January 2014 Vol. 29 – No. 1

Butterworths Journal of

International Banking and Financial Law

The rising risks and roles of financial collateral

Interest rate swaps and the sale of the unknown

Valuation in resolution and the "no-creditor-worse-off principle"

In Practice

The interpretation of contracts relating to financial transactions: Part 1: the current position and what will change

Differences between subscription line and corporate facilities

The regulation of shadow banking: are you affected?

Energy derivatives and EMIR: is clearing unclear?

Cases Analysis

3 Verulam Buildings reports on the latest banking law cases

Market Movements

DLA Piper UK LLP reviews key market developments in the banking sector

KEY POINTS
- We seem to have developed a *cordon sanitaire* between the regulatory structure, with its strikingly restricted remedies, and private law duties.
- The distinction between information and advice is an illusion, particularly where the requirement is to achieve understanding of the nature of risk.
- An obligation to put another's interests ahead of one's own may readily indicate a fiduciary relationship.

Feature

Author Paul Marshall

Interest rate swaps and the sale of the unknown: blind alleys, an enfeebled equity and the triumph of certainty over fairness

In this article, Paul Marshall considers the unsatisfactory interface between financial regulation and private law illustrated by *Green and Rowley v Royal Bank of Scotland* [2013] EWCA Civ 1197 (October).

"The real trouble with this world of ours is not that it is an unreasonable world, nor even that it is a reasonable one. The commonest kind of trouble is that it is very nearly reasonable, but not quite. Life is not an illogicality; yet it is a trap for logicians. It looks a little more mathematical and regular than it is; its exactitude is obvious, but its inexactitude is hidden; its wildness lies in wait.[1]"GK Chesterton writing in 1909.

Quoted in 1996 by Peter Bernstein in *Against the Gods, The Remarkable Story of Risk* (in a chapter entitled *Awaiting the Wildness*) writing that *"we are still trying to understand … how human beings make choices and respond to risk"*;[2] apt to the banking crisis. It is a commonplace that the crisis was not precipitated by unlawfulness (such as the supposed threat to the stability of the financial system presented by money laundering) but by inappropriately sold securities, bundled, and then sold on. When multiplied by bundling, the risk carried, once identified, was sufficiently toxic to jeopardise interbank trust and bring the international banking system to the brink of collapse. That widespread collapse in inter-bank trust would result from contracting for inappropriate risk on mortgages was unforeseen. It was, to use Nassim Taleb's vivid metaphor, a black swan[3]. On one view, systemic failure caused by ethical failure.

Does private law have anything to say about problems of this kind, that is to say, lenders who take advantage of and contingently benefit from the relative ignorance of their counterparty (informational/expertise imbalance) in allocating a risk, the nature and possible *dimensions* of which are not known, and the means for knowing them not available to the buyer? The decision of the Court of Appeal in *Green and Rowley v Royal Bank of Scotland*[4] (October 2013) suggests not, instead locating the problem (where a contract is otherwise silent on the issue) exclusively in the scheme of statutory regulation provided under the Financial Services and Markets Act 2000.

To some, the result in *Green and Rowley* will seem unsatisfactory for reasons including some discussed here. It is suggested that the approach in that case is not the only available approach. The Financial Conduct Authority (FCA) has disagreed with the first instance judge's view (necessarily *obiter*) that RBS provided sufficient information and warning to Green and Rowley of the cost of breaking the swap. The FCA's view, together with the provisions under the Conduct of Business (COB) Rules[5] made pursuant to the Financial Services and Markets Act 2000, provide support for the view that there may be a role for equitable considerations in connection with swaps that remain to be properly considered. The apparent antipathy of the English courts to such a possibility, commented upon, notably[5a], by the Hon Paul Finn (below), should not deter discussion.

Chesterton's sentiment will resonate with those who purchased protection, or hedged, against interest rate variations on loans under OTC interest rate swap contracts[6] (a species of "Interest Rate Hedging Product" or IRHP) where the risk that was protected against failed to materialise in a market of falling interest rates, but the cost of the protection, more particularly, the magnitude of the cost of terminating fixed-term swap contracts, has caused surprise, often outrage. In the nature of such deals one does not acquire the product predicting that the protection premium approximates or exceeds that of the risk becoming reality. The prevalence of the mis-selling of swaps identified by the Financial Services Authority (now FCA) Review has tended to reinforce this. It has commonly not been recognised by borrowers agreeing to swap contracts that, in a market of low interest rates, exit costs might be potentially ruinous. As with other kinds of risk, even a small risk of financial disaster requires careful evaluation. The Court of Appeal judgment in *Green and Rowley* is authority for the proposition that, unless expressly provided for under the terms of a contract, a firm contracting for an IRHP owes no common law duty of care to bring home to the purchaser the potential magnitude of a break cost risk for early termination of a swap. His Honour Judge Waksman QC, in the decision subject of the appeal[7], described the issue of the break costs of the swap as merely an "ancillary" consideration.

The conclusion in *Green and Rowley v RBS* is at odds with the duty of a regulated person to warn of risk under financial regulatory law.

The result is counter-intuitive. A borrower hedging a loan is essentially contracting for protection. That protection is the only reason why the borrower makes the deal. It is a separate product from the loan that is hedged. The contract (being a contract for differences, and thus regulated) is of a fundamentally different kind from the ordinary creditor/debtor banking relationship. What has frequently not been understood is that in a market of falling rates a swap becomes an increasingly valuable asset to the lender/firm and for which the borrower must pay market value should they wish to exit, for example, because the underlying loan is discharged. A known risk has been substituted in many cases for an unknown risk where the lender/firm is typically able to quantify this by financial modelling, but the customer invariably cannot.

The conclusion in *Green and Rowley v RBS* is at odds with the duty of a regulated person to warn of risk under financial regulatory law. That duty and its content/scope was explained by the FCA in written submissions provided to the Court of Appeal, it having been given permission to intervene on the appeal[8]. The FCA disagreed that the break costs of swaps were, on the bank's case and in the words of the judge, "*an ancillary matter*" and that these do not arise from ordinary performance of the contract. The FCA contended that the "reversibility" of an IRHP is an inherent feature of the transaction and, to the extent that there are associated, potentially very substantial, costs involved in the exercise of such exit or break terms, these should be disclosed to the customer in a way that is clear, fair and not misleading, and enable the individual customer to understand the nature of the risks involved. Further, the FCA said that while the generic nature of the risk was financial the true nature of *the risk could not be understood* without having regard to its potential magnitude[9].

Green and Rowley offers no comfort to borrowers who have found break costs on swap contracts unexpectedly large and damaging. Lord Justice Tomlinson (with whose judgment Lady Justice Hallett and Lord Justice Richards concurred, without contributing observations of their own) pointed out that a brochure had been provided that included the statements:

> "If interest rate derivative contracts are closed before their maturity, breakage costs or benefits may be payable. The value of any break cost or benefit is the replacement costs of the contract and depends on factors on closeout that include the time left to maturity and current market conditions such as current and expected future interest rates. … There will be a breakage cost to you if the interest rates prevailing on closeout are lower than the fixed rate of the Swap… ."

In early 2009 the cost to Messrs Green and Rowley of early termination of the Swap was calculated as £138,650. The Lord Justice records that this came as a shock to them as evidently it also did to Mrs Gill of the bank[10]. He formulated the essential point on the appeal:

> "… is that compliance with the COB Rules required the Bank not only to warn that break costs could be substantial but also to explain clearly and fairly the true potential magnitude of those costs so that they as the potential counterparty could understand it. In that duty, so Messrs Green and Rowley allege, the Bank failed. There was, it is said, inadequate disclosure of break costs. As I have already indicated, the judge disagreed. If it becomes relevant, the Appellants on this appeal challenge the judge's finding as to the adequacy of the warning as to break costs.[11]"

HH Judge Waksman QC had held that no recommendation or advice for the swap contract was given at the relevant meeting in May 2005 and found that no advisory duty of care was assumed by the bank nor did such a duty arise as a result of anything that was said by the bank's representatives, Mrs Gill and Mrs Holdsworth. There was no appeal against those findings. Accordingly, the judge did not regard the content of RBS's common law duty in relation to the accuracy of its statements (for the purposes of the principle under *Hedley Byrne v Heller & Partners*[12]) to be in any relevant manner informed by the content of the COB Rules. Tomlinson LJ said[13] of (the narrow) arguments on the appeal:

> "It amounts to saying that the mere existence of the COB Rules gives rise to a co-extensive duty of care at common law. This proposition invites the question 'why?' … *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*[14]. As [counsel] for the Bank succinctly put it, the Bank did not cross the line which separates, on the one hand, the activity of giving information about and selling a product and, on the other hand, the activity of giving advice[15]. Absent that feature, there is neither justification nor need for the imposition of a common law duty independent of but co-extensive with the remedy provided by statute."

The judge went on[16] to say that the argument that a cause of action of the kind contended for would provide protection to those not within the meaning of "private person" under FSMA who cannot avail themselves of a statutory cause of action (in effect (oddly) any person other than an individual[17]) was an invitation to the court to drive a coach and horses through the intention of Parliament (*sic*) to confer a private law cause of action upon a limited[18] class. Paradoxically, the result might be said to be that the Wild West prevails in the market for these products.

To firms, the restrictive approach adopted by the Court of Appeal will be welcome to a degree commensurate with a corresponding disappointment of borrowers faced with unexpectedly large swap break costs. But it may be doubted whether the decision in the longer term will represent more than a footnote in the development of law at the interface between private and regulatory law. Tomlinson LJ may, however, have been justified in characterising the background and somewhat limited basis upon which the appeal was put as having an "unpromising start" to the quest to persuade the Court of Appeal that at common law a duty existed co-extensive with the duties prescribed by the COB Rules. In similar vein, Judge Waksman QC had said *"[t]his is a highly fact-sensitive case because for the most part it turns on what was said or not said at a meeting between the claimants and the bank on 19 May 2005"*. Such comments do not often presage a new outworking or application of legal principle, neither did they. Within the terms in which the case was argued the decisions may be unexceptionable. Within a broader context they give rise to concern.

A DIFFERENT VIEW AT COMMON LAW: *BRANDEIS BROKERS V BLACK AND ORS*[19]

Tomlinson LJ dismissed the appellants' argument as "misconceived"[20] but to those who consider the result of the appeal predictable, this was not necessarily so. Under a different regulatory regime, provided by rules of the Securities and Futures Authority (SFA), a precursor to what became the single regulator regime established by the Financial Services Act 2000, Mr Justice Toulson (now a justice of the Supreme Court) gave one possible answer to Tomlinson LJ's question "why" a duty at common law might be informed by/derived from regulatory rules.

Brandeis was a long-established London Metal Exchange Broker and a claimant in an arbitration. Mr Black and two corporate respondents on appeal to the High Court on a point of law were Brandeis' clients. Brandeis had brought arbitration claims for debts in connection with copper futures. The respondents countered Brandeis' claims by claims for breaches of duty on grounds including mis-pricing and misuse of confidential information. The appeal on findings of law included an appeal against the arbitrators' finding that the contracts between Brandeis and the respondents incorporated certain rules of the SFA.

Brandeis' "Terms of Business Letter" referred to Brandeis' business as an authorised person being subject to the SFA rules and breaches were stated to be referable to SFA arbitration. The SFA Rules at the relevant time included a provision that where a firm had a material interest in a transaction to be entered into with or for a customer or a relationship which gave rise to a conflict of interest, that the firm was not to knowingly either advise or deal unless it had taken reasonable steps to ensure fair treatment of the customer.

It was contended by Brandeis that the fact that the contracts made reference to the SFA rules did not mean that this was intended to make alleged breaches of those rules referable to the relevant exchange for arbitration instead of, in the usual way, to SFA arbitration as expressly provided for.

The argument in *Brandeis* was thus different from the way in which the issue in *Green and Rowley* was argued. However, Toulson J in his judgment made the following observations about the argument as to whether the SFA rules were actually incorporated in the contract, concluding that the *relevant* rules were. But he added:

> **"I would add that, as the point came to be developed in argument, it seemed to me to become increasingly academic. For Mr Brodie accepted, indeed submitted, that Brandeis was under a duty to exercise skill, care and fairness in and about the performance of the services which it contracted to provide. He also accepted that the SFA rules were relevant as part of the 'contractual matrix' and as a guide in determining whether Brandeis had met the standard which *the respondents were reasonably entitled to expect*[21]. I strongly suspect that this approach would have led the arbitrators to the same result on the facts.[22]"**

To say that regulatory rules are relevant to a duty to exercise skill, care and fairness in and about the performance of contracted services, and that these may be referred to as a guide in determining whether the standard that the other party was reasonably entitled to expect was met, is as close to *identification of a duty of care* derived from (or the content of which is informed by) the regulatory rules as makes no difference other than as a matter of semantics. Had *Brandeis* been considered in *Green and Rowley* the argument advanced might not have received such short shrift.

Toulson J's approach might be seen as an illustration of the court giving effect to what Jack Beatson (now a judge of the Court of Appeal) in his paper, *The relationship between regulations governing the financial services industry and fiduciary duties under the general law*[23] described as the "hybrid model": "*the court properly has regard to the custom and practice of the market and, in particular, to regulatory practices and rules, which should be taken to have effect if reasonable*". It is difficult to see why the duty of care – which is rooted in reasonableness – should ignore the requirements of the regulatory regime in which the parties must operate. Moreover, it is difficult to see the presence of any of the usual considerations that normally temper the enlargement of the content or existence of a duty of care. All that is being required is that a seller of a swap contract share some of the knowledge that it holds so that the borrower can make an informed, as opposed to uninformed, decision.

ANOTHER VIEW: FIDUCIARY OBLIGATIONS

The other limb of the appeal in *Brandeis*, germane to the present discussion, was an appeal against arbitrators' findings that Brandeis owed fiduciary obligations to the respondents. In rejecting that appeal, Toulson J referred to the Law Commission Report of 1995[24] *Fiduciary Duties and Regulatory Rules*[25]: "Conflicts of interest and duty which could breach these obligations are most common in financial services conglomerates because of the range of services that they provide, the composition of their customer base, and the different capacities in which they conduct their businesses...".

While the judge accepted that Brandeis was not an agent for an undisclosed principal, in the sense of creating a contractual relationship between the respondents and the other party involved in the back-to-back purchase or sale, and while the nature of the transactions were principal-principal, in all other respects the substance of the relationship between Brandeis and the respondents was held to be more closely akin to that of agent and principal than of buyer and seller at arm's length. The judge held the arbitrators right to regard the relationship between the parties in respect of the relevant transactions as fiduciary in character. In doing so he relied, in particular, upon Lord Browne-Wilkinson's description of these duties in *Henderson v Merrett Syndicates Ltd*:[26]

> "... the extent and nature of the fiduciary duties owed in any particular case fall to be determined by reference to any underlying contractual relationship between the parties ... The existence of a contract does not exclude the co-existence of concurrent fiduciary duties (indeed it may well be their source); but the contract can and does modify the extent and nature of the general duty that would otherwise arise."

The remainder of this article is concerned with an outline of some further considerations which might suggest that the limitations of common law remedies available to customers of banks faced with unexpectedly large break costs for interest rate swaps may not be the only way of skinning this particular cat.

THE BREAK COSTS OF SWAPS

The exit or break costs of a swap will commonly be the net present value (NPV) of the swap to the counterparty "in the money". The bank will be "in the money" and the customer required to make payments to the bank when the bank expects overall to receive future payments until the contract ends – assuming yield-curve expectations are accurate. When a derivative contract is terminated the bank has to write down the value of the asset on its books to *nil*. Without a corresponding payment from the customer the write-down of the asset to *nil* would have a negative impact on the profit and loss account and overall balance sheet. The break cost accordingly is the value (NPV) of the asset the bank loses upon termination of the derivative contract by the customer. As the FCA has emphasised, unless the customer appreciates that the contract has such an inherent value as an asset of the bank, it will not understand the risk of such economic costs crystallising. The potential break costs increase the further interest rates (or the market expectations of future interest rates) fall. Thus, unless the customer understands the way in which the swap contract is valued by the bank it is running a risk the possible dimensions of which are simply unknown.

HH Judge Waksman QC in his judgment was impressed by Mrs Holdsworth of RBS having received training that *"enabled her to appreciate the difference between giving information and advice, which she observed"*. He recorded that: *"She would inform customers about break costs by saying that if a swap was terminated early there could be a costs or a benefit to the customer depending on market conditions at the time. But she would not say much more"*. But the then COB Rules included:

> COB 2.1.3R "When a firm communicates information to a customer, the firm must take reasonable steps to communicate in a way which is clear, fair and not misleading".
>
> COB 5.4.3R *"A firm must not:*
>
> ....
>
> (3) arrange (bring about) or execute a deal in a warrant or derivative; or
>
> (4) engage in stock lending activity;
>
> with, to or for a private customer unless it has taken reasonable steps to ensure that the private customer understands the nature of the risks involved."

COB 5.4.3R apply both to advised and arrangement or execution only transactions, as do COB 2.1.3R and the Principles.

The judge said[27] that had he found COB 2.1.3R and COB 5.4.3R to be relevant to a duty not to misstate, he would have found no breach of rule 2.1.3 finding the explanation of the break cost of the swap not to be misleading nor unclear. Nor was it in his view unfair. In relation to COB Rule 5.4.3 the judge found the explanation given in the brochure satisfied the requirement that reasonable steps be taken to explain the nature of the risks involved in the swap. The judge said that the essential risk was the obvious one which Green and Rowley understood, namely, that if interest rates fell they would do worse overall by having the Swap than by not having it, because they would be paying less without it. He added: *"It was right [for the bank] to say something about the ancillary matter of Break Costs but what was said was sufficient"*. As to the two bank's employees who arranged the swap contract, Mrs Holdsworth and Mrs Gill, it is striking that the judge observed that neither had any direct prior experience of the early termination of a swap with break costs being paid and so neither knew what costs would be involved[28]. But this meant that they were not in a position to carry out what the FCA itself considers that the COB Rules required.

A DIFFERING VIEW: THE FINANCIAL CONDUCT AUTHORITY

The view expressed by the learned judge as to adequacy of the explanation given by the bank employees is not shared by the FCA. In the event, that view was not relevant to the decision because the Appellants failed on the principal issue. The FCA's view, as expressed in its written submissions to the Court of Appeal, is nonetheless of considerable interest and importance. It said:

> "… there is typically a significant asymmetry in the knowledge and bargaining power of the consumer and the seller of the financial product. Consumers are not, in the main, legally or financially trained, and often seek out financial products, particularly credit, in circumstances of real or perceived need. Regulated firms are, by contrast, frequently well-financed organisations which benefit from sophisticated legal advice".

The FCA referred to the Conduct of Business Rules including COB 2.1.3R and COB 5.4.3R (above) and to the Guidance on the Rules. It pointed out that the Principles impose requirements upon firms in relation to their clients or customers. These requirements depend, in part, on the characteristics of the client or customer concerned. This is because the expressions used under the Principles, specifically: "due regard"; "fairly"; "clear, fair and not misleading"; "reasonable care"; and "adequate" depend upon those characteristics. The information needs of a general insurance broker will be different from those of a retail general insurance policyholder.

As to Judge Waksman QC's view as to the adequacy of the warning of risk given to Green and Rowley, the FCA commented that:

> "the Judge found that the explanation given in the Brochure *satisfied the requirement that reasonable steps be taken to explain the nature of the risk involved in the Swap*[29]. The FCA is concerned by this analysis; the Judge appears to have decided what was required by COB 2.1.3R and COB 5.4.3R but how he arrives at this conclusion is somewhat opaque. Moreover, the FCA's position is that the relevant regulatory requirements extend far beyond the substance of the common law duty not to make misrepresentations.[30]"

A ROLE FOR EQUITY: FIDUCIARY OBLIGATIONS OWED BY BANKS IN CONNECTION WITH SWAPS AND ANALOGOUS INSTRUMENTS?

Consideration of how exactly fiduciary obligations may arise in the context of swap contracts as a result of regulatory requirements is beyond the limited scope of this article. Nevertheless, some outline observations may be made.

Matthew Conaglen, in his survey *Fiduciary Loyalty Protecting the Due*

> … any relevant information had to be communicated to [*Green and Rowley*] … in a way that was clear, fair and not misleading.

As already noted, the FCA took the view that the reversibility of a swap was an inherent feature, rather than ancillary to it as the judge had said, and that the scale of the cost of exiting the swap or terminating it was as important as the fact of that risk[31]. The FCA took issue with the bank's position. In particular, the FCA emphasised that COB Rule 5.4.3 should not be considered in isolation. As with any customer, in considering what constituted such reasonable steps, regard had to be had to Green and Rowley's information needs[32], and any relevant information had to be communicated to them in a way that was clear, fair and not misleading. Further, the FCA demurred from the bank's contention that the duty under COB 5.4.3R was usually discharged by provision by the firm of a "risk warning" in prescribed form and by the firm requiring this to be signed by the customer[33].

In fact, the FCA said, a firm is required to assess each individual customer's *needs* for the purposes of determining whether provision of the notice was suitably clear, fair and not misleading as well as sufficient and what, if any, additional information should be provided to that individual customer for the purposes of enabling it to understand the nature of the risks involved.

Performance of Non-Fiduciary Duties[34], has suggested, as Finn had earlier proposed, that in broadest terms, the existence or otherwise of a fiduciary duty will depend upon whether the court considers it legitimate in all the circumstances of the case for one party to expect the other will act to the exclusion of his own interest. Fiduciary doctrine requires that a fiduciary put aside all possible self-benefit from a transaction unless the contrary has been properly authorised. He concludes that:

> "… All things considered, the cases can be seen to support the view, advanced most comprehensively by Paul Finn, that there is no clear rule as to when fiduciary duties arise but rather that they respond to a standard of legitimate expectation. In considering whether that standard has been met in individual cases the courts can, and do, take into account analogies with pre-existing patterns of judicial conduct on that question, while bearing in mind also the need to move cautiously and take account the societal value placed on the kind of relationship at issue".

In saying this he refers to the Canadian Supreme Court decision in *Lac Minerals Ltd v International Corona Resources Ltd*:[35]

> "Certainty, in commercial law is, no doubt, an important value, but it is

not the only value... In any event, it is difficult to see how giving legal recognition to the parties' expectations will throw commercial law into turmoil. Commercial relationships will more rarely involve fiduciary obligations. That is not because they are immune from them, but because in most cases they would not be appropriately imposed[36]".

The distinction between information and advice is an illusion, particularly where the purpose is to achieve understanding of the nature of risk.

In the present context, the regulatory structure requires that a firm selling a swap ensures that the customer *understands* the nature of the risk involved and the information is required to be provided in a way that is clear and fair. One of the reasons for this requirement is that, absent that requirement, there is obvious opportunity to take advantage of an imbalance in information and expertise. Understanding of complex products and associated risks usually requires explanation. The distinction between information and advice is an illusion, particularly where the purpose is to achieve *understanding* of the nature of risk. The requirement to support a finding by the court of a fiduciary relationship requires a "crossing of the line"[37] from merely a requirement for honesty, skill and care and requires a factual matrix which can justify both the entitlement to expect that the adviser is acting, and the consequential obligation is that he must act, in the other's interest in the giving of advice, information and so on. Given the requirements of the Rules (now COBS) it is suggested that it is but a small step to conclude that a firm should be required to demonstrate that a risk is undertaken by the counterparty with its free and informed consent – a familiar equitable requirement. Such *informed* consent would reflect the regulatory obligation, and trigger the entitlement for the firm to benefit from the transaction. Such an obligation, further, would accord with the duties owed under MiFID.

Finn has recently expressed his surprise that, in relation to quite a number of equitable doctrines, English law stands apart from most other countries[38]. English law, he suggests, has its own concerns not shared elsewhere. Four particular areas are identified which include:

"The first is the privileging of contract law as the all but exclusive source of voluntarily assumed rights and obligations – hence, for example, the observation of the Court of Appeal denying relief to a person who was excluded from the commercial exploitation of a confidential business plan to which he was a contributor: 'Mr Murray's lack of any remedy arose from the undisputed fact that his relationship with the other five members of the original team was not regulated by contract'[39]. Associated with privileging contract is a corresponding reluctance to enlarge the scope of equitable intervention in contracts. Relatedly, there is a marked antipathy to making relied upon voluntary promises and representations actionable.

……..

Fourthly, a constant refrain in the cases is the earnest to leave commercial parties to fend for themselves – hence the sentiment: 'In a commercial context a degree of self-seeking and ruthless behaviour is expected and accepted to a degree'.[40] The assumption in this, seemingly, is that commercial parties could and should look after their own interests and should bear the risk of their failure to do so. Little by way of concession is to be made for the possibility that a small or medium business enterprise might be quite vulnerable to exploitation by a large, well-resourced enterprise because of its lack of power, urgent need, etc."

Finn contrasts the English and Australian approaches to equitable thinking in a commercial context: Sir Peter Millett: "*It is of the first importance not to impose fiduciary obligations on parties to a purely commercial relationship*"[41]; Sir Anthony Mason: "*it is altogether too simplistic, if not superficial, to suggest that commercial transactions stand outside the fiduciary regime*". Finn suggests "*[t]hat certainty should triumph over fairness became an almost unchallenged and unchallengeable creed and made the more so, because, unlike Australia, the United States, Canada and New Zealand, statute did little to redress the imbalance between certainty and fairness*". It may be supposed Messrs Green and Rowley would concur. Finn was writing prior to the decision in *Green and Rowley v RBS* but his comments could scarcely be more pertinent, regardless of the specific, and plainly rather narrow, grounds upon which the claim and appeal were brought. We have developed a regulatory system, the third regulatory objective of which is the protection of consumers, but appear at the same time to have developed a *cordon sanitaire* between the regulatory structure, with its strikingly restricted remedies, and private law duties. Even statutory rights have been construed as narrowly as is reasonably possible: *Titan Steel Wheels v Royal Bank of Scotland*[42], a case decided "*in complete ignorance of the obligations imposed on the defendant by the Conduct of Business Sourcebook*"[43]. Hudson has formulated the problem:

"The heart of the matter is this. The common law, in particular as exercised through the agency of the Commercial Court judges, takes the view that the documentation entered into between the parties is decisive of the relationship between them, but fails to acknowledge that in financial transactions there is a context beyond the traditional concerns of the common law with holding the parties to the terms of the agreements which they have signed...".

The swaps cases have to date met with little success in litigation. Typically the purchaser/

Biog box

Paul Marshall is a barrister and member of the Chancery Bar Association, practising in commercial and company law from No 5 Chambers, Salisbury Court, London.
Email: pma@no5.com

claimant is comparatively inexpert and only limited information about the attendant risks of swap contracts has been made available to them. The COB Rules and now COBS are supposed to protect against a Hobbesian state of nature in relation to regulated activities. The statutory obligations imposed upon firms undertaking regulated activities are intended to temper pure self-interest in favour of the customer whose interests are required to be taken into account, their information needs considered and satisfied and their interests thereby protected. The firm's interest is correspondingly restrained and, to that extent, subordinated to the interest of the customer. An obligation to put another's interests ahead of one's own, or put another way, subordination of a person's immediate interest in preference to that of another (by reference, for example, to their level of expertise, understanding of risk and information needs), may readily suggest a fiduciary relationship. MiFID Art 21 now makes express the requirement for firms to take all reasonable steps to obtain, when executing orders, the best possible result for their client. As Hudson has pointed out, that is essentially the same as a fiduciary relationship as described by Asquith LJ in *Reading v R*[44].

In *Green and Rowley* the way in which the fact that the bank's employees were as surprised as the claimants by the scale of the break cost was treated as meriting no comment might be thought seriously unsatisfactory. That those selling the product were unaware of the possible value to the bank in certain circumstances was the reason why that possible value and associated risk went un-communicated to the bank's customers. That, in the FCA's view, constituted a failure to comply with the regulatory requirements.

To draw a "bright line" (or, perhaps, build a wall) between such rule-based obligations and private rights (however characterised), to make a hard-edged distinction between "information" and "advice" that owes more to language than to meaning, and to give no recognition to a customer's expectation (surely legitimate given the COB Rules) that risks in the nature of elephant traps should be properly identified and *explained* by the bank, might be seen, in Finn's phrase, to promote certainty at the expense of fairness. It is a fair bet that *Green and Rowley* will be far from the last word on the nature of the interface between financial regulation and private law, the nature of which remains yet to be properly explored. ■

1 G K Chesterton, *1909 Orthodoxy*, New York Lane Press (reprinted by Greenwood Press, Westport, 1974) (reprinted in *The Everyman Chesterton* 2011).
2 p 231.
3 *The Black Swan* Penguin Books 2008 (revised ed. 2010).
4 [2013] EWCA Civ 1197.
5 Pre-dating the Conduct of Business Sourcebook.
5a But not only, see for example, Atiyah: "*if Equity, as a source of independent legal rules and ideals, largely died with the Judicature Acts, it was eventually replaced by the phenomenon of judicial discretions.*" *The Rise and Fall of Freedom of Contract*: OUP 1988 p 676.
6 For a description see *Hazell v Hammersmith and Fulham LBC* [1990] 2 QB 697, 739.
7 21 December 2012.
8 Given the public importance of the issue in the event that Green and Rowley succeeded on the primary issue on appeal – namely whether a duty of care existed in tort is to be derived from the FCA's Conduct of Business (COB) Rules – but on which issue the appeal failed, so the FCA was not in fact called upon.
9 FCA written submissions dated 17 May 2013 § 37.
10 At the time of inception of the swap, the Area Manager specialising in the arrangement of interest rate management products such as the swap sold to Green and Rowley.
11 § 16.
12 [1964] AC 465.
13 § 23.
14 emphasis supplied.
15 The dichotomy manufactured between "information" and "advice", though doubtful, appears not to have been questioned. As to linguistic imprecision, see generally L Wittgenstein.
16 § 30.
17 *Titan Steel Wheels v Royal Bank of Scotland* [2010] EWHC 211 (Comm).
18 (very) *ibid*.
19 [2001] 2 Lloyd's Rep 359.
20 § 23. The *conception* upon which the appellants' argument in *Green and Rowley* was founded appears to be one and the same.
21 Italics supplied. As to reasonable expectations see further below.
22 p 363, col 2.
23 Reprinted in *Commercial Aspects of Trusts and Fiduciary Obligations*, Ed. McKendrick Clarendon Press, 2003.
24 Cm. 3049.
25 §1.4.
26 [1994] 2 Lloyd's Rep 468, p 505 col 2.
27 Judgment § 85.
28 § 40.
29 § 85 emphasis FSA's.
30 § 27 emphasis supplied.
31 § 37.
32 *Ibid*.
33 *Ibid*.
34 2007 Hart Publishing (reprinted in paperback 2011).
35 [1989] 2 SCR 574.
36 pp 666-667.
37 *Lloyds Bank v Bundy* [1975] QB 326, 342 Sachs LJ. The proposition is Finn's: *Fiduciary Law and the Modern Commercial World reprinted in Commercial Aspects of Trusts and Fiduciary Obligations, ibid.*
38 *Common Law Divergences* Melbourne University Law Review (2013) Vol 37(2) The Hon Paul Finn. I am grateful to Philip Coppel QC of Landmark Chambers for drawing this (advance publication) to my attention.
39 Finn's *fn* (25): *Murray v Yorkshire Fund Managers Ltd* [1998] 1 WLR 951, 960 (Schiemann LJ). For, to Australian eyes, a stunning example, see *Baird Textiles Holdings Ltd v Marks and Spencer Plc* [2002] 1 All ER (Comm) 737.
40 Finn's *fn* (27) *Vercoe v Rutland Fund Management Ltd* [EWHC] 424 (Ch) (5 March 2010) [343] Sales J.
41 *Equity's Place in the Law of Commerce* (1998) 114 *Law Quarterly Review* 214, 217.
42 [2010] EWHC 211 (Comm).
43 Professor Alistair Hudson *The Law of Finance* Sweet & Maxwell (2013) § 25-58.
44 [1949] 2 KB 232, 236 cited by Hudson *ibid* §10-44.