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Unnatural selection in financial mis-selling

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A High Court claim being brought by Wenta, a Queen's award-winning not-for-profit, against NatWest and RBS in relation to interest rate hedging product (IRHP) mis-selling may have important implications for the approach adopted by claimants, defendants and the court in IRHP mis-selling litigation.

Titan Steel & the "private person" test

Under s 138D (previously s150) of the Financial Services and Markets Act 2000 (FSMA 2000), a "private person" is entitled to bring a claim for damages against a bank that has breached the *Conduct of Business Sourcebook* rules (COBS), which are the rules that govern how IRHPs should be sold (prior to 1 November 2007, the relevant rules were the Conduct of Business rules).

In *Titan Steel Wheels v The Royal Bank of Scotland* [2010] EWHC 211 (Comm), [2010] All ER (D) 137 (Feb), the High Court decided that companies carrying on business of any kind were not "private persons" and were therefore not entitled to bring claims under s 138D of FSMA 2000 (which meant that those companies would not be able to rely on any breaches of COBS).

The approach adopted by claimants, defendants and the court in relation to the issue of whether companies have a direct cause of action under s 138D of FSMA 2000 has been heavily influenced by *Titan Steel*—the High Court reaffirmed the *Titan Steel* interpretation of "private persons" in *MTR Bailey Trading Limited v Barclays Bank plc* [2014] EWHC 2882 (QB), [2014] All ER (D) 151 (Aug) and in *Thornbridge Limited v Barclays Bank plc* [2015] EWHC 3430 (QB), [2016] All ER (D) 16 (Jan), and the parties in *Crestsign Limited v National Westminster Bank plc and another* [2014] EWHC 3043 (Ch), [2015] 2 All ER (Comm) 133 treated the *Titan Steel* interpretation of "private persons" as common ground.

Unnatural selection

One might quite reasonably ask at this stage why the case law in interest rate hedging product (IHRP) mis-selling litigation has ended up being based on large, often quite sophisticated, company claimants (who are more likely to fail the "private person" test as it is currently construed) rather than on less-resourced claimants such as individuals and not-for-profits (who are more likely to pass the "private person" test as currently applied by the court).

The simple answer is that large companies have the financial resources to go to trial and so are more likely to end up at trial (and as the subject of legal precedent) than individuals or not-for-profits who lack such resources.

A disparity of resources between claimants (who are usually individuals, not-for-profits or small and medium-sized enterprises) and defendants in IRHP mis-selling litigation is common. In Wenta's case, for example, NatWest and RBS are together budgeting to spend around £430,000 on the litigation, which is a sum that Wenta (who have been providing free advice and support to start-up businesses for over 30 years) and most other claimants cannot hope to match.

Heavily resourced defendant banks usually seek to capitalise on such an advantage by increasing the costs of litigation to deplete the claimants' inferior financial resources and leave the claimants with no alternative but to discontinue their claims.

Many claimants with limited resources are left with no alternative but to discontinue their claims in order to preserve their resources and avoid the risk of being liable for substantial legal costs in the event of defeat at trial, although Wenta managed to avoid having to discontinue its claim by entering into a conditional fee agreement with its solicitors (LEXLAW Solicitors & Barristers).

Consequently, defendant banks have been able to carefully shape IRHP mis-selling litigation via a circular and reinforcing process of "unnatural selection", which operates as follows:

- defendants use their superior financial resources and the pressures of substantial litigation costs to pressure smaller claimants into discontinuing their claims;
- given the substantial litigation costs involved, only larger claimants are able to afford to proceed to trial, where the court reaffirms its commitment to the *Titan Steel* interpretation of the "private person" test and decides against the claimants;
- defendants use the accretion of case law favourable to them (together with their superior financial resources and the pressures of substantial litigation costs) to pressure smaller claimants into discontinuing their claims; and
- only the remaining larger claimants are able to proceed to trial, through which the body of case law favourable to defendants will gradually continue to increase.

As a result of this "unnatural selection", IRHP mis-selling litigation is subject to a catch-22—any claimant who is able to get to trial will fail the "private person" test and any claimant who would pass the "private person" test will fail to get to trial. (It should be noted that the claimants in *Green & Rowley v The Royal Bank of Scotland plc* [2012] EWHC 3661 (QB) , [2013] All ER (D) 36 (Jan) would have qualified as "private persons" if they had not abandoned their cause of action under s 138D of FSMA 2000 beforehand.)

***Bailey* & the development of the "private person" test**

In *MTR Bailey Trading Limited v Barclays Bank plc* [2015] EWCA Civ 667, the Court of Appeal gave the claimant permission to appeal in relation to the issue of whether companies have causes of action in relation to breaches of COBS on the basis that "this issue does merit consideration by this court and it is one upon which the company has a real prospect of success".

Given the importance to defendants of preserving *Titan Steel* as a precedent, it is entirely unsurprising that *Bailey* was settled before it was due to be heard by the Court of Appeal.

However, with Wenta's case due to be heard by the High Court in October 2017, the issue of the "private person" test will be revisited, which will allow the Court to interpret the various COBS rules (for example, what it means in the court's view to communicate in a "fair, clear and not misleading way". The ability of the court to consider COBS will also likely have a significant effect on any further attempt by defendants to rely on contractual estoppel as a means of avoiding any liability.

These developments could play a significant role in undermining "unnatural selection" and allowing case law in this area to be shaped by the court rather than by the defendants.

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