MAYER·BROWN

Legal Update
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The latest swaps litigation: the English High Court rules that the Bank of Scotland was entitled to exclude obligations by express agreement and the parties are bound by their agreement that there was no advisory relationship.

Summary

The latest swaps mis-selling decision was handed down on 5 December 2017 in ***Marz Limited v Bank of Scotland Plc*** (2017).

The High Court was required to consider the bank's written contractual terms, which sought to exclude duties of care to its counterparty. Consistent with the judiciary's application of ***Springwell***, Mr Rosen QC, sitting as a deputy High Court judge, held that the bank was entitled to exclude obligations by express agreement. Rather than this amounting to a contractual estoppel (which remains a controversial doctrine), the judge regarded his decision as "***more of a matter of contract***", holding the parties to the agreement they made, namely that no advisory relationship exists between them.

The decision is also the latest in a trend of decisions rejecting the imposition of a "mezzanine duty" on banks as a matter of general application, reiterating long-standing concerns of several judges, that such a duty will blur the distinction between salesman and advisor.

Background

The claimant, a catering business, brought proceedings against the bank alleging that in entering into a trigger swap (interest rate swap protection being a condition of the bank's lending), the bank breached its express contractual duties contained within the Terms of Business. The relevant terms of the bank's Terms of Business conflicted with the ISDA Master Agreement (which were expressly stated to prevail in the event of any such conflict). The Terms of Business provided that the bank would "***..advise and deal with you on the basis that we are meeting your objectives to manage risk***" and "***take reasonable steps to assess whether such services are suitable for you based on the information provided by you...***".

Further, the claimant alleged a breach of contractual and tortious duties to use reasonable skill and care when providing information or advice. The Bank of Scotland in turn argued that the claimant was contractually estopped from claiming there was a wider duty of care, on the basis of the ISDA Master Agreement which contained the standard: "non-reliance", "assessment and understanding" and "status of parties" clauses and expressly provided that the bank was not acting as an adviser and that the claimant was making its own independent decision to enter into the swap.

Issues

Perhaps unsurprisingly, the judge held that the terms of the ISDA Master Agreement (which were signed after the Terms of Business) must prevail.

As regards the bank's alleged duties of care, he found as follows:

1. Advice/Recommendation - As a matter of fact, none of the instances relied upon by the claimant amounted to "positive" advice or recommendations. To make out a duty of care to provide suitable advice, is much more than pointing to some statements made by salesmen. A party must establish the scope and subject of the

duty, the alleged breaches and that the bank was a counterparty with opposing economic interests [J198]. Further, there was no advisory agreement or fee charged for advice, in contrast to an independent advisory retainer which the claimant had in place with a third party.

2. "Mezzanine duty" – Banks' duties owed to counterparties have been the subject of much litigation over recent years. Following decisions such as ***Rubenstein v HSBC*** and ***Green & Rowley v Royal Bank of Scotland Plc***, the law in this area was reasonably well established and provided that where a bank assumes responsibility for and provides advice, its duty is to do so fully and accurately. Where a bank provides information, it is required not to mislead or misstate (as per the ***Hedley Byrne*** test).

   On the back of a 2014 decision in the case of ***Crestsign v National Westminster Bank Plc and another***, in which Mr Timothy Kerr QC, sitting as a High Court deputy judge, sought to widen the bank's duty and imposed a so-called "mezzanine duty" on a bank that embarks on an explanation of financial products but does not go so far as providing advice, the claimant argued that such a duty applied here. The duty, said to be less onerous than the duty in relation to giving advice but more onerous than the bare duty not to misstate, requires a bank to take reasonable care to give "accurate and proper" explanations as to the nature and effect of financial products. The decision in ***Crestsign*** has since provoked much judicial disagreement on the existence and scope of such an intermediate duty. Indeed, decisions at first instance in the cases of ***Property Alliance Group Limited v Royal Bank of Scotland Plc*** and ***Thornbridge Ltd v Barclays***, expressly rejected the imposition of such a duty as a general principle. Both decisions are subject to appeal in 2018.

   The judge here agreed and adopted the principles of Asplin J in PAG v RBS that this has to be a duty "***falling on the advisory spectrum***" and that to impose a wider duty than the duty not to misstate on the giving of information by a salesman, would be to "***blur the lines between a salesman and advisor***". Indeed, the judge echoed Asplin J's remarks, saying that he did "***not consider that a salesman, if he provides any information, has to explain fully the products he wishes to sell, including alternatives and comparisons***" [J237].

3. Exclusion or basis clauses -The claimant argued that the terms in the ISDA Master Agreement and relevant confirmations (agreed after the transaction) were exclusion, rather than basis clauses, compelling the bank to establish that the clauses are reasonable within the meaning of UCTA 1977. Mr Rosen QC held that the terms in the ISDA Master Agreement and confirmations were basis clauses and that in his view, the questions of whether a clause is a basis or exclusion clause should not "***depend on a detailed factual finding as to the position had the terms not been agreed and applicable***". Rather than attempting to "***rewrite history***", the relevant clauses were no more than an attempt to avoid a later dispute as to whether salesman talk had "***crossed the line***" [J262]. There was no evidence to suggest that misrepresentations had been made by the bank and as such, no attempt to "***alter the character and effect of what has gone before***" (***Raiffeisen v Royal Bank of Scotland Plc***). It was clear from other earlier material that the bank did not intend the claimant to place any reliance on its statements [J271].

4. Even in the event that the clauses were exclusion clauses, they were reasonable because, amongst other factors, the claimant was sufficiently familiar with the standard industry document, had independent advisors and had experience of interest hedging products [J274, 275].

5. As for contractual estoppel, he held that "***I myself regard this more as a matter of contract than estoppel, the parties being bound by an agreement that there is no advisory relationship between them…***" Further, if parties were not free to exclude obligations by express agreement, "***sales and other commercial transactions might give rise to all sorts of unmanageable and unforeseeable obligations***" [J356].

The judge held that the claims against the bank failed as a matter of fact and law. If the bank were to be burdened with the risk of the transaction, it would be "***underwriting any loss suffered by reason of changes in the market- precisely what it required for its own (adverse) benefit..***". He added that the fact that the bank made a profit on the swap, was no good reason to reverse that burden.

Comment

Counterparties face high hurdles in existing financial transactions in circumstances where contractual documentation contains a raft of basis and/or exclusion clauses and the usual armoury of contractual estoppel will be available. Disgruntled investors continue to look for ways around this and the decision in ***Crestsign*** and the potential "mezzanine duty" on banks has undoubtedly created a new avenue for claiming counterparties and in turn, a degree of uncertainty for financial institutions. This decision, however, follows the trend of decisions since 2014, to curtail claims seeking to widen the duties of financial institutions.

It is anticipated the subject will be revisited again by the Court of Appeal in the ***PAG*** and ***Thornbridge*** appeals early next year.

Authors

For more information about any of the issues raised in this update, please contact:

Alistair Graham
Partner, London
E: alistair.graham@mayerbrown.com
T: +44 20 3130 3800

Gemma Rochelle
Senior Associate, London
E: grochelle@mayerbrown.com
T: +44 20 3130 3473