Feature

KEY POINTS

- In *London Executive Aviation Ltd v The Royal Bank of Scotland plc* [2018] EWHC 74 (Ch) Rose J held that "investment advice" for the purposes of a common law negligence claim means something different from the "wide definition of advice used in the regulatory context".
- The judge's decision to disregard regulatory definitions and guidance in determining whether advice was given is unprecedented and creates yet another layer of difficulty and uncertainty for claimants in this already over-complex area of the law.

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Spot the difference? "Investment advice" under FSMA and at common law

In this article, Richard Edwards QC considers the legal test for "investment advice" adopted in the recent case of *London Executive Aviation Ltd v The Royal Bank of Scotland* and questions whether the judge was right to draw a distinction between the definition of "investment advice" under FSMA and "advice" for the purposes of a common law negligence claim.

In *Robinson v Chief Constable of West Yorkshire* [2018] UKSC 4, [2018] 2 WLR 595, Lord Reed noted that "long-established principles of the law of negligence … have been eroded in recent times by uncertainty and confusion". Arguably, this phenomenon is nowhere more apparent than in the growing body of mostly first instance decisions dealing with claims against banks for the alleged mis-selling of financial derivatives. Unwarranted obstacles have been erected in the way of claimants wishing to complain of unsuitable financial products recommended to them by their banks, undermining the role of the common law in holding banks accountable for harmful conduct.

The problems in this area of the law originate in the mis-selling litigation following the Russian debt crisis of 1998. That crisis had little impact on most UK SMEs, but affected the fortunes of some very rich and "sophisticated" investors who had bought derivatives linked to Russian government bonds. Some of these investors, having lost vast sums, brought proceedings seeking to pass on their losses to the institutions which sold them the products. The most influential of these cases is, of course, *J.P. Morgan Chase Bank v Springwell Navigation Corp* [2008] EWHC 1186 (Comm) (Gloster J).

Springwell is most often cited for its unblinking application of the so-called "contractual estoppel" or "basis clause" doctrine, first enunciated by the Court of Appeal two years earlier in *Peekay Intermark Ltd v Australia and New Zealand Banking Group* [2006] Lloyd's Rep 511. Readers of this Journal will be well aware of the difficulties that doctrine has created for claimants in mis-selling claims. But *Springwell's* endorsement of the contractual estoppel doctrine is not the only aspect of the decision that has proved influential. In *London Executive Aviation Ltd v The Royal Bank of Scotland plc*, Rose J drew extensively on Gloster J's judgment in holding:

- that the bank did not recommend the products complained of; and
- that if it did, the bank owed no duty of care – even without regard to the "non-reliance" and similar clauses relied on by the bank.

This article looks at Rose J's approach to the first of these questions; a future article will return to the duty issue.

The facts in a nutshell were as follows. The claimant (LEA) was an SME running a private jet charter business. It banked with NatWest, an RBS subsidiary, and had term loan facilities with Lombard North Central plc, also an RBS group company. In 2007 LEA was negotiating a new £12m loan facility with Lombard to finance new aircraft.

A feature of the Lombard facilities was that although the interest rate was variable, the periodic payments were fixed at a pre-agreed amount, with a balancing or "balloon" payment at the end of the 10-year term (the amount of which was uncertain because it would depend on how much capital had been repaid out of the fixed payments during the term). This feature was described by Lombard as offering borrowers "the benefits of both worlds with a fixed repayment but linked to a variable rate facility to benefit from possible rate reductions and early settlement without penalty". Lombard did not require LEA to enter into any interest rate hedging product.

LEA's relationship manager at NatWest nevertheless wanted LEA to consider hedging the new facilities, and for this purpose introduced LEA to RBS's Global Banking and Markets division (GBM). GBM's role according to its own description at the time was to "provide tailored solutions to your specific risk management requirements", the first stage being "to understand as much as possible about your business objectives and the parameters affecting your exposures". Ostensibly for this purpose, GBM obtained details of LEA's facilities and elicited information about its business and future plans. There then followed a number of telephone calls and emails in which various bespoke structures were proposed by GBM and discussed. In November 2007 however, LEA's directors paused the discussions, saying that they expected interest rates to fall, and anyway since LEA's payments under the Lombard loan were fixed they did not feel particularly exposed if interest rates rose.

This news was poorly received by the relationship manager, who in internal emails had been looking forward to "celebrating the income" from the sale of the products, and now expressed his desire to "scare the s**t" out of LEA in order to "make them trade". He asked GBM to produce a statistical analysis demonstrating the potential

magnitude of the balloon payment at the end of the 10-year term if interest rates were to increase. This analysis was shown to LEA at a meeting in February 2008 along with a presentation offering variants on the products previously discussed. Shortly afterwards, LEA entered into two interest rate hedging products. The bank's internal records indicated that GBM's balloon payment analysis had been "a deciding factor" in persuading LEA to change its mind.

The principal basis on which LEA put its claim was that RBS had been negligent in recommending the products, arguing that they were unsuitable for several reasons, chiefly to do with the fact that the notional amounts (£8m for five years, then stepping up to £12m for another five) bore no relation to the actual loan amount, and the fact that they were cancellable by the bank after five years if rates increased. These features meant that if interest rates had risen the products would have been cancelled at the five-year point, leaving unhedged the very risk that RBS itself had identified as needing to be addressed; whereas if interest rates fell (as happened), the debt would be substantially overhedged for much of the term.

WHAT IS "INVESTMENT ADVICE"?

LEA argued that to make good its advice case, it did not have to show that RBS "advised" that the products were "suitable", or "recommended" them using those exact words. It was enough that the products were presented by GBM as beneficial for LEA, ostensibly based on a consideration of LEA's circumstances and objectives. To do that *is* to give investment advice, in line not just with the views of the regulator but with the expectations of clients in everyday life.

RBS was intent on convincing LEA, using arguments backed by technical analysis produced specifically for the purpose, that it ought to hedge its exposure using one or more of the "solutions" "tailored" for that purpose by GBM. GBM did not merely elicit from LEA what its risk management objectives were, but actually advised LEA what those objectives ought to be, telling LEA about the risk it would face if it chose not to hedge, quantifying that risk to impress LEA with its magnitude, and putting forward the products as a means of addressing that risk. If this does not count as "investment advice" and a recommendation to enter into the products, it is difficult to see what would. It is respectfully suggested that the judge's finding that the products were not recommended can only have been arrived at by applying the wrong legal test.

The section of the judgment dealing with the legal test is dense and resistant to accurate précis. However, the main points that emerge appear to be as follows:

- "Advice" in the context of a common law negligence claim has a different and narrower meaning than the "wide definition of advice used in the regulatory context".
- It is necessary for the claimant to identify "actual words of advice", that is to say, "some written or oral statement … which properly construed amounts to advice, applying the test described in the case law".
- The "test described in the case law" is a "pragmatic and commercially sensible" one which "respects the distinction between a salesman and adviser".
- Even if a salesman selects a product to meet the client's objectives, and makes what is apt to be described as a personal recommendation according to "the FSA rule book", that is not advice for the purposes of a common law claim.

Statutory definitions and guidance

In essence, in the rules made under FSMA, "advising on investments" means giving advice to a particular person on the merits of his buying a particular investment; a "personal recommendation" means a recommendation which is presented as suitable or based on a consideration of the circumstances of that person; and "suitability" under COBS 9 involves meeting the client's objectives in a manner consistent with his attitude to risk. These are not rarefied or esoteric concepts but are consistent with the meaning of "advice" in ordinary language. As Carnwath J said in *Re Wizard Market Systems* [1998] 2 BCLC 282 at [34], "guidance as to the course of action which [a person] should take in relation to the buying or selling of investments … in the ordinary use of English, is 'advice on the merits' of purchasing those investments". And to present a product to a client as one that is suitable in the sense of meeting the client's objectives goes to the heart of what an investment adviser does.

LEA also referred at trial to the extensive regulatory guidance on the meaning of "investment advice" – not because the guidance is binding *per se* (regulatory guidance given by the FSA/FCA under s 157 of FSMA does not bind the court even in a s 138D case), but because (as the judge acknowledged at [166]) courts have found it helpful in the past in resolving disputes as to whether or not advice has been given. So for example, in *Wilson v MF Global* [2011] EWHC 138 (QB) and *Rubenstein v HSBC* [2011] 2 CLC 459 there were parallel claims for breach of regulatory rules and for breach of alleged common law duties, yet the regulatory guidance on the meaning of advice was treated as applicable for both purposes without drawing any distinction; and in *Crestsign Ltd v NatWest* [2015] 2 All ER (Comm) 133 and *Thornbridge v Barclays Bank* [2015] EWHC 3430 (QB) the court had recourse to the regulatory guidance even though those claims were brought exclusively in negligence at common law.

Even in *LEA*, RBS did not seek to argue that the statutory definition of investment advice and its associated regulatory guidance were irrelevant, or that they should be disregarded, or even treated with caution, just because this was a common law claim. Indeed, RBS itself cited *Zaki v Credit Suisse* [2011] 2 CLC 523, a pure s 150 case, for two propositions: "[a]dvice requires an evaluative judgment or an element of opinion on the part of the adviser" and "whether or not advice has been given will depend on the context", both of which derive from the FSA's Perimeter Guidance Manual. Notably, when Teare J said in *Zaki* that "what amounts to advice will … depend on the context", he was not making the point

that an ostensibly advisory statement may be shorn of its advisory character by the context in which it is made. He was making precisely the opposite point, that context may confer an advisory character on an ostensibly factual statement (ie one that does not use overtly "advisory language"), referring with approval to statements to this effect in the Perimeter Guidance Manual (specifically PERG 2.7.15).

It was therefore common ground at trial that even though this was a purely common law claim, the court was entitled to adopt the statutory definition of investment advice and related guidance. Notwithstanding this, the judge took the unprecedented step of holding that "investment advice" in a common law negligence claim means something different from "advising on investments" in financial services regulation, citing *Green & Rowley v RBS* [2014] Bus LR 168 in support of her observation that "the courts are cautious about importing concepts from the regulatory rules and guidance into the discussion of the scope of the common law duty of care or the circumstances in which it arises".

However *Green & Rowley* is authority only for the limited proposition that a person who is not eligible to sue for breach of regulatory rules as such under FSMA s 150/138D cannot overstep that obstacle by asserting a freestanding common law duty to comply with the rules. *Green & Rowley* is not authority for any wider doctrine that courts applying the common law of negligence must steer clear of regulatory concepts or guidance.

The judge's decision to reject regulatory definitions and guidance in determining whether advice was given could have far-reaching consequences if followed in other cases. Eschewing regulatory guidance as an aid to resolving disputes as to whether investment advice has been given in common law negligence cases leaves it wholly unclear what amounts to "advice" for that purpose. The only alternative "test" to which the judgment refers is said to be derived from *Springwell* and *Wilson v MF Global*, but on analysis neither of those cases establishes usable criteria for cases of this kind. As to *Springwell*, Gloster J found that Chase on occasion gave advice and made recommendations but on the facts of that particular case, as this was done in his capacity as a salesman of a limited class of securities, no legal responsibility attached to what he said. *Springwell* cannot be said to lay down a "test" for whether any particular statement amounts to investment advice. *Wilson v MF Global* is arguably more relevant, but still contains no general test and is clearly distinguishable from cases of the *LEA* type.

In *Wilson* the claimants had opened "execution only" accounts with the defendant in order to trade "frequently and aggressively … in contracts for difference (CFDs), futures and options and also by way of spread betting". For the purposes of their trading in CFDs, futures and options, the claimants were classified as "intermediate customers" (as a result of which no regulatory suitability duty was owed to them even in respect of personal recommendations under the then current regime). The relevant part of the claim for present purposes was a claim that the "account handler" had given negligent investment advice. The alleged advice was extracted from transcripts of "hundreds of conversations" which took place over a long period. Eady J rejected the claim that advice had been given essentially for two related reasons:

- The account had been set up as an execution only account, at the claimant's request, specifically to enable the claimant "to implement his own strategy and personal day-to-day judgments about the market and the opportunities it presented". That strategy "was not something on which Mr Gainsley was called upon to advise or on which he ever did so". In that context it was "not simply a question of taking passages from the transcripts in isolation, regardless of those individuals' past relationship, and asking whether it should be construed to contain a personal recommendation".
- The conversations in which the "advice" was allegedly given were best characterised as "exchanging information and 'bouncing ideas' off each other or swapping hunches about the market", much of it being "spontaneous and off the cuff". It would be "quite unrealistic" to treat such observations as "personal recommendations" involving a careful consideration of the claimants' circumstances.

As Eady J's judgment does not quote verbatim any of the passages in the transcripts that were alleged to amount to advice in that case, it is not possible to make a direct comparison with anything said on behalf of RBS in *LEA*. However, the case is clearly distinguishable in critical respects. LEA was a first-time buyer of an interest rate hedging product, correctly classified as a retail client, which had no strategy for interest rate hedging at all until GBM came on the scene and persuaded it to enter into the products. Further, although GBM gave some of its advice on the telephone those conversations were not "off the cuff" but part of a continuum which included several formal presentations and involved a great deal of work, all directed towards persuading LEA of the merits of entering into a one-off, substantial, long-term bespoke transaction, "tailored" by GBM to suit LEA's "specific risk management requirements". On a proper analysis, *Wilson v MF Global* cannot be taken as a realistic guide to determining whether what GBM said and did amounted to advice in *LEA*. The circumstances of the two cases were not properly comparable.

Adviser/salesman distinction

The adviser/salesman distinction as it is articulated in recent case law was first made by Gloster J in *Springwell* where it was one of many factors leading to her rejection of Springwell's "general advisory claim". Since then it has seemingly been elevated to the status of a principle of law whereby the utterances of salesmen are presumptively treated as being made without responsibility. It has thus become yet another source of unnecessary difficulty and uncertainty for claimants in cases of this kind.

Whatever relevance the distinction may have had to the analysis of "the daily

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interactions of an emerging markets bond salesman" with a client such as Springwell, which "invested enormous sums aggressively and on a leveraged basis in the emerging markets for the best part of a decade", it is of no relevance to the sale of complex and bespoke interest rate derivatives to inexperienced retail clients such as LEA. There is no strict delineation between salesmen and advisers in the retail financial services sector; indeed, until the Retail Distribution Review in 2013, commission sales by financial advisers were commonplace – including by advisers employed in the RBS Group. As pointed out by Kerr J in *O'Hare v Coutts* [2016] EWHC 2224 (QB), people employed by banks to give investment advice to retail customers use sales techniques and persuasion to sell products, since that is the *raison d'être* of any bank. Advisers sell products; salesmen give advice. This is a fact of commercial life.

Nor can there be any presumption that when a salesman gives "advice", it must be "advice" of a type to which no legal duty can attach; in *Springwell* itself Gloster J made clear at [454] that her findings in this regard were specific to the facts of that case. In other areas of law parties are rightly held responsible for things said and done on their behalf by salesmen. For example in the sale of goods context, where the buyer makes known to the seller any particular purpose for which the goods are being bought, there is an implied term that the goods supplied under the contract are reasonably fit for that purpose, except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the skill or judgment of the seller: see s 14(3) of the Sale of Goods Act 1979. So, if a salesman ostensibly using his skill and judgment recommends a product that is unfit for the purpose made known to him by the buyer, the seller is strictly liable. It is no defence that the recommendation was made "by a salesman acting in his capacity as such".

Likewise, although a contracting party will not be held liable for "mere puffs" (aka "sales talk"), "the expression 'puffery' does not include communications which the recipient is expected to take seriously": *Shaftsbury House (Developments) Ltd v Lee* [2010] EWHC 1484 (Ch) at [35] per Proudman J. What GBM said to LEA was not mere "sales talk" or "puffery" – LEA was expected to take what GBM said about risk very seriously indeed. The real distinction in this context is that which was drawn in *Hedley Byrne* at 495 between "deliberate advice" (which attracts legal responsibility) and "casual or perfunctory conversations" (which do not). Eady J's refusal to characterise "spontaneous and off the cuff" remarks by an account handler as "advice" is consistent with that approach. But GBM's presentations in *LEA* were not casual or perfunctory, spontaneous or off the cuff. They were deliberately made to be taken seriously and relied on.

"Advisory language"

As to the need to identify "some written or oral statement … which properly construed amounts to advice", the judgment begs the question how such statements are to be recognised; the judge does not say what kind of language is required. Viewed both in detail and as a whole the language used by GBM, culminating in the arguments successfully deployed at the February meeting, was clearly calculated to persuade LEA that it was a good idea to enter into the products. The fact that the witnesses could not recall precisely what was said at the February meeting does not mean that LEA was unable to identify the advice given. The presentation at the meeting was the culmination of a process in which GBM constantly sought to persuade LEA of the merits of the products. Taken as a whole, the substance and "decisive" impact of what GBM said was apparent from the contemporaneous evidence.

The judge said that:

> "The holistic approach adopted by LEA makes the test for liability too subjective and dependent on the impression that a mass of material was said to create in the mind of the claimant. It makes the claim almost impossible for a defendant to contest" [175].

These criticisms appear unwarranted. There is nothing wrong with a holistic approach; the construction of contracts is often described as a "holistic" process (see eg *Shaw v Hutton-Shaw* [2007] 1 FLR 1839 at [44] per Arden LJ) but that does not mean that it is subjective or impossible to argue about. It should not have been difficult for RBS to understand LEA's case that its salesman recommended the products, which relied on the words he used in presentations, emails and meetings to persuade LEA of their merits.

Further it should not be necessary for LEA to identify precisely which words, to the exclusion of all the others, had the clinching effect. LEA was entitled to say that it relied on the effect of what was said as a whole. As Lord Halsbury LC said in *Arnison v Smith* (1888) 41 ChD 348, a company prospectus case:

> "for a shareholder … to analyse his mental impressions after an interval of several years, so as to say what representation in particular induced him to take shares, is a thing all but impossible. A person reading the prospectus looks at it as a whole … and on the whole he forms his conclusion. You cannot weigh the elements by ounces".

Finally, the judge's disapproval of the "holistic" approach sits uneasily with her observation that it is not appropriate for claimants to base their claims on "statements that could aptly be described as a 'personal recommendation'" which have been "plucked" out of the conversations and emails between the parties. If both are right then claimants are in a double bind: forbidden from relying on individual pieces of advisory language extracted from the record of the parties' communications, but also prevented from relying on the overall thrust of what was said. The combined effect of these strictures is unjustly to put claimants, not defendants, in an impossible position. ■

Further Reading:

- Information or advice: the value judgment (2015) 11 JIBFL 693.
- To advise or not to advise? (2014) 11 JIBFL 686.
- LexisNexis Loan Ranger blog: Options for those seeking to bring a mis-selling claim against a bank (*Parmar and another v Barclays Bank Plc*).