HIGH COURT DISMISSES MIS-SELLING CLAIM AND CLARIFIES STANDARD OF CARE REQUIRED OF FINANCIAL ADVISORS

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Legal Briefings

In *O'Hare v Coutts*, the High Court dismissed a claim alleging that the defendant bank breached duties in contract and tort to use reasonable care and skill when recommending five investments that the claimants entered between 2007 and 2010.

The Court held that the bank's duties when giving advice required proper communication and dialogue with the client regarding the proposed investment, in order to ensure the client understood the advice it was given and the risks arising from the recommended course of action. However, the Court found that the relevant approach in this context was not to assess the bank's actions by reference to what a body of financial advisors would consider acceptable (the "Bolam test"). Rather, the Court would ask whether the bank had taken reasonable care to ensure the claimants were aware of any material risks. This approach, the Court said, takes into account the lack of any clear industry consensus about the extent of communication required and the fact the bank's regulatory duties—which are "*strong evidence of what the common law requires*"—do not require reference to industry practice.

Another key issue was the extent to which it was appropriate for the bank to persuade the claimants to take more risks than they otherwise would. The Court could not find anything intrinsically wrong with persuasive salesmanship, provided the products sold were objectively suitable (in which regard the Court said the *Bolam* test is still applicable). Although, with the benefit of hindsight, the investments had not performed as well as the clients had wished, the Court nevertheless found that reasonable practitioners professing the expertise of the bank could properly have given the same advice the bank did. The Court therefore concluded that the investments were suitable and the claimants should take responsibility for their own investment decisions.

The case is also interesting for the following reasons:

- The bank did not call a pivotal witness, the claimant's former relationship manager, but relied on his contemporaneous notes. The Court admitted the notes as hearsay evidence and declined to draw any adverse inferences in respect of the weight to be given to them because there was no procedural failure on the bank's part. Nevertheless, the Court was not always prepared to favour the relationship manager's written notes over the claimants' oral evidence.

- The Court said that if the claims in contract and tort had succeeded, the claimants' damages would be limited by the more restrictive test of remoteness under contract law.

- The Court found that the bank's promise to apply discounts in favour of the claimants as a "gesture of goodwill" in settlement of a separate dispute constituted a binding legal settlement.

We discuss the decision in more detail below.

BACKGROUND

Mr and Mrs O'Hare (**the Claimants**), whose joint net worth was in excess of £25 million, began their relationship with the bank in 2001. Their relationship manager from 2001 to 2008 was a Mr Kevin Shone, after which a Mr Ray Eugeni took over.

Although Mr O'Hare was an astute businessman, the Court did not accept that he was necessarily an experienced investor. The Court found that he was willing to accept some—but not too much—risk, provided he was properly informed about how much risk he was taking.

In 2007 and 2008, the Claimants invested over £8 million on the bank's advice in three products from the bank's new line of "Novus" funds (**the Novus Investments**). The bank classified these as "wealth generation products" (its most risky investment category). The result was a significant shift in the Claimants' portfolio towards higher risk investment, concentrated in three untested hedge fund products. The Claimants alleged that the Novus Investments were unsuitable because the bank downplayed the substantial increase in risk, there was no capital protection, and the investments caused the Claimants to expose an unjustifiably high proportion of their wealth to loss.

In 2010, the Claimants invested a further £10 million in two additional products that the bank recommended: RBS International funds called Autopilot and Navigator (**the RBSI Investments**). Unlike the Novus Investments, the RBSI Investments were classified by the bank as "wealth preservation products" (the bank's least risky investment category). However, the Claimants alleged the RBSI Investments were unsuitable because the bank should have advised against concentrating so much money in one institution and it should have recommended products other than those of it and its parent.

The market declined in value, following the 2008 financial crisis and the Claimants issued proceedings against the bank, alleging breach of contract and negligence on the part of the bank.

1. SUITABILITY OF THE PRODUCTS: WHAT STANDARD OF CARE IS EXPECTED OF FINANCIAL ADVISORS?

The bank undertook to advise the Claimants in their personal capacity, including working with them to understand their "circumstances, objectives and requirements" and to formulate "an investment strategy". The bank was obliged to give its advice in writing, at such times as it considered appropriate (or otherwise as agreed). Because the bank had undertaken advisory duties, the Court considered whether the products had been suitable for the Claimants (as opposed to just whether the bank has correctly described them).

Uncontroversially, the Court found that the bank owed identical duties in tort and contract to use reasonable skill and care when recommending investments, to the standard of a reasonably competent private banker.

Were the Claimants adequately informed?

The Court held that in the context of giving investment advice, there must be proper dialogue and communication between adviser and client. The bank submitted that this ought to be assessed in line with the traditional test from *Bolam v Friern Barnett Hospital Management Committee* [1957] 1 WLR 583: namely, by reference to whether a body of financial advisors would consider the extent of its communications acceptable. The Court noted that the *Bolam* test had recently been overturned in a medical context (so far as the duty to explain is concerned), in favour of a duty to take reasonable steps to ensure the relevant patient is aware of any material risks (see *Montgomery v Lanarkshire Health Board* [2015] UKSC 11). In *Montgomery*, the Supreme Court said that a risk is material if, in the circumstances, (1) a reasonable person in the patient's position would be likely to attach significance to it; or (2) the doctor is aware that the patient would be likely to attach significance to it.

In the context of duties to explain investment risks, the Court also preferred the *Montgomery* approach to *Bolam*, in particular because the expert evidence did not establish any industry consensus delimiting the proper role of a financial adviser in this regard. The Court supported its decision by reference to the regulatory regime, which is "*strong evidence of what the common law requires*". In particular, the Conduct of Business Sourcebook (**COBS**), which apply where a sale is advised, includes a duty to explain in similar terms to *Montgomery* and, unlike *Bolam*, does not require reference to the opinion of a responsible body within the profession.

The Court went on to say that "*compliance [with the COBS] is ordinarily enough to comply with a common law duty to inform, forming part of the duty to exercise reasonable skill and care; while breach of them will ordinarily also amount to a breach of that common law duty*." Accordingly, the Court observed that the content of the various COBS provisions relied on by the Claimants added nothing to the bank's common law and contractual duty to ascertain the client's requirements and to advise, including explaining and informing them, about suitable investments. In any event, the Court did not find that the bank had breached any COBS duties.

Applying the *Montgomery* approach first to the Novus Investments, the Court concluded that the bank's sales presentations had "*left no room for any suggestion that Mr O'Hare did not fully understand the Novus products*", *including* "*an understanding of their higher risk classification as wealth generation products*".

Similarly, in relation to the (later) RBSI Investments, the Court concluded that Mr O'Hare was "*fully aware that the capital would be at risk if RBSI should become insolvent but was happy to run that risk because, he reasoned, RBS was effectively state owned*." Likewise, the Court rejected the allegation that "*insufficient information about the products (including costs and charges), and insufficient comparative information about alternatives, was provided*".

<u>Were the investments objectively suitable?</u>

Given the Court's decision that the Claimants were properly informed, the case turned on whether the investments were objectively suitable for the Claimants (the case being one where it was not disputed that advice had been provided by the bank). In this context, the Court accepted that the *Bolam* test continued to apply, the relevant question being whether "*reasonable practitioners professing the expertise of the defendants could properly have given advice in the terms they did*".

The key issue was the extent to which it was acceptable for the bank to persuade clients to take more risk than they otherwise would (and conversely, when the bank would be required to step in and "save the clients from themselves"). Perhaps in a welcome recognition of commercial reality, the Court did not find anything intrinsically wrong with a financial advisor using persuasive techniques to induce a client to take risks (s)he would not take but for the adviser's powers of persuasion, provided the risks were not so high as to be foolhardy (avoiding the temptation to use hindsight), the client could afford to take the risks, and the client showed itself willing to take the risks. Critically, the Court said that the duty of care must reflect a balance between the client taking responsibility for investment decisions (even mistaken ones) and the principle that the advisor must sometimes save the client from him/herself.

In considering the (earlier, higher risk) Novus Investments, the Court explicitly applied the *Bolam* test, ultimately agreeing with the bank's expert witness that "*competent practitioners at the time – avoiding hindsight - would not regard investment in the Novus products as foolhardy for persons in the position of the O'Hares, with their wealth and investment objectives*".

In contrast, the Court did not explicitly invoke the *Bolam* test in its analysis of the RBSI Investments. This may be because the capital-protected RBSI Investments involved de-risking and consequently, there was less scope for the Claimants to suggest that the products were objectively unsuitable. In any case, Mr Eugeni, in his unchallenged evidence for the O'Hares, said that after the 2010 RBSI Investments, he considered the portfolio suitable and well balanced. As such, the Court's focus was on whether the O'Hares were properly informed about material risks relating to the RBSI Investments (in light of the fact such a large amount of money was being placed with a single banking institution).

On the evidence before it, the Court held that all of the investments in question were objectively suitable for the Claimants, who should therefore reasonably bear responsibility for their own mistaken investment decisions (even in light of the bank's salesmanship).

2. THE ABSENT WITNESS: WILL COURTS DRAW ADVERSE INFERENCES IF KEY WITNESSES ARE NOT CALLED?

A key factual issue relevant to suitability was the extent to which the Claimants were persuaded by their first relationship manager, Mr Shone to make higher risk investments than would be consistent with their unconditioned risk appetite.

Although he was a material witness, the bank did not call Mr Shone and instead chose to rely on his contemporaneous notes (which were referred to and implicitly adopted as true in the statements of two other Bank witnesses, both called orally). The bank explained that Mr Shone was a former employee and had indicated he was too busy to devote time to the proceedings.

The Court first accepted that the hearsay notes were admissible, by virtue of section 1 of the *Civil Evidence Act 1995*, which abolished the rule against the admissibility of hearsay in civil proceedings. Moreover, because they formed part of the agreed bundle and the Claimants did not give a written notice of objection in respect of them, paragraph 27.2 of Practice Direction 32 confirmed the notes would be admissible as evidence of their contents.

Section 2(4)(b) of the *Civil Evidence Act 1995* provides that a failure to comply with the relevant procedural rules may be taken into account as a matter adversely affecting the weight to be given to hearsay evidence. Here, the Court declined to draw an adverse inference in respect of Mr Shone's notes because it found that the Court had complied with its obligations under CPR 32 and 33 (given that the witnesses who referred to those notes gave oral evidence). It was open to the Claimants under CPR 33.4 to call Mr Shone for cross-examination, but they did not.

In terms of the weight given to those notes, the bank relied on *Gestmin v. Credit Suisse* [2013] EWHC 3560 (Comm), in which the High Court had held that the best approach for a judge to adopt in a commercial case is "*to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts.*" Whilst the Court agreed that the approach in *Gestmin* is "very useful", it did not accept that the effect of *Gestmin* was to cause Mr Shone's notes to be admitted unchallenged (their accuracy having been disputed by the Claimants). Nor did it go so far as to mean Mr Shone's notes should always be preferred to the oral testimony of the Claimants. Indeed, the Court ultimately preferred Mr O'Hare's testimony that Mr Shone used persuasion on him over Mr Shone's notes, which repeatedly described the Claimants as "keen", without mentioning the exertion of persuasion or influence by the bank.

Although the tactical question of which witnesses to call will always be highly fact specific, this case illustrates the importance of complying with the procedural rules for adducing hearsay evidence in the absence of a witness (and considering whether to apply to cross examine an absent witness on whose hearsay evidence the other party relies).

3. THE SETTLEMENT AGREEMENT: WHEN WILL "GESTURES OF GOODWILL" BE LEGALLY BINDING?

In 2008 and 2009, the Claimants complained that the bank had not properly explained the risk profile of another product called "Orbita Capital Return", which had performed poorly. The bank had at that time rejected the Claimants' complaint explaining why it considered that the product had not been mis-sold. Nevertheless, recognising the value of the Claimants' business the bank agreed as a gesture of goodwill to apply a refund of $250,000 by way of a reduction in fees over a period of time in consideration for the Claimants forbearing to sue. Although Mr O'Hare gave evidence that the agreed currency was pounds sterling, the Court found that Mr O'Hare was genuinely mistaken and that the agreed currency was dollars, reflecting Mr Eugeni's written notes.

In the proceedings concerning the other products, the Claimants sought to argue that this obligation remained outstanding. In doing so, they sought to exclude discounts that had been negotiated with the bank arguing that these discounts were separate and distinct from the $250,000 that the bank had agreed to pay.

The bank's primary argument was that the "settlement agreement" was not binding; rather, it was merely a "gesture of goodwill" made without intention to create legal relations. The bank referred to *Clarke v Nationwide Building Society* [1998] EWCA Civ 469 in which a refund sent in "full and final settlement", but described as a "goodwill gesture", was held not to be binding.

The Court expressly declined to hold that *Clarke* provided authority for a general proposition that offers made as a gesture of goodwill are not capable, on acceptance, of binding the offeror. The Court noted that this was a question that depended on the circumstances of the case. Unlike *Clarke*, the bank's offer was made in the context of a pre-existing contractual relationship. This placed a heavy onus on the bank to show that the parties did not intend to be legally bound, which it failed to discharge. Nevertheless, the Court held that the bank had complied with its side of the bargain by applying $250,000 worth of discounts, despite Mr O'Hare's genuine belief that some of those discounts ought to have been excluded from the sum.

The Court's approach to this issue highlights the risks in entering into settlements which are not formally documented, given the potential for later disagreement over their terms and the extent to which they have been satisfied. The difficulties here were exacerbated by the absence of evidence from key witnesses (both Mr Shone, who was not called, and Mr Eugeni, who had not given evidence about this point).

4. THE DAMAGES ISSUE: CONCURRENT CLAIMS IN TORT AND CONTRACT

Interestingly, the Court said that had the Claimants been successful, it would have confined damages to the more restrictive contractual test of remoteness (rather than the more generous tortious measure). The Court said that it would have taken this approach even in respect of the Novus Investments, where the Claimants' contractual claim was time barred but its tortious claim was not. To do otherwise would be to allow the Claimants to benefit from their failure to bring the contractual claim less than six years before the cause of action arose and fly in the face of the fact that there was a contractual relationship between the parties.

This follows the approach in *Wellesley Partners LLP v Withers LLP* [2015] EWCA Civ 1146, where the Court of Appeal said that in cases of concurrent liability in tort and contract, the parties are not strangers and should be confined to the contractual measure of damages (since the contract reflects the consensus between the parties which ought to be reflected when dealing with issues of remoteness).

In this case, the Court doubted whether the distinction would make any real difference. However, in other circumstances, it might be relevant whether the financial advisor is liable for all foreseeable consequences of the breach (for instance, unexpected or catastrophic falls in the market) as opposed to merely loss that is within the reasonable contemplation of the parties at the time the contract is made.

CONCLUSION

O'Hare v Coutts provides helpful guidance about the extent of financial advisors' duties to their clients. In particular, the decision erodes the *Bolam* test in the context of the duty to explain investment risks (as had already happened in cases of medical negligence): in cases where objectively suitable advice has been given, the extent of communications required is simply to take reasonable steps to ensure the client is aware of material risks. On the other hand, the decision affirms that the *Bolam* test still applies to the assessment of whether the advice given is objectively suitable (which requires reference to whether reasonable practitioners with the expertise of the defendant could properly have given the advice the defendant did).

This decision adds to the theme of recent cases, that make clear that informed investors must be prepared to accept responsibility for their own investment decisions, even where the advisor has used sales techniques to push a particular product or to encourage the investor to take more risk than s/he otherwise would.

The decision also serves to reinforce the basic proposition that evidence at trial should generally be given orally by the witness who proves the fact. Where this is not possible, contemporaneous hearsay notes (albeit admissible) may not be preferred to contradictory oral evidence. Parties who intend to adduce hearsay evidence should take steps to protect themselves by complying with the relevant procedures in the CPR. Equally, parties should consider giving written notice of objection to the admissibility of hearsay evidence which the other side seeks to include in agreed bundles, and consider applying to cross examine the relevant witness, where possible.

Finally, the decision clarifies the approach to damages in cases of concurrent liability in tort and contract. While it may not always be relevant, the Court's approach of limiting damages to the more restrictive contractual test of remoteness could cushion a bank in circumstances where investments perform poorly due to unexpected or catastrophic changes in the market.

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