KPMG were amenable to judicial review?

What has the FCA said publicly about 'skilled persons' reports?

At the FCA AGM held on 19 July 2016, Mr Ian Morris questioned Mr Andrew Bailey, the CEO of the FCA about 'skilled persons' reports. His question was raised in the context of his case where a structured collar was sold to him by RBS in January 2007. A 'skilled person' was appointed to make a report in his case. He said in 2015 he was offered a 'take it, or leave it' deal. Mr Bailey promised to look further into his case but he stressed that an independent review '*could only be done when the outcome of the Holmcroft Properties case was known*'.

At the FCA AGM on 22 July 2015, Mr Keith Wates questioned the previous CEO (Mr Martin Wheatley) of the FCA about skilled person's reports. Mr Wates said that in evidence to HM Treasury Select Committee, Mr Wheatley had told Andrew Tyrie MP that typically a skilled person takes representations from a customer as well as a firm. Mr Wates maintained that he was not allowed access to the skilled person appointed by his bank. He asked Mr Wheatley to clarify his evidence to Parliament. Mr Wheatley was forced to concede that '*his words were not as clear as they should have been*'. Mr Wheatley claimed that a skilled person would see everything brought to a firm.

What other criticisms are made about skilled persons reports?

The overarching criticism made of these 'skilled person' reports in these IRHP cases is that their scope is so narrow being limited to an oversight of the process adopted by the bank. It is said that the skilled person has not really scratched the surface and made any or any proper investigation. Finally it is said that although the skilled person report is prepared in the name of a prestigious firm such as KPMG, in reality any investigation and report is conducted by a junior and/or unqualified person to render such a report effectively worthless.

Were there any restrictions imposed on the grant of permission?

On 7th April 2016 an application was lodged with the Court of Appeal for permission to appeal. It seems to have been overlooked until it was kicked back into life in January 2017. On 23 February 2017 a single Lord Justice on the papers granted Holmcroft Properties permission to appeal.

When will this appeal be heard?

The Civil Appeals Office has given this case a 'hear by' date of 16 June 2017. As there are 4 parties this may prove to be optimistic. An appeal date will be fixed when leading counsels' clerks attend the listing office to fix a date. This is more likely to be in quarter 4 of 2017.

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David Bowden is a solicitor-advocate and runs [David Bowden Law](http://DavidBowdenLaw.com) which is authorised and regulated by the Bar Standards Board to provide legal services and conduct litigation. He is the cases editor for the Encyclopedia of Consumer Credit Law. If you need advice or assistance in relation to consumer credit, financial services or litigation he can be contacted at info@DavidBowdenLaw.com or by telephone on (01462) 431444.