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3 KEY DEVELOPMENTS

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March 2022: This month sees a discussion on the Quincecare duty, the 'business purpose exemption' under the Consumer Credit Act 1974 and the FCA's swaps in mis-selling.

Philipp v Barclays Bank UK Plc [2022] EWCA Civ 318

The *Quincecare* duty was formulated by Steyn J in the case of *Barclays Bank Plc v Quincecare Ltd* [1992] 4 All E.R. 363 as follows: *"a banker must refrain from executing an order if and for as long as the banker is 'put on enquiry' in the sense that he has reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate funds of the company."*

Historically, this duty has always been applied in cases involving fraudulent agents acting for a company, firm or government in situations of internal fraud. The first time that the *Quincecare* duty was considered in the case of an individual victim of the rapidly growing scam known as authorised push payment ("APP") fraud was in *Philipp v Barclays Bank Plc*. In this case, Dr and Mrs Philipp were persuaded by very sophisticated fraudsters to transfer the sum of £700,00 to a bank account in the United Arab Emirates.

In his judgment, HHJ Russen QC held that the Quincecare duty ought not to be extended to such situations (i.e. applied to individual customers) and instead "should be confined to cases where the suspicion which has been raised (or objectively ought to have been raised) is one of attempted misappropriation of the customer's funds by an agent of the customer". Therefore, as Mrs Philipp was acting on her own account and could not misappropriate her own funds, the Quincecare duty did not apply to her. HHJ Russen QC concluded that the *Quincecare* duty did not apply to personal customers where the fraud takes place externally and struck out Mrs Philipp's claim summarily.

Mrs Philipp appealed the decision and the Consumer Association, Which?, intervened to advocate for consumer interests and the application of the *Quincecare* duty to individual victims of APP fraud.

Barclays' primary argument was that the *Quincecare* duty is limited to cases where there is fraud by an agent acting for the customer because in those cases the fraud means that there is in truth no authorisation by the customer for the transfer. Therefore, the Quincecare duty does not extend to cases like Mrs Philipp's as she authorised the transfer albeit as an unwitting victim of a sophisticated fraud.

Judgment in the appeal was handed down on 14 March 2022 and it was unanimously allowed. The Court of Appeal was persuaded by the arguments put forward by the Appellant and on behalf of the Intervener and rejected the Respondent's submissions.
The Court of Appeal held that it was *'at least possible in principle that a relevant duty of care could arise in the case of a customer instructing their bank to make a payment when that customer is the victim of APP fraud'*. In essence, the *Quincecare* duty could in theory apply to victims of APP fraud and that bankers could be put 'on inquiry' in the same way as they are in relation to companies. The Court of Appeal also concluded that the question of whether the duty arises should be determined at trial rather than summarily.

This judgment represents a landmark decision in this area as it confirms that the Quincecare duty is also capable of being applied to individual customers who have been the victim of an APP or other external fraud. The scope of this duty is yet to be determined and it will be interesting to see how Mrs Philipp's case will be decided when it is remitted to trial. The most important outcome of the case will be the particular the circumstances in which a bank would be put *'on inquiry'* when dealing with victims of APP fraud.

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Campbell v Tyrrell [2022] EWHC 423 (Ch)

The High Court granted the Claimant judgment in part in a claim for a declaration that a loan agreement was unenforceable as a regulated credit agreement.

The Claimant, Ms Campbell, and her then husband, Mr Tyrell (First Defendant) entered into a joint loan agreement for £250,000 with Goldcrest Finance Ltd (Second Defendant), which was secured over their matrimonial home, for the stated purpose of refinancing debts owed to HSBC incurred by the business carried on by Mr Tyrell in partnership with Mr Laitak (a director of Goldcrest). Ms Campbell sought a declaration that the loan agreement was unenforceable as a regulated credit agreement for the purposes of the Consumer Credit Act 1974 ("CCA").

The decision is particularly noteworthy for addressing the following issues. The judge held that the persuasive burden of proving that the business purpose exemption did not apply to the loan agreement or that the loan agreement was a regulated credit agreement rests with the party seeking declaratory relief to that effect. There was nothing in the CCA to displace the general legal rule that where a given allegation, whether affirmative or negative, forms an essential part of a party's case, the proof of such allegation rests on them. In such circumstances, given it was Ms Campbell who was asserting that the busines purpose exemption did not apply and that the loan agreement was regulated credit agreement, the burden was on her to establish this [19]-[20].

As to the wording of the business purpose declaration, it was held that where a creditor seeks to rely on the business purpose declaration for the purpose of section 16B(2) of the CCA (now article 60C(3) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("RAO")), the declaration will be valid and still comply with section 16B(2) despite it omitting the words "or predominantly" in circumstances where it was accepted that the loan, which had been taken out to repay existing business borrowing, was taken out "wholly" for business purposes. In effect, omitted words will not invalidate a business purpose declaration where the words omitted are considered to be redundant [56].

However, irrespective of the business purpose declarations validity, an important consideration was 'whose' business the loan

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was taken out for. Given Goldcrest actually knew that the loan was not being taken out by Mr Tyrell and Ms Campbell wholly or predominately for the purpose of their own business but instead to repay existing business debts arising from the partnership involving Mr Tyrell and Mr Laitak, the presumption arising under section 16B(2) had been rebutted [26]-[27], [38], [72].

On the basis of these findings, the loan agreement was therefore a regulated credit agreement for the purposes of the CCA. Since no default notice had been served, and no enforcement order had been obtained from the court, the loan agreement and the legal charge were unenforceable by the appointment of the LPA receivers and the sale of the property [75], [105].

The High Court also held that there was no unfair relationship between Ms Campbell and Goldcrest for the purposes of section 140A and 140B of the CCA [90], [103].

Importance/Practical Implications

It is helpful (even if not revolutionary) that the court was able to affirm the general principle that 'they who asserts must prove' in the context of the CCA and the business purpose exemption.

Further, whether an arrangement constitutes a regulated credit agreement can be fertile battleground for a party seeking a declaration that an agreement is unenforceable. This is therefore a useful High Court decision which illustrates how the court can bring to life the 'fact sensitive' business purpose exemption, particularly when arguments are raised that the presumption the exemption gives rise is rebutted.

Equally, the courts consideration of the prescribed text of the declaration is useful for those who may not have thought it necessary to include the full wording of the declaration (because parts of the declaration did not apply to a particular parties' circumstances) or simply mistakenly failed to include them all. Given CONC App 1.4.8R simply says that *'A declaration for the purposes of 60C…must have the following form and content"* but is then silent on the effect of omitting certain words, it is helpful to now have an authority directly on point confirming that the omission of redundant words would not invalidate the declaration.

Whether the word(s) omitted are redundant is of course open to argument.

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There May Still Be Life in The FCA's Swaps in Mis-selling Review

Between 2001 and 2011, the UK's biggest banks mis-sold thousands of interest rate hedging products ("IRHPs") to more than 30,000 SME customers. The mis-sold products lost customers more than an estimated £3bn.

In 2012, in response to the widespread mis-selling, the Financial Services Authority (now Financial Conduct Authority, "FCA") decided not to take regulatory action against the

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banks. Instead, it entered into an agreement with 9 UK banks which provided that the banks would review their own sales of IRHPs and decide whether their customers were due compensation.

The Review was implemented between 2013-2016. Its terms meant that the 9 banks only had to consider two thirds of their mis-sold IRHPs (20,207 of the 30,784 SME customers that purchased IRHPs). On completion of the Review, the banks, with the benefit of oversight of an Independent Reviewer, had found that 90.6% of sales were mis-sold. Compensation of more than £2bn was paid.

The exclusion of 10,577 businesses from the Review has meant that those customers lost the opportunity of recovering more than £1bn in compensation without having to embark upon costly (and high risk) legal proceedings.

The basis upon which those businesses were excluded was that, under the agreement between the FCA and the banks, they were deemed to be "sophisticated". Sophistication in financial services ordinarily has to do with one's level of understanding of a product and experience in a marketplace. The combination of knowledge and experience means the regulator and banks consider those persons who are sophisticated require less protection when dealing with financial services institutions than other consumers.

However, the criterion used to define a customer as sophisticated within the Review was arbitrary; it had very little to do with whether the customer had relevant knowledge and or experience of IRHPs. There were 3 tests. One was based upon metrics derived from the Companies Act 2006 as to a company's size (this test excluded 4,977 customers). A second was whether the value of IRHPs the customers had purchased (and its connected entities), was more than £10m (5,309 customers excluded). This test ignored the fact many customers' first purchase of an IRHP was for £10m or more. The third criterion was whether the banks themselves considered the customer was sophisticated (291 customers excluded).

In 2019, the FCA commissioned John Swift QC to Report on the "quality and effectiveness" of the FCA's supervisory intervention into IRHP mis-selling. That Report was published in December 2021. The most interesting finding in the Report was that the FCA had been wrong in law to deal with a single regulatory cohort of customers in different ways. That is, either the FCA should have provided for all retail customers (the regulator's designation of the most vulnerable financial services consumer) to be included in the Review, or not. It was unfair to further sub-divide retail customers into supposed sophisticated and unsophisticated customers on grounds that were unrelated to their true IRHP sophistication.

Following the Report, the FCA published its Response by which it communicated that, despite some adverse criticisms in the Report, it would not require banks to reopen the Review to the excluded customers.

The All-Party Parliamentary Group on Fair Business Banking ("APPG") is currently crowdfunding to pursue a judicial review of the FCA's decision not to reopen the Review. At the time of this update, it has reached its

£100,000 target.[1] The pre-action correspondence for the judicial review may be found on the APPG's solicitors' website.[2]

3 Points of Interest

Having considered the pre-action correspondence there are 3 matters of particular interest. First, there is the revelation that in 2012, FCA employees felt pressured by HM Treasury's requests that the FCA broaden the sophistication test. The FCA moved a long way from its original proposed test, which increased the number of businesses excluded from the Review and so minimised the compensation banks would pay. At the time, HM Treasury had a direct financial interest in RBS Bank plc and Lloyds TSB Bank plc due to bailouts provided in response to the global financial crisis in 2009.

Second, is the battle of classification of the challenge in the judicial review proceedings. The FCA will say that the APPG's challenge is aimed at the FCA's decision *in 2012* to agree to the sophistication test in the Review, not with the FCA's decision *in 2021* not to reopen the Review. If the FCA is correct then the APPG's challenge is likely to be out of time.

Finally, there is a legal question as to whether the FCA was justified in differentiating between retail clients without adequate objective justification and proper consultation with stakeholders - i.e. the adoption of the sophistication criterion.[3] John Swift QC and the APPG consider such action was outside the FCA's powers. The answer to that question could well shape the future of regulatory responses to widespread mis-selling.

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[1] https://www.crowdjustice.com/case/irhp-compensation/.
[2] https://www.hausfeld.com/en-gb/news/judicial-review-to-force-fca-to-make-banks-pay-for-financial-mis-selling/..

[3] Page 319, paragraph 10, Report of the Independent Review John Swift QC available here: https://www.monckton.com/john-swift-qcs-review-into-the-fcas-supervisory-intervention-on-interest-rate-hedging-products-published/.