KEY POINTS

- According to *Hedley Byrne*, banks have no duty to advise their customers, but if they choose to do so they owe a duty of care.
- Recent mis-selling cases have paid too little regard to this authority, preferring a more sceptical case-by-case approach much influenced by *Springwell*.
- This case-by-case approach unduly favours banks. To avoid a repeat of the mis-selling scandals of the 2000s, there needs to be more accountability. A return to basic *Hedley Byrne* principles is long overdue.

Spotlight

Author Richard Edwards QC

The liability of banks for negligent advice: time to go back to basics?

This is the second of two articles in which Richard Edwards QC argues that recent case law on financial mis-selling claims places unwarranted obstacles in the way of claimants wishing to complain of unsuitable financial products recommended to them by their banks.

In *London Executive Aviation Ltd v The Royal Bank of Scotland plc* [2018] EWHC 74 (Ch), Rose J held that:

- the bank did not recommend the two structured interest rate derivatives complained of; but
- even if it did, it owed the claimant no duty of care – even without having regard to the "non-reliance" and similar clauses relied on by the bank.

In the first article, published in the November 2018 edition ('Spot the Difference? "Investment advice" under FSMA and at common law' (2018) 10 JIBFL 606), I focussed on the reasoning that led to the conclusion that the product was not recommended to the claimant – in spite of the bank's concerted and eventually successful efforts to persuade LEA that it ought to hedge its exposure using one or other of the bespoke "solutions" that had been "tailored" by the bank for that purpose. In this article I go on to consider the judge's reasons for holding that no duty of care would have been owed, even if she had found that a recommendation had been made.

BANKS' LIABILITY FOR NEGLIGENT INVESTMENT ADVICE

LEA's case that the bank owed a duty of care when recommending the products was based on a straightforward application of the principle established by the House of Lords in *Hedley Byrne v Heller & Partners* [1964] AC 465. That case laid down, as a general proposition of wide application, that (per Lord Morris of Borth-y-Gest at 502-503):

> "if in a sphere in which a person is so placed that others could reasonably rely upon his judgment or his skill or upon his ability to make careful inquiry, a person takes it upon himself to give information or advice to … another person who, as he knows or should know, will place reliance upon it, then a duty of care will arise."

Their Lordships went on specifically to recognise and affirm the application of this principle to banks giving investment advice, expressly approving *Woods v Martins Bank* [1959] 1 QB 55, and endorsing Lord Finlay LC's dictum in *Banbury v Bank of Montreal* [1918] AC 626 that a banker "is under no obligation to advise, but if he takes upon himself to do so, he will incur liability if he does so negligently". Lord Devlin went so far as to categorise the banker customer relationship as a "general relationship" in the same class as the relationship between solicitor and client, stating that "[w]here there is a general relationship of this sort, it is unnecessary to do more than prove its existence and the duty follows".

THE INFLUENCE OF *SPRINGWELL*

Notwithstanding *Hedley Byrne*, Rose J began her discussion of the duty issue by accepting the bank's submission that LEA's analysis of the legal position "misses out an important step", referring to the need to show not only that advice was given but also that there was "a relationship of proximity between the parties giving rise to a duty of care on the part of the Bank". As in a number of other cases in this area over the past decade, both the submission and the judge's acceptance of it were heavily influenced by the decision of Gloster J in *J.P.Morgan Chase v Springwell Corporation* [2008] EWHC 1186 (Comm).

In that case, Springwell's principal claim at trial (though not pursued in the Court of Appeal) was that "Chase was responsible for selecting and constructing Springwell's entire portfolio and providing ongoing investment advice about it, on what became effectively a daily basis, throughout all of Springwell's dealings with Chase" ("the general advisory claim"). The duties contended for were of "a very wide-ranging and onerous nature", for which there was no precedent in any previous case. It was therefore necessary for Gloster J to embark on an exhaustive analysis of the parties' dealings over several years, in search of "low level" factors which might point to the existence (or not) of these novel duties. These included matters such as: Springwell's "sophistication", as an "aggressive" and "greedy" professional investor "in many ways at the forefront of investing in emerging markets"; the absence of an advisory agreement, in circumstances where the relevant investment activity involved "complicated transactions, involving huge amounts of money over many years"; the absence of "the indicia of an advisory relationship" such as the issue of regular "portfolio statements"; and so on. Taken together, Gloster J held that these low level factors pointed decisively away from the existence of the alleged "general advisory duty".

The problem with Gloster J's reasoning on these issues lies not in the reasoning itself

in the context of that particular case, but in the use that has subsequently been made of it in cases such as *LEA* which are of a wholly different kind:

- First and foremost, the duty alleged by LEA was not an unorthodox and onerous *duty to advise* such as that alleged by Springwell, but an entirely conventional *duty to take care when advising*. The existence of such a duty is a normal incident of the banker-customer relationship, as established in *Hedley Byrne*.
- Springwell was a professional investor enthusiastically engaged in speculative trading in rarefied classes of financial instrument on a daily basis. LEA was a retail client, making a first-time purchase of an interest rate derivative.
- Under the FSA rules the bank had a regulatory duty when recommending investments to clients to ensure that the investments were suitable (no equivalent regulatory duty existed in *Springwell*). It therefore could not be said that it would be unreasonable, unduly onerous or commercially unrealistic to expect it to take care when making recommendations, since it was meant to be doing that in any event.

Notwithstanding these differences, the judge was persuaded by RBS that in order to determine whether a bank owes a duty of care to its customer when recommending products, it is not sufficient to follow what was said by the House of Lords in *Hedley Byrne*; instead the court must consider the question from scratch, conducting a *Springwell*-inspired, multi-factorial investigation into the claimant's characteristics as an investor and other features of the parties' relationship in order to decide whether it was fair, just and reasonable to impose a duty of care.
The judge found there were four factors – all derived from *Springwell* – that militated against the existence of such a duty: LEA's level of sophistication; the absence of a "written advisory agreement"; the availability of advice from other sources; and the absence of "the indicia of an advisory relationship".
It is respectfully suggested that none of these factors justified the conclusion they were said to support.

Sophistication

It has become commonplace in these cases for banks to rely on the claimant's "sophistication" (actual or asserted) as a reason why no duty of care should be found to have been owed – the suggestion being, apparently, that even if the bank was careless, the claimant was able to look after itself.
In *LEA* the judge found that the claimant was "sophisticated" because it was represented in discussions by the wife of one of its directors, who had previously worked in banking. One may question whether a truly "sophisticated" investor would need to entrust such an issue to the spouse of one of its directors, who had no formal role in the company. But even leaving that aside, the judgment does not explain why it should follow that the bank owed LEA no duty of care.

In *O'Hare v Coutts* [2016] EWHC 2224 (QB), faced with a similar argument, Kerr J observed that the claimant was "astute in business and in consequence wealthy, and in the course of acquiring wealth had got to know something about investing, but he did not have expertise to match that of Coutts; otherwise, he would not have required advice on how to invest. Similarly, an experienced commercial litigator as a party to lawsuits is not the same thing as an experienced commercial lawyer specialising in litigation. The former needs advice, the latter can give it".

The analogy with the legal profession is a telling one: nobody would dream of suggesting that a member of the legal profession owes no duty of care to a client merely because the client is "sophisticated", or has a law degree, or practises or has practised as a barrister or solicitor; large financial institutions such as RBS are still owed duties of care by their external legal advisers, even though they have sophisticated in-house counsel and well-staffed legal departments. In solicitors' negligence cases it is well established that the terms in which advice is expressed may vary according to the client's level of understanding ("legal advice, like any other communication, should be in terms appropriate to the comprehension and experience of the particular recipient": *County Personnel (Employment Agency) Ltd v Alan R. Pulver & Co* [1987] 1 WLR 916 at 922 per Bingham LJ), but not the very existence of the duty.

There is no reason why the position should be any different in the case of financial advice. Even a bank may be owed a duty of care by another bank when it is reasonably relying on the other bank's expertise: *Riyad Bank & Ors v Ahli United Bank (UK) plc* [2006] 1 CLC 1007. In *Springwell* the "sophistication" issue was part of the multi-factorial enquiry necessitated by the unusual nature of the duties alleged. Where the duty alleged is the standard duty owed by a bank to its customer, as in *LEA* and similar cases, the customer's "sophistication" (a vague concept in any event) should be legally irrelevant.

Absence of written advisory agreement

If there had been a written advisory agreement LEA would no doubt have had a claim in contract and would not have to rely purely on its cause of action in negligence. The whole point of the *Hedley Byrne* doctrine is that it enables the law to find a duty of care in spite of the absence of a contract. So the absence of a "written advisory agreement" is not in itself a reason to find there was no duty of care. As was said in *Hedley Byrne* itself:

> "Payment for information or advice is very good evidence that it is being relied upon and that the informer or adviser knows that it is. Where there is no consideration, it will be necessary to exercise greater care in distinguishing between social and professional relationships and between those which are of a contractual character and those which are not. It may often be material to consider whether the adviser is acting purely out of good nature or whether he is getting his reward in some indirect form."

In a case such as *LEA*, it goes without saying that the relationship was not a "social" one, and the bank was not "acting purely out of good nature". Although no fee was paid for the advice, it was clearly not gratuitous in any commercially realistic sense given the

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"top end return" that the sale of the products generated. The judge considered that the bank's interest in generating revenue from the sale gave rise to a divergence of interests which militated against the existence of a duty of care. But this ignores the realities of the market for investment advice, in which advisory services were often rewarded by commission on the sale of recommended products rather than by a flat fee, as *O'Hare v Coutts* illustrates.

Availability of advice from other sources

It is unclear why the supposed availability of advice from other sources should be relevant to the existence or otherwise of a duty of care. If the products were negligently recommended by the bank, why should it matter that LEA could have gone to someone else for a second opinion, if that was the case? In any event, on the facts it was unclear from whom a second opinion could realistically have been sought. The bank suggested that the director's wife who was involved in some of the discussions could have approached one of her former colleagues working in an investment bank. But investment banks are not in the business of advising retail customers about interest rate hedging, and a quick chat on the phone with an old contact would not have put LEA in a position where it was no longer relying on the bank's recommendations.

As in *Crestsign Ltd v National Westminster Bank* [2015] 2 All ER (Comm) 133, the evidence was that there were few if any independent advisers on interest rate hedging products in the market at the relevant time. As the judge recorded, the bank objected that it had been given "insufficient notice of this line of argument". This objection had little merit however as it was the bank that was relying on the supposed availability of advice from other sources as reason why no duty was owed, so the burden of proving the availability of such advice (to the extent that this was relevant at all) should have fallen on the bank. Again, this was a *Springwell*-inspired argument which overlooked the distinction between the unusual and onerous duties alleged in that case, and the entirely standard duty relied on by LEA.

Indicia of an advisory relationship

It is unclear what is meant by an "advisory relationship" in this context (as Gloster J herself observed in *Springwell* the term is ambiguous), what the *indicia* of such a relationship might be or what the concept adds to the analysis. In *LEA* the judge relied on the absence in any of the emails or phone conversations of instances in which LEA specifically asked the bank's salesman "what he thought LEA should do". But such a request would have been otiose as the salesman at all times made it abundantly clear that he thought LEA should take one of the products he was offering them. The actual decision was made at a meeting during which the salesman presented an elaborate, specially prepared "decision tree" for LEA to follow in choosing between the limited range of products he had selected for them. In deciding to enter into the products LEA was clearly being guided by the bank. It was superfluous to look beyond that fact for "the indicia of an advisory relationship".

TIME FOR A RETURN TO FIRST PRINCIPLES

In *Robinson v Chief Constable of West Yorkshire* [2018] AC 736, decided shortly after judgment was handed down in *LEA*, Lord Reed noted that "long-established principles of the law of negligence … have been eroded in recent times by uncertainty and confusion". This has come about as a result of a misconception that the court is required to assess each case on its own facts to see whether it would be fair, just and reasonable to impose a duty of care, applying the so-called "three-fold test" said to have been laid down by the House of Lords in *Caparo Industries plc v Dickman* [1990] 2 AC 605. As the Supreme Court pointed out in *Robinson*, however, *Caparo* has been misunderstood; it does not lay down a three-fold test to be applied afresh in all cases, but instead requires the court to "consider what has been decided previously and follow the precedents (unless it is necessary to consider whether the precedents should be departed from)". Hence "[i]t is normally only in a novel type of case, where established principles do not provide an answer, that the courts need to go beyond those principles in order to decide whether a duty of care should be recognised". The law "cannot be re-made for every case", and to start the analysis afresh with each new set of facts is "a recipe for inconsistency and uncertainty".

LEA was not a novel type of case. *Hedley Byrne* established more than 50 years ago that a duty of care is owed when a banker chooses to give investment advice to its customer. The liability of banks to their customers for negligent investment advice is an established category of liability, and there should be no need to enquire further whether a sufficient relationship of proximity existed, or to question whether it is fair, just and reasonable to recognise such a duty, as if starting with a blank sheet of paper.

The sceptical, *Springwell*-inspired approach adopted in *LEA* and in other cases like it, such as *Thornbridge v Barclays Bank plc* [2015] EWHC 3430 (QB), is based on a misunderstanding of *Springwell* itself and has turned the law in this area into "a wilderness of single instances". The need to investigate issues such as the claimant's "sophistication" or lack of it, and to debate their significance if any, adds to the burden of disclosure, takes up time at trial, distracts attention from the real issues of negligence and suitability, and makes outcomes highly unpredictable. The only beneficiaries of this state of affairs are the banks. If we want to avoid a repeat of the mis-selling scandals of the 2000s, there needs to be more accountability. A return to first principles is all that is required to bring that about. It is long overdue. ■

Further Reading:

- Spot the difference? "Investment advice" under FSMA and at common law (2018) 10 JIBFL 606.
- Disclosure of risk in SME swap transactions: the Court of Appeal wreaks havoc with accepted principles (2018) 5 JIBFL 282.
- LexisPSL: Financial Services: RBS beats UK misselling case over "toxic" swaps deal (*LEA v RBS*).