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Update

Swaps mis-selling claims: Court of Appeal confirms that no common law duty arises from COB Rules

In *Green & Rowley v Royal Bank of Scotland plc* (2013), the Court of Appeal has recently given its first decision in relation to the current wave of English swaps mis-selling cases. In a helpful but relatively narrow ruling, the Court upheld a first instance decision that the (former) FSA's Conduct of Business ("COB") rules do not give rise to a co-extensive common law duty of care in the tort of negligent misstatement.

Background

The Claimants and Appellants, Green and Rowley, were two individuals in partnership as commercial property developers. In May 2005, they had a pre-existing loan liability of GBP 1.5 million with the Royal Bank of Scotland (RBS). The loan was for a 15 year term on an interest only basis at 1.5% above the base rate. After meeting with RBS in May 2005, they entered into a swap which had the effect of fixing the interest payable under the loan for a term of ten years at 4.83% – at the time only fractionally more than the prevailing base rate. Prior to the swap's execution, they had signed to confirm their acceptance of the bank's terms of business, which stated that RBS was providing execution-only services.

In early 2009 they decided to restructure their partnership, necessitating an early break of the swap, which at that point still had six years to run. Given the steep drop in interest rates, following the September 2008 financial crisis, the swap was at that point substantially "out of the money", with a break cost for early termination being calculated at GBP 138,650.

On 25 May 2011, they issued a claim form against RBS for allegedly mis-selling them the swap.

The claim at first instance

The claim consisted of two parts. First, an "advice claim", based on an alleged advisory relationship pursuant to which the bank was required to provide investment advice. Second, an "information" claim, based on the tort of negligent misstatement, as developed following *Hedley Byrne and Co Ltd & Heller and Partners* (1964).

An important element of both the above claims was that RBS had, in its communications with the Claimants prior to the entry into the swap, been

in breach of two COB Rules, namely COB Rule 2.1.3 (the duty to take reasonable steps to communicate in a way which is clear, fair and not misleading) and Rule 5.4.3 (the duty to take reasonable steps to ensure that a private customer understands the risks of the transaction).

Ordinarily, that would have given rise to a separate statutory cause of action under section 150 of the Financial Services and Markets Act 2000 ("FSMA"), but in the present case the Claimants accepted that their claim under s.150 was time-barred. They sought however to bring in the above COB provisions by alleging that they formed an integral part of both the advice claim and the information claim (neither of which were time barred).

As regards the "advice claim", it was alleged that the advisory duty came into play because the swap was positively recommended to the Claimants, and that the relevant COB requirements would have formed part of that advisory relationship. In line with previous recent case law, including *Rubenstein v HSBC* (2011), Judge Waksman QC found that, had the relationship between the Claimants and RBS indeed been an advisory one, the relevant COB requirements would have been relevant to RBS's obligations. However on the facts, he found that although *"there was undoubtedly an element of recommendation"*, no advice was given by the bank and as a result, no duty of care arose.

As regards the "information claim", which alleged that RBS were guilty of negligent misstatements about a number of issues including the break costs, the Claimants argued that the requirements of the above COB Rules formed part of the scope of the *Hedley Byrne* common law duty. The judge however rejected that view, stating that (in clear distinction to his ruling regarding the "advice claim") the COB rules did not form part of the *Hedley Byrne* duty not to make negligent misstatements. Against that background, he held that RBS did not make any negligent misstatements to the Claimants (or provide any information that was misleading, unclear or unfair).

The appeal

On appeal, the Claimants did not appeal the finding of the High Court that no advice or recommendation had been provided by RBS.

The appeal comprised two components. First, an appeal against the judge's finding that, alongside the common law duty not to make negligent misstatements, there existed a "concurrent" or co-extensive common law duty for the bank to comply with the COB Rules. This, they contended, meant that RBS should have warned them that the break costs could be substantial and explained the magnitude of the costs, thereby ensuring that they understood the risks involved. Second, as a follow-on point, the Claimants alleged that the judge erred in his decision that the warnings provided by RBS in this regard were adequate, for the purposes of compliance with the relevant COB Rules.

The "concurrent" duty argument was dismissed. Giving the judgment of the unanimous Court of Appeal, Tomlinson LJ stated that, to the extent considered necessary by Parliament, a breach of COB Rules has already been provided with a remedy under s.150 of FSMA and *"there is no feature of the situation which justifies the independent imposition of a duty of care at common law to advise as to the nature of the risks inherent in the regulated transaction"*.

Tomlinson LJ said that since RBS did not step into the realm of giving advice and merely gave information about and sold the swap to the Claimants, there was no need to impose an independent common law duty. It was also noted that neither Rule 2.1.3 nor Rule 5.4.3 made any

reference to the assumption of a duty of care or the appropriateness of imposing such a duty.

Tomlinson LJ provided a helpful recap of the residual scope of the *Hedley Byrne* duty in such cases, namely that it does not comprise a duty to give information unless, without it, a relevant statement made within the context of the assumption of responsibility is misleading. Thus, he stated, insofar as COB Rule 2.1.3 refers to a duty to take reasonable steps not to mislead, this is comprised within the common law duty, but insofar as it refers to a duty to take reasonable steps to communicate clearly or fairly, this introduces notions going beyond the accuracy of what is said, which is the touchstone of the *Hedley Byrne* duty. He also agreed with the first instance judge's view that the duty imposed by COB Rule 5.4.3, to take reasonable steps to ensure that the counterparty to a transaction understands its nature, goes "well outside any notion of a duty not to mis-state".

After dismissing this "concurrent duty" argument, it was not necessary for the Court of Appeal to consider the second point, about whether RBS had in fact complied with the relevant Rules, and it did not do so.

Comment

This decision is useful because it provides clarity, at Court of Appeal level, regarding the status of the COB Rules. It confirms that, whilst the COB Rules may give rise to a statutory cause of action pursuant to s.150 of FSMA, and may inform the scope of any otherwise applicable advisory duty, their scope cannot be extended further to create some form of "concurrent" or "co-extensive" duty of care in *negligent misstatement*.

The ambit of the decision is however narrow, with little guidance being provided regarding the practical implications of particular mis-selling scenarios. Most significantly, given that the statutory COB claims were themselves time-barred in this case, the Appeal Court was not required to and did not address the important substantive question of how far the COB Rules required the bank to go in explaining the seriousness and/or magnitude of any adverse break costs to which its customers might be exposed. It is to be hoped that more concrete judicial guidance on this and related points will emerge as the present spate of swaps litigation proceeds through the Courts.

Further information

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Further advice should be taken before relying on the contents of this summary.