When is a risk too risky? Analysis of *Kays Hotels Ltd v Barclays Bank plc*

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BANKING : FINANCIAL SERVICES : DATE OF KNOWLEDGE : LIMITATION PERIODS : INVESTMENT MIS-SELLING : INTEREST RATE SWAPS : RISK

Summary: *Analysis of recent High Court decision in Kays Hotels Ltd (t/a Claydon Country House Hotel) v Barclays Bank plc*

To while away the quiet summer months in Chambers I have been reading a book about the great Stock Market crash of October 1929. One of the contributing factors to the losses suffered by individual investors was the mis-information from various authority figures to wait out what was surely a temporary blip and that the market would soon rally. Partly as a result of that advice and partly as a consequence of the exclusively upward trend of the preceding years, investors were generally unwilling to conclude that enough was enough and cut their losses. The consequent losses were inevitable and, for many, devastating. In fact, it took the Dow Jones over 25 years, until November 1954, to recover to its pre-Crash peak closing value.

However, the risk of loss is inherent in almost all investment products. Indeed, as all FCA-compliant advertising should inform us: 'your investment may go down as well as up'. The harder question is when does 'down' become 'too far down', and when should one say 'enough is enough'? In the context of limitation in an investment mis-selling claim, that was the question under consideration for Mr Justice Hamblen in *Kay Hotels Ltd (t/a Clarendon Country House Hotel) v Barclays Bank plc*[1].

The facts of *Kay Hotels* will be familiar to all those who have dealt with investment mis-selling cases. The claimant company ran a hotel in Suffolk and, in March 2005, had taken a £1.34m loan from the defendant bank, repayable over 20 years. Following subsequent meetings between the parties in August 2005, on the defendant's advice the claimant entered into an interest rate hedging product with a collar. The terms of the collar were as follows:

1. There was a 10 year term with a notional amount of £1m amortising;

[1] [2014] EWHC 1927.

2. If the Bank of England base rate increased above 5.5% the defendant would pay the claimant the difference between Bank rate and 5.5%;
3. If the Bank of England base rate fell below 4% the claimant would pay the defendant interest at 4% plus the difference between the 4% and the weighted average base rate for each relevant calculation period, subject to a maximum rate of 5% if the base rate fell below 3%;
4. If the Bank of England base rate remained between 4% and 5.5% neither party would make payments to the other.

From December 2005 to November 2008, save for a brief period in 2007 when the defendant was obliged to make payments to the claimant totalling around £1,000, the Bank of England's base rate remained in the 4% to 5.5% range such that neither party incurred liability to the other. However, from November 2008 to March 2009 the Bank of England base rate fell rapidly to its current low[2] of 0.5%. Accordingly, pursuant to the terms of the collar, from 1 December 2008 to 2 November 2009 the claimant would have been obliged to make payments to the defendant totalling some £36,000.

Mis-selling proceedings were issued by the claimant on 8 November 2012. The Particulars of Claim alleged breach of contract, breach of statutory duty, and negligent misrepresentation at common law and included a raft of well-trod factual allegations. For example that: the claimant's director was informed that the collar was a condition of obtaining the earlier loan; the defendant's representative stated interest rates were likely to continue to rise over the 10 year term; and the claimant should enter into the collar. Further, the Particulars of Claim alleged that the collar was not suitable for the claimant since it did not meet its needs or wishes, i.e. to protect itself against rises in the Bank of England base rate without exposure to *'excessive'* risk.

The Defence averred that the entire claim was statute-barred pursuant to sections 2 and/or 4 of the Limitation Act 1980 ("the 1980 Act"). The claimant conceded the point on the first two heads of claim but, in respect of the breach of common law duty of care, sought to rely upon section 14A of the 1980 Act. That provides for a three year extension of the usual six year limitation period from the time when the claimant

> '…had both the knowledge required for bringing such an action for damages in respect of the relevant damage and a right to bring such an action.'[3]

[2] As at August 2014.

[3] Section 14A(5).

Thus, in the context of the defendant's summary judgment application, the question arose as to when the claimant had the necessary knowledge to bring a claim.

The defendant submitted that because the essence of the claim was that the claimant had been told that interest rates would rise throughout the lifetime of the collar (such that payments would always be in the claimant's favour), the knowledge must have been obtained in or shortly after December 2008. Thus the negligence claim was statute-barred. Against that, the claimant argued that its primary complaints were as to the risks and suitability of the collar over the lifetime of the product, thereby rendering it unsuitable.

Hamblen J. agreed with the claimant, concluding as follows:

> '[The Particulars of Claim] is clearly putting the case of suitability in fairly broad terms and it is not focussing on the fact that there might be some interest rate loss. It is acknowledging that there might be. The point being made is that the claimant was not meant to be exposed to "excessive" risk; that connotes some loss, but not excessive loss. So the mere fact that the claimant may have suffered some loss would not lead him to know that there was a lack of suitability as there described.'[4]

The learned Judge therefore rejected the defendant's application for summary judgment on the grounds that: (a) there was a real prospect of the claimant successfully establishing that it was entitled to rely upon section 14A of the 1980 Act; and (b) the required knowledge was a question of fact most appropriate for investigation at trial[5]. However, no attempt was made to consider what features of a product might render it excessively risky or how, with any certainty, the issue might be resolved.

It is submitted that, while in some ways a conventional conclusion at summary judgment stage, the decision is nevertheless likely to give rise to difficulty for defendants in similar types of claims.

From the earliest PPI claims in 2007/08, limitation has been a key battleground in mis-selling litigation. That is partly a result of the manner in which many mis-selling claims originate – through claims management activity or as a result of media coverage many years after the event – and partly as a result of the term of some the products in question. Consequently, it is not uncommon for financial services providers and intermediaries to be faced with allegations as to conversations or representations alleged to have been made up to 10 years earlier, with all the requisite evidential difficulties that entails.

[4] Paragraph 20.

[5] Paragraph 27.

Thus limitation is frequently used to attempt to dispose of claims at an early stage. Certainly (as was conceded by the claimant in *Kay Hotels*) there can be no argument as to the application of the ordinary six year limitation period to ordinary contractual or tortious claims (sections 2 and 4 of the 1980 Act).

However, the position in claims of negligence is more complex. Section 14A of the 1980 Act applies to extend the usual six year time limit by three years from the claimant's date of knowledge of facts necessary to bring the claim. "Knowledge" for these purposes has generally been held to be

> '…knowing with sufficient confidence to justify embarking on the preliminaries to the issue of a writ.'[6]

In some cases, a claimant will simply concede the point. Less commonly, the defendant may be able to produce some knock-out blow establishing that the claimant must have had the relevant knowledge before the time alleged. For example, through a complaint made to the defendant directly or to the Financial Ombudsman Service prior to the alleged date of knowledge, or by a contemporaneous declaration signed by the claimant expressly acknowledging the disputed feature of the product. However, in the vast majority of cases, whether the requisite knowledge existed is likely to be considered a triable question of fact. In that regard at least, the conclusion in *Kays Hotels* is unremarkable.

The difficulty with the decision arises from the court's focus on the claimant's pleading that it wished to take out a product which did not expose it to *'excessive'* risk. In particular, that knowledge for the purpose of section 14A would be attained by the claimant as and when it deemed the payments made by it under the collar to have (or be likely to) become *'excessive'*. The consequence of such an approach is that section 14A could be used by a claimant to avoid the ordinary limitation period at will by pleading that it wanted to avoid excessive risk and then defining what it considered excessive to suit the circumstances.

For example, on the facts of *Kay Hotels*, if liability to make payments of £50,000 under the collar only occurred within the three year period preceding the date of issue, the claimant could say that it considered that figure to constitute an *'excessive'* risk such that only at that point did it gain the requisite knowledge to investigate a claim under section 14A. On Hamblen J.'s approach, that would be an arguable basis on which to extend the limitation period.

However, as a result of the subjectivity of such an approach, it creates a position which is very difficult for a defendant to rebut, either at strike out stage or, potentially, at trial. Indeed, it is submitted that the approach is contrary to the objective approach to knowledge set down by

[6] *Haward v Fawcetts* [2006] 1 WLR 682, 716.

sub-section 14A(10) (which was in fact noted by Hamblen J.[7]). Further, it flies close to Sir Thomas Bingham MR's warning in relation to section 14A that:

> '…this section should be approached in a broad common-sense way… There is a danger of being too clever and it would usually be possible to find some fact of which a plaintiff did not become sure until later. It would be a pity if a desire to be indulgent to plaintiffs led the court to be unfair to defendants.'[8]

Instead of focussing upon when it became apparent that the risk was "excessive" by virtue of losses incurred, it is suggested that the focus should have been upon the point at which the claimant could reasonably have discovered the true features of the product. On any view, risk is entirely separate to loss: a product can be hugely risky (and therefore unsuitable for a risk-averse investor), yet if the risks do not materialise, may result in no loss. Where there are two commercial parties bargaining at arms'-length, it cannot be reasonable to gain knowledge that an investment product is unsuitably risky as (or even after) it has crashed. There must be an expectation of some due diligence on the part of the investor either through reading contractual/explanatory documentation, undertaking independent market research or, possibly, seeking independent legal advice.

It is submitted that such an approach would bring forward the relevant date of knowledge to a more easily and objectively ascertainably moment – i.e. under section 14A(10), when could or should the claimant have read all the details of the product so as to have gained an understanding of its risk profile? Commercial investment mis-selling cases are different from previous PPI litigation (where a county court district judge might well consider it unreasonable for a consumer to pore through contractual small print) and should be treated accordingly.

Certainly, it cannot be right to allow a claimant to, in effect, define its own boundaries on limitation. Such an approach undermines the certainty provided by the 1980 Act and further removes section 14A from its legislative origins in latent-damage claims[9] (where key information necessary to bring a claim is often truly unknowable until after the expiration of the limitation period).

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[7] Paragraphs 27 – 28.

[8] *Spencer-Ward v Humberts* [1995] 1 EGLR 123, 126M.

[9] Section 14A was inserted into the 1980 Act by section 1 of the Latent Damage Act 1986, following the much-criticised decision of the House of Lords in *Pirelli General Cable Works v Oscar Faber & Partners* [1983] 2 A.C. 1.