Feature

KEY POINTS

- The Court of Appeal's decision in *CGL v RBS* confirms that the courts will not create a common law right of action to allow small companies to hold banks to the standards which the regulator has imposed on the banks.
- While the decision in the case had been anticipated, the outcome is profoundly unsatisfactory. No small business owner would have realised that they were far better protected if they entered into financial services contracts in their own name than if they entered into them in the name of their company. The distinction which the regulators have drawn between "private persons" and "non-private persons" is illogical because it bears no relationship to size or sophistication. The result is unfair because it deprives small companies of the protection which they require as "retail clients", dependent in practice on banks for both advice and information about the financial products and services which are offered to them.
- Unless the Supreme Court decides to overturn the Court of Appeal's decision, only an extension of the right to sue for breach of the financial services regulations to all small businesses, incorporated or not, will ensure that SMEs are not ripped off and are able to act as the economic motor which any country needs.

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Unexpected, illogical and unfair: the distinction between who can and who cannot sue for breaches of financial services rules

This article considers how the Court of Appeal's decision in *CGL v RBS* [2017] EWCA Civ 1073 affects the ability of small businesses to obtain adequate compensation from banks in respect of mis-sold financial products. The Court of Appeal's decision means that companies will only be properly protected by the financial services regulations if the government and the regulators allow companies to sue for breaches of the regulations.

The Court of Appeal's decision in *CGL v RBS* probably marks the death-knell for attempts by small companies to argue that they ought to be able to sue banks for breaches of the regulatory rules which are supposed to apply to banks when they are dealing with small companies. These rules are now to be found in the handbook produced by the Financial Conduct Authority (FCA), the successor agency to the Financial Services Authority (FSA), pursuant to powers granted to it as regulator under the Financial Services and Markets Act 2000 (FSMA 2000, as amended.

Each of the claimants in the three conjoined appeals had been sold an interest rate hedging product (IRHP) in circumstances which the claimants alleged involved a breach of one or more of the financial services rules.

They had submitted a claim which the bank had considered under the redress scheme which the FCA had established in respect of IRHPs.

They alleged that the bank had not dealt with their claim fairly and had not applied properly the rules which the banks had agreed to apply when the redress scheme was established.

They argued that had they been "private persons" they would have been entitled to sue the bank for breach of regulatory rules which specify how banks have to deal with complaints (Schedule 5 DISP).

They argued that the banks owed companies a common law duty of care which paralleled the regulatory rules. In each case, the judge at first instance had struck out such an allegation as having no real prospect of success.

THE REGULATORY AND LEGISLATIVE PROVISIONS

DISP 1.4.1R of the FCA Handbook requires financial services firms to, among other things, investigate complaints competently, diligently and impartially and to assess them fairly, consistently and promptly.

Section 138D of FSMA 2000 provides:

'(1) A rule made by the PRA may provide that contravention of the rule is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.

(2) A contravention by an authorised person of a rule made by the FCA is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.

(3) If rules made by the FCA so provide, subsection (2) does not apply to a contravention of a specified provision of the rules.

(4) In prescribed cases, a contravention of a rule which by virtue of subsection (1) or (2) would be actionable at the suit of a private person is actionable at the suit of a person who is not a private person, subject to the defences and other incidents applying to actions for breach of statutory duty.

(5) …

(6) "Private person" has such meaning as may be prescribed.'

The meaning of "private person" is prescribed by regulation 3(1) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 as including the following:

'(a) any individual, unless he suffers the loss in question in the course of carrying on—

(i) any regulated activity; or
(ii) …

(b) any person who is not an individual, unless he suffers the loss in question in the course of carrying on business of any kind…'

The effect is that any sole trader or English partnership (not having a separate legal person from its members) can sue for breach of the regulatory rules unless it is itself engaged in financial services activities. The sole trader IFA is therefore not a "private person", but almost all other sorts of unincorporated businesses are. By contrast, following the decision in *Titan Steel Wheels Limited v The Royal Bank of Scotland Plc* [2010] EWHC 211 (Comm), a company or LLP will almost always not be a private person. One possible exception is an incorporated charity which does not carry on any trading activities, but other than that, if it has separate legal personality, it cannot sue for breach of the financial services regulations.

THE COURT OF APPEAL'S REASONING

Beatson LJ gave the sole judgment, which was agreed by Lewison and McFarlane LJJ. The key parts of that judgment for the purposes of this article can be found at §85 onwards. At §86 Beatson LJ referred to the (in)famous Court of Appeal decision in *Green & Rowley v RBS* [2013] EWCA Civ 1197 which rejected the argument that banks providing information owe a common law duty of care to customers quite apart from the claim for breach of statutory duty which private persons enjoy. Tomlinson LJ, in *Green & Rowley* described the common law duty contended for as 'an invitation to the court to drive a coach and horses through the intention of Parliament to confer a private law cause of action on a limited class'.

In *Green & Rowley*, the common law duty for which the claimants were arguing was said to apply to the circumstances of the sale of the IRHPs. In *CGL*, the claimants said that a common law duty applied when the bank was considering whether or not to award redress and how much redress to award, pursuant to the Redress Scheme which the FCA had set up.

Beatson LJ considered that the recognition of a duty of care in relation to the Redress Scheme 'would undermine a regulatory scheme which has carefully identified which classes of customers are to have remedies for what kind of breach'. The Court of Appeal's argument was based on the premise that the private persons could sue when banks had failed to handle complaints fairly under the Redress Scheme but companies could not.

At §87 Beatson LJ held that '…the effect of the regime is that *a non-private customer* cannot sue in relation to a complaint or a complaint handling issue. Nor can *a non-private customer* complain about a redress determination if a bank proactively sets up a redress scheme. If a bank fails to comply with the terms of the Review agreement, it is the responsibility of the FCA to bring enforcement proceedings.' (emphasis added).

ANALYSIS OF THE JUDGMENT

So far as small businesses are concerned, the state of the law following the Court of Appeal's decision is unexpected, illogical and unfair.

Unexpected

No small businessman ever decided not to incorporate his business because he wanted to retain the benefit of being able to sue for breaches of the financial services rules. Equally, no small businessman ever factored in the cost of losing that right as a price worth paying for the benefits of incorporation. Decisions whether to incorporate or not are driven by considerations of tax and business structure which have no correlation whatsoever with the business's ability to understand the financial jungle.

The ordinary small businessman would expect that as the financial services regulator has put in place specific rules to protect SMEs, a business would be able to sue if those rules had been broken. Banks, of course, do not mention their immunity from suit when presenting their services to incorporated SMEs. The first time the small company finds out that it was subject to *caveat emptor* in respect of financial products, which it had no hope of understanding without advice from a specialist lawyer, an accountant and an economist, is when the horse has already bolted through the stable door.

English law has always prided itself on reflecting the reasonable expectations of business people. The approach taken to financial services claims now fails that test. From the point of view of the small company, the inability to sue for breach of the financial services rules which are supposed to protect them comes as an unexpected shock.

Illogical

An ice cream van man who operates through a company cannot sue for breach of the financial services rules. An English partnership which operates a series of petrol stations can. A Scottish partnership which carries out the same business cannot, because Scottish partnerships have separate legal personality. A landlord who has never seen the point in incorporating despite having built up a £30m property portfolio can sue for breach of the financial services rules. A corner shop business in which a husband chose to give his wife shares in the company which operates the business rather than pay her a salary for acting as personal assistant to him as a sole trader cannot.

The line between "private persons" and "non-private persons" is illogical. It does not track size or sophistication. It is also, for what it is now worth, very probably illegal as a matter of EU law in that the UK government

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did not have a sufficient margin of appreciation when implementing the MiFID Directives 2004 and 2006 to split the class of retail clients into some who could sue for breach of the regulatory duties and some who could not.

Unfair

The distinction between private persons and non-private persons is also unfair. The EU Commission's nuanced approach to the definition of SMEs is to treat an enterprise as being any entity, irrespective of its legal form. The Commission's focus is, correctly in our view, on the economic activity of the entity rather than its legal form (which will in any event differ between EU member states).

While the Financial Ombudsman Service takes this approach in respect of micro-enterprises, in terms of ability to sue for breach of the regulatory duties everything depends on the legal form of the business. The decision to exclude small companies from the definition of private person hit Mr and Mrs Bartels (whose appeal was conjoined with CGL) particularly hard as it resulted in them recovering nothing from the bank despite the fact that the sale of a swap had caused the failure of their hotel business and had left them homeless and out of work simply and solely because they chose to run it through a company rather than as a partnership.

The essential foundation of the claimants' arguments in *Green & Rowley*, in *MTR Bailey Ltd v Barclays Bank* [2014] EWHC 2882 (QB) (which settled before the appeal was heard), and in *CGL* was that it was unfair that the outcomes for individuals and companies should be so different despite the fact that it was the same behaviour by the banks and the same rules which had been breached. The Court of Appeal has twice given such an argument short shrift.

The best that can be said for the courts' decisions in this area is that they are respecting the will of the now defunct Department of Trade and Industry that only natural persons and not legal persons should be able to sue for breach of the financial services rules. Even if such a rule was fit for purpose in 1986, when the Financial Services Act 1986 came into force, it is long past its sell-by date.

As the Court of Appeal recognised in *CGL*, companies' ability to obtain any compensation for breaches of the Conduct of Business Sourcebook rules is dependent on the whim of the FCA. This means that whether or not a company is protected from a breach of the rule is almost a matter of luck, whether the FCA has the appetite and the resources to enforce the rule or not. In a context where the regulator has limited resources and is prone to regulatory capture this is clearly inadequate. Litigation can be an effective early warning system, helping the regulator to identify recurring or widespread issues.

The distinction between individuals and companies is not the same as the distinction between consumers and non-consumers, but small companies are just as vulnerable to mis-selling as individuals are in their private lives. It is not just consumers mis-sold payment protection insurance who were sold unnecessary and expensive products without any adequate understanding of their risks and benefits. The UK's SME sector was decimated by banks transferring on to those customers enormous additional costs which had the effect of depriving the affected SMEs of the flexibility to respond to the changed economic circumstances which usually make SMEs the first businesses to start hiring once economic fortunes improve.

A PAPER-THIN JUSTIFICATION

The counter-argument put forward by financial services firms is that if SMEs were able to sue for breaches of statutory duty, then every time a lender sought to recover a loan or an insurer sought to decline a claim, the customer would sue, which would raise the costs of financial services for everyone. Such an argument seems to be straightforwardly false. Consumer financial services have not become prohibitively expensive, despite the jurisdiction of the Financial Ombudsman Service to award compensation even if a financial services firm has complied with all the regulatory rules, as made clear in *R (IFG Financial Services Ltd) v FOS* [2005] EWHC 1153 (Admin) and subsequently approved in *R (Heather Moor & Edgecomb Ltd) v FOS* [2008] EWCA Civ 642. Furthermore, the £10,000 issue fee and the costs of litigation act as powerful deterrents to frivolous claims, and banks can always apply to strike out any which get through.

One might be justified in thinking that at the heart of the financial services firms' insistence that they should not be sued for breach of the financial services rules lies the knowledge that very few of their sales practices come close to complying with those rules. As the FSA found in a Consultation Paper published in January 2011, "Assessing suitability: Establishing the risk a customer is willing and able to take and making a suitable investment decision", financial advisers failed to comply with this fundamental requirement in at least half of cases while, in the case of IRHPs, bank salesmen broke at least one regulatory rule in 90% of sales.

The stability of the UK's financial services industry surely can survive allowing small companies to sue financial services firms which fail to provide the basic information about financial products which customers need to make an informed decision and which small businesses, whatever their legal form, can only get in practice from the firms selling the products.

CONCLUSION

Unless an appeal to the Supreme Court is successful, the Court of Appeal's decision in *CGL v RBS* puts the ball back into the regulators' court. A regulator regulating in the public interest would acknowledge that SMEs are innocents abroad in the jungle of financial services and would give teeth to the sensible rules in the FCA Handbook which treat both natural and legal SMEs as "retail clients" in need of either advice or at least clear and fair information in order to make informed decisions. ■

Further Reading:

- The big picture about the small print: why the courts' approach is unreal [2016] 11 JIBFL 649.
- Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions [2014] 11 JIBFL 679.
- LexisPSL: Banking & Finance: a bank's duty of care in a mis-selling case (*CGL v RBS*).